



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

August 11, 2011

Clerk of the Board
Mr. James Goldstene, Executive Officer
Ms. Mary Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, California 95814

Comments Regarding ARB's Proposed Amendments to the Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Mr. Goldstene and Ms. Nichols:

The Metropolitan Water District of Southern California (Metropolitan) has reviewed the Air Resources Board's (ARB) Proposed Amendments to the Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Cap and Trade PA), which ARB released on July 25, 2011, and is providing the following comments on this document. Metropolitan has closely followed and participated in the AB 32 rulemaking process, including the submittal of detailed written comments on the Cap and Trade Proposed Draft Regulation on January 11, 2010, and on the Proposed Regulation to Implement the California Cap and Trade Program on December 14, 2010. Additionally, Metropolitan provided comments on the AB 32 Scoping Plan in 2008, as well as on the ARB's Supplement to the AB 32 Scoping Plan Functional Equivalent Document dated June 13, 2011.

Background

As the nation's largest provider of drinking water, Metropolitan distributes water from the Colorado River and Northern California to 26 member agencies (cities and water districts), and supplies more than one-half of the water used by nearly 19 million people in the 5200 square-mile coastal plain of Southern California. Metropolitan's regional water supply and distribution system includes some of the largest pumping plants and water treatment facilities in the United States. Metropolitan's mission is to provide its member agencies with adequate and reliable supplies of high quality water to meet present and future needs in an environmentally and economically responsible way. Recognizing the existence of a nexus between water and energy supplies, Metropolitan's Board of Directors adopted Energy Management Policies which serve as a blueprint to help ensure energy reliability and efficiency, and protection of the environment. In order to bring Colorado River water to Southern California, Metropolitan will often directly import wholesale energy into California to serve

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exclusively the electrical pumping requirements of the Colorado River Aqueduct (CRA). This wholesale energy is not marketed or resold to other entities; it is used only by Metropolitan to bring water into Southern California, and does not serve any type of retail load.

Treatment of Metropolitan in Cap and Trade Regulations

Most recently, Metropolitan provided comments on the ARB's Proposed Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions (MRR PA) which ARB released on July 25, 2011. Metropolitan has provided testimony at ARB workshops and public hearings, and has had several meetings with ARB staff to discuss the Cap and Trade Program, and its impacts on Metropolitan and the water sector. We are concerned that ARB has not addressed Metropolitan's unique issues and concerns. The proposed staff approach would (1) treat Metropolitan as a water wholesaler with regards to duties imposed on the water sector, (2) also treat Metropolitan as an electric retailer with regards to cap and trade requirements and (3) deny the assistance afforded to electric retailers through free allowances. In our view, this is an inequitable approach. Appendix A (revised July 27, 2011) to the Cap and Trade PA is ARB's Staff Proposal for Allocating Allowances to Electricity Distribution Utilities. The last page of this Appendix (page 16), copied below, provides a paragraph that enumerates ARB's rationale for deciding not to provide free allowances to Metropolitan:

“In December the Board directed staff to further evaluate the appropriateness of allocating allowances directly to the State Water Project (SWP) and the Metropolitan Water District (Metropolitan). After consideration of the potential benefits and dis-benefits to consumers and the integrity of the program, staff has determined that it is not appropriate to include SWP or Metropolitan in the allocation to the electricity sector. While each of these entities use electricity to transport water into and around California, and the emissions associated with this activity are included in the pool of allowances set aside for the electric sector, staff view the role of these entities as analogues to electricity marketers, and not distribution utilities. As described above, these entities do not maintain direct relationships with the end-use consumers of their projects. Rather, they market water to utilities and intermediaries. As such, allocating directly to these entities could result in either the deterioration of the emissions price signal in the water sector, if they used the value to reduce prices, or lost value for end-use customers, if they used the allowance value for something other than direct compensation, which they are not well positioned to provide to end-users.”

