LS POWER ASSOCIATES, L.P
c/o LS Power Development, LLC
5000 Hopyard Road, Suite 480
Pleasanton, CA 94588
(925) 201-5253 · Fax: (925) 201-5230

August 11, 2011

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, California 95814

Subject: Comments of LS Power on July 25, 2011 Revisions to the Cap-and-trade Regulation

Dear Clerk:

LS Power offers the following comments on the California Air Resources Board ("CARB") July 25, 2011 Notice of Availability of Modified Text for the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols ("cap-and-trade"). LS Power also offers comments on CARB's July 25, 2011 proposed changes to provisions of the Mandatory Reporting Regulation ("MRR"). LS Power is engaged in the development, acquisition and management of power generation and transmission infrastructure. In addition to its natural gas facilities, LS Power is currently investing in wind and solar resources. LS Power's comments request CARB: (1) not rely on e-tags to designate ownership of imported power; (2) revise the default emissions factor in the cap-and-trade and the MRR to more closely reflect marginal generation within the WECC; (3) allow for upfront determinations that an entity has not engaged in "resource shuffling"; and (4) remove restrictions on replacement electricity when the renewable generation and replacement electricity do not originate from the same balancing authority area.

1. **CARB Should Not Rely on the Electronic Tagging (E-tags) Process to Determine When an Entity Owns Imported Power.**

The cap-and-trade regulation places a compliance obligation on the first jurisdictional deliverer of electricity, which can include generators located in state, or out-of-state importers that own power as it crosses the political boundary of California. There is no question that an electricity importer delivering power to a point physically located within the state is subject to a cap-and-trade compliance obligation. However, CARB's method for determining the entity that owns power as it crosses California's political boundary is flawed and should be revised. The proposed regulation relies on e-tags, which were never intended to serve as a mechanism to track ownership of power. E-tags were designed to address and track compliance with the Western Electricity Coordinating Council's reliability standards, and do not definitively track title to power. For the reasons discussed below, LS Power recommends that the CARB delete provisions that rely solely on e-tags in the identification of the electricity importer, and work with the CAISO in a public process to

develop a better tool which will more accurately reflect the ownership of power as it crosses the State's border.

Section 95802(a)(84) defines the "electricity importer" as the purchasing and selling entity ("PSE") listed on the physical path where the delivery point is in California. In some cases, the PSE identified on the e-tag does not correctly identify the entity that owns or has title to power as it crosses the State's borders. While bilateral out-of-state power transactions may be structured to clearly confer title to a purchaser at that out-of-state point, this is not the case when an out-of-state power plant sells into the CAISO's markets at an out-of-state node. The CAISO's e-tagging conventions will require an entity delivering at an out-of-state node to identify itself as the PSE as if it is making a physical delivery into the state, even though from a contractual standpoint, the out-of-state power plant does not retain title to the power after it delivers to the out-of-state node. It is the CAISO's e-tagging convention that may still identify the out-of-state selling entity as the entity holding title into California when in fact they have contractually delivered at a location physically outside of California. Moreover, when that delivery occurs to the CAISO market at the out-of-state node that makes up the interface between balancing authorities, the selling entity no longer holds any of the risks and benefits of holding the title nor does it carry the risk of losses downstream from that delivery point across the border into California. For example, when an out of state power plant delivers to an out of state node such as Mead, and there is an unexpected transmission Outage between Mead and SP 15 (the physical path that crosses the California border), neither the out of state power plant nor its scheduling coordinator carry any risk of loss for the failure of the power to sink in California at SP 15, that risk is born by the CAISO. This example further illustrates that when an out-of-state power plant delivers to an out-of-state node, it does not continue to have rights or obligations that would be indicative of title when the power is delivered into California.

