THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

December 14, 2010

The Honorable Mary Nichols, Chairman
Mr. James Goldstene, Executive Officer
California Air Resources Board
1001 I Street
Sacramento, California 95812

Electronic Filing

Dear Ms. Nichols and Mr. Goldstene:

Comments Regarding CARB's Proposed Regulation to Implement the California Cap-and-Trade Program

Thank you for the opportunity to submit comments on the Proposed Regulation to Implement the California Cap-and-Trade Program (Cap & Trade Regulation). Metropolitan Water District of Southern California (Metropolitan) has closely followed and participated in the Cap & Trade rulemaking process, including the submittal of detailed written comments on the Proposed Draft Regulation (PDR) on January 11, 2010 and meeting with California Air Resources Board (CARB) staff involved in writing the regulation. Metropolitan recognizes and appreciates the hard work of staff at CARB in development of the Cap & Trade Regulation, particularly given the short timeframe that was provided.

Background

Metropolitan continues to have serious concerns regarding the potential applicability and unintended consequences of the Cap & Trade Regulation on Southern California water supplies, specifically as it relates to the imported electricity that is used to power Metropolitan's Colorado River Aqueduct (CRA) Pumping Plants. 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). Metropolitan supplies more than one-half of the water used by nearly 19 million people in the 5,200 square mile coastal plain (Los Angeles, Orange, San Diego, Riverside, San Bernardino, and Ventura counties) of Southern California. Metropolitan's regional water supply and distribution system includes five of the largest drinking 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 (Board) recently adopted Energy Management Policies (see attached) which serve as a blueprint to help ensure energy reliability and efficiency, and

protection of the environment over the next 20 years and beyond. Metropolitan has implemented a 1 megawatt (MW) photovoltaic solar project at its Skinner Treatment Plant, and intends to invest in an additional 9 MWs of solar projects at its other water treatment facilities, in addition to other energy efficiency and conservation projects along the CRA.

In order to bring Colorado River water to Southern California, Metropolitan will often directly import wholesale energy into California to serve exclusively the electrical pumping requirements of the 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. Metropolitan is a water supply agency, not an electric utility, and does not provide electrical service to any load other than its CRA pumping plants. The CRA electrical load is tied directly to Metropolitan's own high-voltage transmission system that connects to the Western Area Power Administration's (WAPA's) electrical grid at locations near Hoover Dam in Nevada and Parker Dam on the border of California and Arizona. Metropolitan's transmissions system was built in the 1930s to support the energy requirements of the CRA pumps that were located in a remote and isolated area of the Mojave Desert. It is on these lines that Metropolitan transports its contractual electricity from the Hoover and Parker Dams on the Colorado River, and unspecified wholesale energy purchased from suppliers in the southwest.

The amount of water Metropolitan conveys through the CRA is highly variable from year to year, and subsequently impacts the imported energy requirements. CRA water supply depends on such factors as the availability of water from farmland fallowing water conservation measures and utilization of water storage programs along the Colorado River. For example from 2001 through 2009, water conveyed through the CRA has ranged from approximately 1.25 million acre-feet per year (MAF) down to 0.65 MAF per year (1 acre-foot is equal to approximately 326,000 gallons). The amount of imported electricity during this time varied from a little over 905,000 Megawatt-hours (MWh) to zero.

In June 2009 and 2010, Metropolitan reported its CRA imported energy for calendar years 2008 and 2009 respectively, under the provisions of the Greenhouse Gas (GHG) Mandatory Reporting Rule (MRR) applicable to the electricity marketing sector. Although Metropolitan is in a unique situation and is not technically a marketer of electricity, this was the sector category and definition that appeared to best capture Metropolitan as an importer of electricity. Metropolitan reported information on its imported electricity from unspecified, non-hydroelectric sources for both years to ensure that CARB was provided the needed data on imported energy consumed in California for use in its GHG inventories under the mandates of AB 32. The direct emissions from each of Metropolitan's facilities, such as drinking water treatment plants, are well below the current reporting threshold of 25,000 metric tons of CO2e per year as well as the proposed lower reporting threshold of 10,000 metric tons of CO2e per year. As such, there was no past or anticipated future reporting obligations for direct emissions.

