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RE: Pacific Gas and Electric Comments in Response to the Air Resources Board's November 15, 2018 Modifications to the Draft Cap-and-Trade Regulation Amendments

Pacific Gas and Electric Company (PG&E) appreciates this opportunity to provide feedback in response to the Air Resources Board's (ARB) release of modifications to the draft amendments of the Cap-and-Trade Regulation (Modified Regulation) on November 15, 2018.

Cap-and-Trade plays a critical role in California's GHG reduction strategy and will be even more important as we move to make deeper, more ambitious GHG reductions from 2020 to 2030. It is therefore imperative to design a post-2020 program that will be sustainable and capable of driving the necessary GHG reductions.

PG&E's comments on the Modified Regulation are divided into the following sections:

I. Establishing a Sustainable Price Ceiling
II. GHG Accounting for the Energy Imbalance Market (EIM)
III. Natural Gas Allocation
IV. Equitable Treatment of Eligible Allowance Value Uses
V. Legacy Contracts

I. Establishing a Sustainable Price Ceiling

PG&E reiterates its October 22, 2018 comments[1] in support of establishing a sustainable price ceiling. PG&E would like to note that during the November 15, 2018 Board Meeting on the proposed cap-and-trade amendments, there was discussion suggesting that fears of high price ceiling values can be dismissed because ARB would take some unspecified action in the future when allowance prices reach some unspecified point below the proposed price ceiling to prevent allowance prices from reaching too high a price. While PG&E agrees an intervention would likely occur in these circumstances, this structure does little to inspire confidence in the cap-and-trade market. Instead, PG&E agrees with the ARB's Emissions Market Assessment Committee that "It is far better to have a transparent and credible process for limiting allowance prices established in advance than relying upon ad hoc emergency measures during periods of stress."[2] Further, we believe the Legislature made its intent clear in AB 398 that the credible process for limiting allowance prices would include a meaningful hard price ceiling, with provisions for maintaining environmental integrity. PG&E encourages ARB to establish a price ceiling at level that will accomplish this purpose, without need for "ad hoc emergency measures".

II. GHG Accounting for the Energy Imbalance Market (EIM)

A. *PG&E Requests Additional Description of the Required Data and Formulas*

PG&E appreciates ARB staff's engagement with stakeholders on this topic and would like to acknowledge that the changes in the Modified Regulation for outstanding GHG emissions address some of the concerns that PG&E raised with the previous approach in the 45-day Draft Regulation. However, PG&E requests ARB provide more detail on the modified approach in order to make sure that PG&E and other stakeholders completely understand the proposal.

As PG&E has interpreted the Modified Regulation, the California Independent System Operator (CAISO) would operate EIM essentially as it does today. For each resource bid into EIM, EIM would limit the deemed import into California to the minimum of:

- The limit on the import specified in the resource's bid and
- The difference between the maximum dispatch level specified in the bid and the base schedule for the resource.

EIM only considers as-bid, GHG costs for emissions from imports deemed sourced from the specific resources in its dispatch and pricing. EIM would track the resulting emissions from the

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[1] PG&E Comments on 45-Day Cap-and-Trade Amendments, October 22, 2018: https://www.arb.ca.gov/lists/com-attach/68-ct2018-VSUCY1M3BQkEYVR5.pdf

[2] Emissions Market Assessment Committee Discussion Paper: Price Ceiling in the GHG Emissions Cap-and-Trade Market, November 8, 2013: https://www.arb.ca.gov/cc/capandtrade/emissionsmarketassessment/priceceiling.pdf

several resources using the unit specific emissions rates as it does today and assign responsibility for the emissions to the responsible resource as determined by EIM.

ARB would next calculate the total emissions caused by imports by multiplying the total imports determined in EIM by ARB's unspecified emission rate[3]. ARB would finally calculate the outstanding emissions by subtracting the resource-specific GHG emissions for the deemed imports from the total emissions. ARB would track the outstanding emissions over the year and reduce the allocation of allowances to participating Electric Distribution Utilities (EDUs) in the next-year's allocation by the amount of the outstanding emissions pro-rata to their retail loads.