Metropolitan disagrees with ARB's decision and the reasoning behind the decision, and considers the way that the decision was communicated to us, i.e. via an Appendix to the Cap and Trade PA, as inappropriate. Although Metropolitan did not publicly testify at the ARB Workshop on July 15, 2011, Metropolitan staff spoke with ARB staff about our unique issues, and broached various alternative strategies or exclusions as appropriate for a public water agency providing a critical

public service. Based on our reading of this appendix, our ideas and comments have apparently all been rejected.

We recognize that Metropolitan's issues overlap with some of the concerns of DWR in regards to its SWP; however there are also some unique differences as to the impacts and mitigation of the impacts on these two entities. We understand that DWR and the State Water Contractors (SWC), a non-profit mutual benefit corporation that represents the interests of the water agencies that receive SWP water, will be submitting individual comment letters to ARB that focus directly on their specific issues and recommended solutions to best meet their needs. We urge the ARB to recognize that a "one size fits all approach" may not work for both Metropolitan and DWR.

Metropolitan's Key Concerns with the Cap and Trade Program and PA

As we have noted in multiple instances in our comments to ARB and discussions with staff, Metropolitan is a public water supply agency providing a critical public service and is not an electric utility. Metropolitan does not provide electrical service to any load other than its CRA pumping plants. Metropolitan is unique in all of these aspects, and is not comparable to utilities in the electric sector. As such, we strongly believe that Metropolitan should not be included in a Cap and Trade Program that is designed and structured for the electric and industrial sectors. For these reasons, Metropolitan reiterates that it should be exempted from the Cap and Trade Program and its associated compliance obligations, and removed from the category of marketer under the MRR PA (Section 95102 Definition (229)) and in the Cap and Trade PA (Section 95802 Definition (153)). Under these definitions, a marketer is defined as "a purchasing/selling entity that takes title to wholesale electricity and is not a retail provider."

After careful internal review and discussions, Metropolitan has determined that the Cap and Trade regulatory scheme developed by ARB is simply not viable or feasible for a public water supply agency, such as Metropolitan for the following reasons:

- Metropolitan is not a marketer of electricity, although it is assigned that classification due to the limited definitions provided in the MRR and Cap and Trade PAs.
- Metropolitan does not purchase power for resale or for a profit.
- Unlike retail electricity providers, including electric publicly owned utilities, Metropolitan (based on ARB's decision) will receive no cost mitigation for its member agencies (ratepayers).
- As a public agency, Metropolitan should not be compelled to participate in the carbon market against for-profit market participants, including opt-in entities.
- Metropolitan's role, specifically the purchase of imported power to deliver water, is as a consumer of electricity, not a marketer, retail provider, or generator.
- The compliance obligation to acquire and surrender allowances will result in highly volatile costs to Metropolitan because of the variability of Metropolitan's energy imports for the CRA and the anticipated increase in the auction price of allowances. (For example, from

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2005-2010, Metropolitan's historical imported electricity has ranged from 0 to 750,000 megawatt-hours).

- Metropolitan's emissions from its imported electricity are already below its 1990 levels.

For the above reasons, Metropolitan asserts that ARB should modify the Cap and Trade PA and the MRR PA where applicable, to provide for the following:

- A new reporting category and corresponding definition appropriate to Metropolitan's role and use of imported electricity; and,
- Inclusion of water wholesaler in the list of source categories in the Cap and Trade PA entitled Emissions without a Compliance Obligation.

As an alternative to the above:

- Develop a compliance strategy or memorandum of understanding for Metropolitan as a consumer of wholesale electricity that integrates the imported energy issue into a comprehensive water sector program that includes measures identified in the AB 32 Scoping Plan, such as energy efficiency and renewable energy projects; and,
- Defer Metropolitan/water sector measures until 2014 or 2015, after the Cap and Trade Program is implemented.