Issues and Concerns

After reviewing the proposed Cap-and-Trade Regulation, Metropolitan has many of the same issues and concerns previously expressed in its January 2010 comment letter on the PDR. The proposed Cap-and-Trade Regulation does not resolve nor address several key issues that Metropolitan raised in its prior comments. These issues include the following:

1. **Applicability of the Cap-and-Trade Regulation to Metropolitan's unique wholesale power operations.** Metropolitan is a public water utility that purchases energy at wholesale and consumes that energy rather than reselling it. Entities covered in the Cap-and-Trade Program are specific industrial facilities that directly emit greenhouse gases, and electric investor owned utilities (IOUs) and electric publicly owned utilities (POUs) with retail customers. The Cap-and-Trade Program that CARB has laid out is not applicable to a public water utility, such as Metropolitan. Metropolitan is not aware of any other regional Cap-and-Trade Programs that capture water utilities under the state-wide limit on GHG emissions (cap).

2. **Allocation of Free Allowances** should be made to Metropolitan, analogous to the allocation that will be provided to the electric POUs and IOUs, if CARB determines that Metropolitan is to be included in the cap. Free allocation solely to electric utilities with retail customers and to specified manufacturing facilities is inequitable, unfair, and penalizes Metropolitan who buys energy at wholesale and consumes it for its own use for critical water deliveries into southern California.

3. **Auction Infrastructure and the Cost of Allowances**, as described in the Cap-and-Trade Regulation, is overly complicated, administratively burdensome, and does not guarantee cost containment for allowances. If Metropolitan is covered under the Cap-and-Trade Regulation, as a public entity, it should not have to compete against private sector companies or IOUs for purchase of allowances annually or for each compliance cycle. Based on current information on energy usage, Metropolitan estimates that the potential costs of purchasing such allowances for CRA power at auction could range from $11 million to $22 million per year. These numbers will vary greatly depending on the amount of electricity Metropolitan must purchase and import to move the available CRA water supply and pumping requirements, and the costs of allowances. Metropolitan assumes that these costs will increase over time during each successive compliance period, as the number of available allowances declines. This cost estimate does not include the fiscal impact to Metropolitan from increased retail electricity rates and any power cost increases experienced by the California Department of Water Resources' (DWR's) State Water Project (SWP). Metropolitan is allocated approximately 50% of the water available to the SWP and pays about 70% of the SWP's power costs.

4. **Linkage** to Western Climate Initiative (WCI) and other Cap-and-Trade Programs is mentioned in the Cap-and-Trade Regulation; however such linkages are not expected to

be in place until late 2011. To date, California and New Mexico are the only states who intend to participate in the WCI, and New Mexico's plans for participation are subject to change. A California only Cap-and-Trade Program in lieu of a regional program will be too restrictive and limited, and should not be implemented until other state partnerships are in place.

5. **Offset Credits** allowed for mitigating CO2 emissions in the PDR were limited to 4%; the proposed Cap-and-Trade Regulation raises this allowable percentage to 8%. Additionally, there are only four offset protocols that CARB is currently considering for approval. As the number of available allowances declines, there will be increased need for additional and creative offset projects both inside and outside California. Therefore, more flexibility needs to be built into this aspect of the Cap-and-Trade Regulation, as well as an expedited approval process for new offset protocols.

Recommendations and Requests

Metropolitan is proposing several recommendations to resolve its two critical concerns: (1) whether Metropolitan should be considered a "covered entity" for imported electricity under the Cap-and-Trade Regulation, and (2) that Metropolitan should receive free allowances, if it is included. Metropolitan acknowledges that the definition of electricity importer covers both marketers and retail providers, and that the current proposed definition of marketers covers Metropolitan. However, Metropolitan is not a true marketer of electricity, as the term is typically used. Metropolitan only imports energy for the purpose of serving its own load on the CRA and not to "market" or resell this energy.

Metropolitan proposes a revision of the definition of marketer in Section 95802(a) (113) as follows:

> **"Marketer means a purchasing-selling entity that takes title to wholesale electricity for the purpose of resale and is not a retail provider."**

This change would clarify that Metropolitan is not intended to be included in the Cap-and-Trade Program. However, this modification would not affect the inclusion of the other entities that CARB staff has identified for coverage under the regulation, nor would it impact the requirements that apply to these covered entities. Metropolitan would continue to submit annual reports of its imported electricity under the MRR provisions to ensure that these data are included in the state's GHG inventories, although Metropolitan would not be subject to the Cap-and-Trade Regulation. This is Metropolitan's preferred alternative to resolve this concern.

If CARB is not amenable to this proposed definitional change and Metropolitan is determined to be covered under the statewide cap, then Metropolitan should receive free allowances as will be provided to the electric POUs and to the IOUs. If both sectors are regulated, there is no valid basis for treating the electric and water sectors differently with respect to allocation of free

allowances. Like Metropolitan, the electric distribution utilities (EDUs) buy wholesale energy to serve load. The major difference is that these utilities serve electric customers at retail while Metropolitan consumes the energy it purchases, and passes the costs along to its member agencies, the downstream water customers. In order to address costs, CARB is providing free allowances to utilities that buy energy at wholesale and have a retail customer base. This penalizes utilities that buy energy at wholesale and consume it. These utilities then must pass the cost on to downstream customers.