This avoids two issues that PG&E had identified with previous efforts:

- CAISO does not have to modify the EIM to include the cost of allowances for emissions from secondary emissions in the dispatch and pricing which CAISO and its stakeholders found problematic.
- The approach partially addresses concerns of over collecting revenue for allowances for actual emissions in EIM that arise if requirements to buy allowances for outstanding emissions are allocated to purchasers of energy in EIM after the EIM has run without EIM considering the cost of those allowances in its dispatch and pricing.

PG&E requests staff confirm that this interpretation of the Modified Regulation is correct and since the issues involved are complex, we also request explicit description of the data required and formulas to be used to ensure that there is no misunderstanding.

B. Additional Questions For Future Consideration Stemming from the EIM's Interaction with the Existing Day-Ahead Market

PG&E would like to raise some questions regarding how the calculation of outstanding emissions in EIM, as described in the Modified Regulation, will interact with CAISO's *current* Day-Ahead Market (DA Market). PG&E does not expect these questions to be addressed in the current rulemaking but would like to flag them now for future discussion after this rulemaking is complete. PG&E recognizes that the Modified Regulation is not intended to address a future, expanded Day-Ahead Market (DA Market), and as such, the questions below are with respect to the existing DA Market, not an expanded DA Market.

PG&E is unclear on how emissions caused by changes in schedules between the DA Market and EIM will be handled. In the DA Market, traders can offer imports into California. The traders will include the cost of required allowances for emissions caused by the imports in the price that they offer. If the resources supplying the imported energy are owned by or under long-term

[3] PG&E requests CARB to clarify that energy dispatched on resources outside California owned or under long-term contract to California load serving entities would not be considered as contributing to total emissions from imports as calculated using the unspecified resource emission rate.

contract with CA load serving entities, it is our understanding that they will only be responsible for allowances based on their actual emission rates. Otherwise, they will be responsible for allowances based on the unspecified emission rate.

As long as traders honor their DA awards and submit e-tags based on the DA cleared schedules, PG&E does not foresee any problems. We would like more information on how outstanding allowances will be calculated if a trader backs out of the DA trade in EIM by not scheduling the trade in EIM.

Suppose that a trader submits a bid for an import into California in the DA market with the cost of allowances required based on the unspecified emissions rate. The cost of allowances based on the unspecified emission rate should be incorporated in its energy bid in the DA Market.

If the import were scheduled in the DA Market, the DA Market prices would cover the cost of producing or procuring the energy and the cost of the allowances needed to schedule the import in the DA Market. As a result, the trader would be compensated for the needed allowances in the DA Market.

Now suppose that the trader backs out of the import in EIM by not submitting an e-tag for the import. The energy supplied by the import in the DA Market must be replaced in EIM. The trader whose import is reduced would buy back the energy at the relevant EIM prices. The emissions costs used in setting the EIM prices would be the cost of EIM deemed emissions for the replacement.

One area that is unclear is whether the replacement of the energy from the trade in EIM could result in outstanding emissions in EIM. If it can, the EDUs and their customers would bear the costs of outstanding emissions through the reduction in their allowance allocation the following year. However, the energy import in the DA Market was paid a price that reflected the cost of allowances needed for the DA Market schedule even though the import was not scheduled and the energy was not delivered to California. It seems that EDU customers may pay prices in the DA Market that cover the cost of allowances for the import scheduled in the DA Market while being exposed to future reduction of allowances for outstanding emissions if the import was not scheduled in EIM. It would seem that equity would require that the trader either not be compensated via DA Market prices for allowances if the import was not scheduled in EIM or the trader should be exposed to the cost of allowances for outstanding emissions when the trade is canceled in EIM.

As stated above, since this issue is complex, PG&E requests additional information to ensure an accurate understanding of ARB's approach, which may mean that the concern raised above is unfounded. PG&E appreciates ARB's efforts in this area and looks forward to ongoing discussions.