The CAISO Tariff and relevant authorities supporting the tariff provisions do not resolve questions regarding ownership of power delivered to the CAISO market at an out-of-state node. Section 4.5.3.2.2 of the CAISO Tariff requires scheduling coordinators (the entity transacting with the CAISO on behalf of the out-of-state power plant) to prepare e-tags. However, the CAISO tariff does not specify whether and how an e-tag can be used to track ownership. Guiding documents for the CAISO tariff, such as the North American Energy Standards Board ("NAESB") confirm that e-tags do not necessarily track ownership, and are instead intended to address reliability issues. For example, the NAESB definition for "Purchasing and Selling Entity" is "Any entity eligible to apply for an order requiring a Transmitting utility to provide Transmission Services under Section 211 of the Federal Power Act." Holding rights to transmission does not necessarily mean that an entity has title to power across a physical transmission path. Rather, ownership of transmission rights will satisfy the scheduling coordinators reliability obligations. Further, the NAESB definition for "Transmission Customer" specifically notes that "the PSE may or may not be the energy title holder."

In sum, CARB's reliance on e-tags as conclusive evidence of ownership to power as it

crosses the California border within the proposed regulations definition of electricity importer is problematic. Under the proposed cap-and-trade regulation, CARB will use e-tags for a purpose for which they were never designed. Imputing a legal ownership presumption to e-tags will place new uses and requirements that were not contemplated when the e-tagging concept was originally developed for reliability reasons. In addition, as noted above, there will be instances when CARB misrepresents the nature of the property rights and associated liabilities (such as risk of loss) transferred at the delivery point through the commercial transaction. The result is that CARB may improperly assign a cap-and-trade compliance obligation to an entity that is not subject to California state jurisdiction because it did not own the power when it crossed the State border. This defect creates a risk of potential legal challenge on an interstate commerce clause claim. Avoiding this risk is necessary to provide certainty for regulated entities and credibility for the cap-and-trade market.

To avoid these concerns, LS Power recommends that CARB amend the definition for "Electricity Importer" (Section 95802(a)(84)), so that the definition does not rely on the e-tag to designate ownership of the electricity. Specifically, CARB should strike:"~~is identified on the NERC E-tag as the purchasing-selling entity (PSE)~~",~~~~ from the definition. Unfortunately, LS Power is not aware of another approach that would definitively track the entity with title when the power crosses the State's political borders. LS Power encourages the CAISO and CARB to conduct an open stakeholder process to discern a more appropriate mechanism to track title than e-tagging convention as it is applied to a sale into the CAISO market from out-of-state points of delivery. It is imperative that such an effort be open to public comment and the method that is eventually used not result in a unilateral alteration of commercial terms without the principle parties' consent.

2. CARB Should Amend the Default Emissions Factor to be More Representative of Generation within the WECC and Consistent with the CEC's Emissions Performance Standard.

Section 95111(b)(1) of the MRR sets the default emissions factor at 0.428 Metric Tons of CO2e/MWh. LS Power believes that the current default emissions rate is set too low and will compromise CARB's GHG emissions goals. An emissions factor of 0.428 creates an incentive for any out-of-state power plant with an efficiency factor higher than 0.428 to enter into a transaction with a marketer so that it can report its emissions as unspecified. Consequently, the actual GHG emissions attributable to the state will be far higher than what is reported and satisfied through the cap-and-trade compliance obligation of unspecified importers. Moreover, in-state generation will be disadvantaged because their emissions will appear higher than unspecified out-of-state resources.

We understand that CARB may not want to change the default emissions factor to represent

a higher number like the efficiency factor for coal because CARB is concerned that such a change would be viewed by some as discrimination of out-of-state resources, creating risk of Interstate Commerce Clause challenges. At the same time, the limitations on reporting emissions as unspecified and the resource shuffling provisions do not adequately address the aforementioned concerns with the 0.428 default emissions factor. LS Power therefore recommends that at a minimum, CARB revise its basis for the default emissions factor to more accurately represent emissions rates for generation resources in the WECC and achieve greater consistency with the emissions factor adopted by other state agencies.

The 0.428 figure was taken from the Western Climate Initiative's ("WCI") Default Emissions Factor Calculator for 2008 generation data. WCI used 2008 Energy Information Administration ("EIA") data on power plants located within the Western Electricity Coordinating Council ("WECC"), and specifically included "marginal" plants (i.e., those with a capacity factor below 60%). Due to the relatively low capacity factors used in the WCI calculation, it is LS Power's understanding that a number of coal fired power plants were not included in this calculation. In addition, 2008 was a high hydro year, meaning fossil plants were dispatched less often. Thus, the 2008 default emissions factor will not be representative of default imports that may have included coal resources and will not be representative of generation during an average or low hydro year while the cap-and-trade program is in effect.