There are important differences between water utilities and electric utilities in terms of how wholesale electric costs are ultimately allocated, but these differences should not result in inequitable treatment of the water sector. In the electric sector, IOUs and POUs purchase wholesale power and resell it to retail electric customers. Providing these entities with free allowances enables them to directly offset AB 32 compliance costs imposed on their retail customers. By contrast, Metropolitan purchases wholesale power for its own operations. Since Metropolitan does not have retail water customers, it passes all wholesale power costs, including any costs associated with AB 32 compliance, along to its member agencies. The member agencies in turn then pass the costs along to their retail water customers. Since CARB is not proposing to provide free allowances to retail water utilities; the only way that end-use water customers can be protected from the allowance related costs associated with AB 32 compliance is to allocate free allowances to wholesale water providers, such as Metropolitan.

Another difference is that the electric POUs and IOUs are subject to the recently adopted Renewable Electricity Standard (RES) requirements. Although Metropolitan, as a water utility, is not subject to these standards, our Board adopted Energy Management Policies that call for an increase in Metropolitan's use of renewable energy, such as the installation of solar facilities. Per CARB's Initial Statement of Reasons (ISOR), II-4, "The allocation design will reward those who have invested in energy efficiency and GHG emissions reduction, and will encourage continued investment in clean and efficient technologies in the future." Metropolitan's Energy Management Program demonstrates its commitment for continued investment in energy efficient and renewable technologies. Additionally, Metropolitan and other water utilities will have their own sector specific direct costs and requirements under the AB 32 Scoping Plan WET-CAT measures, as well as other water conservation efforts, including the reduction of per capita water use of 20% by the year 2020.

Metropolitan recognizes that climate change will have significant adverse impacts on many aspects of water resource management, including hydrology, water storage, water supplies, water demand, hydroelectric generation, and water conveyance systems. Metropolitan acknowledges the need for both adaptation and mitigation measures to address climate change, and applauds CARB's work in producing the AB 32 Scoping Plan and associated implementation measures to address the air quality mitigation aspects.

Because of the significance of the proposed Cap-and-Trade Regulation on California electricity imports and on water supply costs in the state, we would be pleased to meet with you to discuss

our comments and concerns, and to gain clarification and mutual agreement before the regulation is finalized for implementation. We look forward to continuing to work with CARB, other applicable regulatory agencies, and affected stakeholders to reach mutually beneficial solutions to these important environmental issues that affect California's water supply, air quality, and economy.

Sincerely,

Jeff Kightlinger
General Manager

Attachment

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OF SOUTHERN CALIFORNIA

At its meeting on August 17, 2010, Metropolitan's board of directors adopted the following Energy Management policies to: 1) contain costs and reduce Metropolitan's exposure to energy price volatility; 2) increase operational reliability by implementing renewable energy projects; 3) provide a revenue stream to offset energy costs; and, 4) move Metropolitan toward energy independence through, for example, maximization of power production facilities and energy contracts for direct use by Metropolitan. These policies are consistent with Metropolitan's goal to balance long-term reliability with cost control, with the added benefit of reducing Greenhouse Gas (GHG) emissions. The specific policies adopted by the board are:

Water/Energy Nexus: Identify collaborative programs and initiatives between the water and energy industries, constructing sustainable partnerships to reduce costs and provide enhanced reliability.

Regulatory: Track federal and state greenhouse gas regulations and develop strategies to hedge against price and regulatory risks towards Metropolitan.

Legislation: Pursue legislation to protect or enhance reliability of energy supply and mitigate energy cost risk.

Contracts: Maintain maximum flexibility on existing and future contracts with Hoover and other energy contracts to hedge against cost and regulatory risks.

Projects/Partnerships: Pursue cost-effective renewable energy projects and partnerships to hedge against energy price increases and regulatory risks, while reducing Metropolitan's carbon footprint.

Revenue Stream: Pursue revenue stream renewable energy facilities on operational lands to assist in cost containment.

Economic & Environmental Stewardship: Based on projected economic and regulatory conditions, develop cost-effective programs, projects and initiatives to control operational costs and move Metropolitan towards energy independence. Implementation of proposed Energy Management Plan activities would result in substantial reductions in GHG emissions.

Energy Management Updates: Staff will return to the Board on a regular basis to report on progress on the Energy Management Master Plan and the suitability of these policies, in light of changing regulatory and economic conditions.