III. Natural Gas Allocation

PG&E requests ARB Staff to continue working with gas utilities on adjustments to the natural gas supplier allowance allocation in the next Cap-and-Trade Rulemaking. In ARB's Initial Statement of Reasons, ARB Staff notes they will continue to review and consider adjustments to natural gas supplier allocation if the natural gas investor-owned utilities undertake voluntary renewable gas programs, if a renewable gas mandate is enacted, or if other changes to the sector occur. PG&E agrees with ARB's continued review of this issue since efforts to decarbonize the natural gas pipeline are already underway, and the current natural gas supplier allowance allocation does not reflect the increased costs of such efforts for utility customers.

RNG will play an important role in helping to achieve the State's climate goals by providing a lower-emission, beneficial use for Short-Lived Climate Pollutants that are otherwise emitted to the atmosphere. PG&E looks forward to continuing to work with ARB to recognize the value of RNG-related and other decarbonization efforts in the natural gas supplier allowance allocation in future Cap-and-Trade rulemaking.

IV. Equitable Treatment of Eligible Allowance Value Uses

PG&E requests that ARB clarify in the Final Statement of Reasons that projects supporting renewable natural gas, including infrastructure, procurement and near-zero emissions vehicles, can be eligible under the "Other GHG-reducing Activities" category in Section 95893. These activities would help drive cost-effective and innovative GHG reduction strategies and are broadly consistent with the 'renewable energy' category for EDUs.

V. Legacy Contracts

The Modified Regulation provides Transition Assistance to legacy contract generators without industrial counterparties for the Third Compliance Period. As PG&E has previously stated, PG&E does not believe that any of its counterparties qualify for such Transition Assistance. The core purpose of Transition Assistance is to reduce the financial responsibility for GHG costs for generators with Power Purchase Agreements (PPA) that do "not allow the covered entity to recover the cost of legacy contract emissions from the legacy contract counterparty."[4]

PG&E's arbitration with Panoche Energy Center ("Panoche"), however, proved that: 1) Panoche's PPA assigned responsibility for GHG costs to Panoche ("Panoche contractually agreed to procure AB 32 allowances at its expense."[5]); 2) at the time Panoche signed the PPA, it understood that it would be responsible for paying future GHG emissions costs ("Panoche

[4] ISOR, Page 56.

[5] See the arbitration judgement in Attachment 1 to PG&E's March 16, 2018 Cap-and-Trade Workshop Comment Letter, Page 16: https://www.arb.ca.gov/lists/com-attach/47-ct-3-2-18-wkshp-ws-VWUBNFRkVzIFMgQ8.zip

agreed to comply with AB 32 and the cap-and-trade regulations …"[6]); and 3) the PPA already provides for Panoche's recovery of GHG costs and provides a payment mechanism for that recovery ([Power Purchase Agreement] "section 4.3 provides a payment mechanism for GHG costs."[7]). The arbitrators ruled for PG&E and against Panoche on all counts and issued a reasoned decision detailing the evidence they heard and the rationale for their ruling. The arbitration was upheld by California's 1st District Court of Appeals. Therefore, PG&E reiterates that Panoche does not meet the requirements for receiving Transition Assistance, including for the third compliance period, because it is *not* a party to a legacy contract.

Furthermore, PG&E believes that the ability to request and obtain a free allocation of allowances from ARB is hindering meaningful and complete renegotiation of contracts to address GHG costs. The board's direction to staff to provide PEC assistance throughout the cap-and-trade program's current statutory authorization (2018-2030) effectively removes any incentive for PEC to reach agreement with PG&E as requested by ARB.

Conclusion

PG&E continues to support Cap-and-Trade as a program that will help the state meet its aggressive environmental goals while maintaining a healthy economy. We look forward to working with ARB staff to further refine the Regulation in line with AB 398.
Please feel free to contact me if you have any questions or concerns.

Sincerely,

/s/

Fariya Ali
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Pacific Gas and Electric

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[6] Ibid, Page 25
[7] Ibid, Page 30