

Memorandum

Date: September 26, 2011

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

From: Department of Water Resources

Subject: Comments on the Proposed Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

DWR refers to its prior comments (attached), dated December 15, 2010, and August 11, 2011, and reminds the Board that the current version has not remedied the deficiencies related to the treatment of DWR as outlined in those comments. As summarized in the December 15 comment letter:

Under AB 32, DWR's unique status as a state agency requires that it be exempt from this regulation. Alternatively, DWR should receive free allowances to mitigate for the impact on water ratepayers. AB 32 also requires that regulated parties be treated equitably and that early action receive appropriate credit. AB 32 requires the proposed regulation be cost-effective, and applying the regulation to DWR is not cost-effective. The proposed regulation results in a transfer of funds from water ratepayers to electricity ratepayers, which cannot be justified. The proposed regulation poses undue financial risk to DWR. Environmental and economic impacts on DWR and water users were not addressed. Finally, the imposition or threat of a fourfold penalty on public agencies is unduly punitive and unnecessary to achieve compliance.

The draft regulation presented to the Board in late 2010 reflected extensive discussions with many interests in the electricity sector – *except DWR*. The result was that DWR's interests and unique issues were not presented to ARB staff and thus not addressed in the draft regulation. In December, the Board directed staff to work with DWR to address its concerns. ARB and DWR staff did subsequently meet, at which time DWR twice presented proposals for the use of allowances. However, the ARB staff asserted that despite the invitation for public comment, strict adherence to the draft structure established for cap & trade was essential, and that DWR's proposals would upset that structure. Because of this stance, a full exploration of the treatment of DWR and its proposals did not occur.

Clearly there are, however, a number of instances in which the draft regulation has been changed to accommodate unique issues and deviate from painstaking adherence to cap & trade's underlying economic theory. It is thus disingenuous to suggest that similar accommodations could not be made for DWR. In fact, equity demands that such accommodations must be made; specifically, DWR should receive allowances similar to the POUs and re-open discussions with ARB staff on the appropriate use of allowance proceeds.

Therefore, DWR requests the Board to direct staff to identify a method for incorporating equitable mitigation of the impacts Cap & Trade will have on DWR as the operator of the State Water Project. As a single entity with unique issues relative to other regulated parties and moreover, as a fellow State agency and member of the Governor's Climate Action Team, it is appropriate to address these issues in a Memorandum of Understanding rather than in regulation.

If you have any questions or need additional information, please contact me at (916) 574-1295.



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