The 0.428 default emissions factor is also problematic because it is inconsistent with the Emissions Performance Standard ("EPS") implemented pursuant to SB 1368. From a policy standpoint, LS Power believes that the State should have a default emissions factor that is consistent. When the California Energy Commission ("CEC") analyzed the appropriate level for the State's EPS, the CEC rejected a number that would have been *higher* than CARB's default rate of 0.428 because "almost no natural gas units (that are not combined cycles) operate at a heat rate of less than 8,590 Btu/kWh". The CEC and California Public Utilities Commission ultimately set the Emission Performance Standard at a level of 1,100 lbs./MWh because that level is more representative of generation within the WECC. LS Power requests that CARB seek to achieve greater consistency with the existing EPS by revising its methodology for the default emissions factor.

If CARB does not adopt the CEC and CPUC's emissions factor from the EPS, CARB should consider using a capacity-weighted average. A capacity-weighted average would not be biased toward the emission rates of the more efficient resources, nor be subject to the fluctuations in annual hydroelectric output. Using the data found in the WCI default emission rate calculator and the same definition for marginal resources, the Western Power Trading Forum ("WPTF") has calculated a WECC-wide capacity-weighted emission average for 2008 of approximately 0.51 metric tons or 1,127 lbs/MWh. LS Power believes that this number would be more representative of generation in the WECC and achieve greater consistency with California's EPS. In sum, LS Power requests that CARB adopt a capacity-weighted average, which will result in a default emissions factor that is much closer to the EPS.

3. CARB Should Not State that Resource Shuffling Constitutes Fraud, and Should Allow Specified Importers to Receive an Upfront Determination that they Did Not Engage in Resource Shuffling.

Section 95852 prohibits "resource shuffling." While LS Power agrees with the general goal of discouraging importers from misrepresenting their GHG emissions, in practice, the resource shuffling provisions are impractical. There are many instances in wholesale markets where a purchasing entity will not know where its power will be coming from. In addition, the regulation applies to all regulated entities, when there are clearly entities that have not engaged in resource shuffling. Specifically, the regulations should allow for an upfront determination that a specified importer is not engaged in resource shuffling where CARB has issued a specified emissions factor for a particular facility that is applied to output sold into the CAISO or other California markets.

In addition, Section 95852(b)(1) provides that "resource shuffling" constitutes fraud. Fraud is a criminal violation that is imposed when there is intent to deceive or misrepresent the truth. Numerous parties have expressed concern about the lack of clarity regarding the definition, that they do not understand the definition, and that they do not know whether otherwise legitimate and routine transactions in today's interstate market could now become criminal actions under the proposed cap-and-trade regulation. LS Power requests that the Board remove this issue from the proposed regulations. This can be done by either deleting the reference to fraud in Section 95852(b)(1), or making it clear in the definition of Resource Shuffling at Section 95802(a)(245) that the definition only applies when an entity intends to misrepresent the nature of imports that were actually made into California.

4. CARB Should Not Limit the Definition of Replacement Electricity to Deliveries from the Same Balancing Authority Area as Renewable Energy Import.

Section 95802(a)(37) provides that the first point of receipt for renewable energy and any replacement electricity used to firm the delivery must come from within the same balancing authority. LS Power urges CARB to remove this restriction because it will limit the ability of existing renewable transactions to avoid cap-and-trade compliance obligations even though the transaction is consistent with the policies adopted pursuant to the 20% RPS laws. Moreover, the definition may be impracticable when it is applied to actual transactions. Many transactions with out-of-state renewables do not identify the source or the balancing authority area for the ancillary and firming services needed to support the renewable generation. Thus, there could be renewable transactions that will face significant GHG compliance costs simply because their contract does not specify the location of the ancillary and firming services. To avoid the unintended implications of this structure, LS Power requests that the Board remove the requirement that replacement power come from the same balancing authority as the source of the renewable transaction.

Sincerely,

Jennifer Chamberlin
LS Power