Proposed New MRR Reporting Category and Definition (Cap and Trade PA Section 95802 Definitions)

To accomplish the above, we urge the ARB to add a new reporting category and definition under both the MRR PA and Cap and Trade PA that accommodate Metropolitan's exceptional differences from the typical marketers of electricity that are listed as reporting entities in the MRR database (Refer to Metropolitan's comments on the MRR PA for the parallel language). Under this proposal, Metropolitan would continue to report our imported electricity annually under the provisions of the MRR, would continue to maintain the required records and verifications, and would continue to pay the annual Cost of Implementation Fee for these imports. However, since Metropolitan would not be classified as an electricity marketer, we would not have a compliance obligation under the Cap and Trade Program. In its comments letter on the MRR PA, Metropolitan requested ARB to create an additional reporting category that applies to electricity importers and is separate from the classifications of electricity marketer and electric retail providers. Unlike electricity marketers, Metropolitan does not take title to imported power for the express purpose of reselling for a profit or otherwise; we are a public water agency that is consuming the imported electricity strictly for our own use. We request that ARB add the following reporting category and definition to both the MRR and Cap and Trade PAs:

Importer/Non-Marketer or Importer/NM means a utility or entity, such as a public water agency, that purchases electricity generated outside the state of California solely to serve its own load. An Importer/NM does not market this electricity for purposes of resale and does not serve electric retail customers or electric end users. Importers/NM will report under the provisions of MRR, but will not have a compliance obligation under the Cap and Trade Regulation.

Inclusion of Metropolitan in the list of Emissions without a Compliance Obligation (Cap and Trade PA Section 95852.2 Emissions without a Compliance Obligation)

This section of the Cap and Trade PA lists 17 source categories and fuel types that count toward applicable reporting thresholds in the MRR but do not count toward a covered entity's compliance obligation set forth in the Cap and Trade Program. Metropolitan notes that ARB has added many additional categories to the list in the Cap and Trade PA. Metropolitan is requesting ARB to include the following additional category (#18) and explanation or footnote to this list:

18. Importer/Non-Marketer (NM) that purchases electricity generated outside the state of California solely to serve its own load. Importers/NMs that are wholesale water agencies will develop an alternative compliance strategy outside of the Cap and Trade compliance obligation. ARB will work with the wholesale water agencies to develop and implement this plan in 2014-2015.

Alternative Compliance Strategy and Deferral for Water Sector

Metropolitan's alternative plan for the water sector will integrate in some manner with the water sector measures for energy efficiency and renewable energy projects that are part of ARB's AB 32 Scoping Plan. Metropolitan proposes to work with ARB along with other water agencies to refine this option and work towards implementation starting in 2014-2015. Deferring actual implementation of this alternative water sector strategy will allow ARB staff to concentrate their priorities and resources on implementing the Cap and Trade Program for the electric and industrial sector in 2012-2013.

Free Allowances

If ARB does not make these changes to exclude Metropolitan from the Cap and Trade Program, or defer its compliance until comprehensive water sector specific measures are adopted, the only equitable alternative is to allocate free allowances to Metropolitan as a wholesale water utility. Wholesale water utilities are essential public services, and like the retail electric utilities, they serve a critical public purpose. We believe that it is inappropriate for ARB to deny the publicly-owned providers of a critical public resource the same price relief for their customers that the electric sector will enjoy.

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Summary

To date, ARB's Cap and Trade rulemaking has not addressed Metropolitan's specific concerns. Metropolitan urges ARB to make the above requested modifications to the MRR and Cap and Trade PAs to address these concerns and interests with respect to AB 32 and Cap and Trade. We trust these changes will be incorporated into the next 15-day rulemaking package that ARB staff releases, and in the proposed Cap and Trade and MRR that are slated to go before your Board for approval in October. Please contact Janet Bell at (213) 217-5516 or jbelle@mwdh2o.com, or Jon Lambeck at (213) 217-7381 or jlambeck@mwdh2o.com with any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Kightlinger". The signature is stylized and cursive.

Jeffrey Kightlinger
General Manager