Modesto Irrigation District
Water and Power

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Ms. Rajinder Sahota
Chief, Climate Change Program Planning & Management Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Filed Electronically

Re: Modesto Irrigation District's Comments from the October 21, 2016 Mandatory GHG Reporting and Cap-and-Trade Program Workshop

Dear Ms. Sahota:

The Modesto Irrigation District (MID) welcomes the opportunity to present our comments on the topics presented by the California Air Resources Board (ARB) during the October 21, 2016 workshop. MID appreciates Staff's continued work with stakeholders on proposed amendments to the cap-and-trade program. However, we are concerned with the overall messaging of the Legislature, non-market participants like the environmental justice community and ARB itself that support for the cap-and-trade program is waning in favor of more direct, costly command-and-control measures. MID is strongly in favor of the use of a well-designed market mechanism, like the cap-and-trade program, as the vehicle for achieving the State's emissions reduction goals in a cost-effective manner.

The Environmental Justice Advisory Committee (EJAC), in particular, continues to mount pressure in opposition to the cap-and-trade program in favor of mandatory reduction targets at the individual facility level. These types of point-source reductions will increase the cost of compliance, and citizens in disadvantaged communities will experience the most severe impacts of these increases. MID's service territory is predominantly classified as a disadvantaged area, and our region struggles with employment, education and poverty rates that lag far behind the rest of the state and nation. MID opposes increased costs on an already struggling customer and urges Staff and the ARB Board members to continue to support the cap-and-trade program as the preferred Scoping Plan option for achieving California's climate goals.

MID supports a cost-effective cap-and-trade program and has several concerns with Staff's latest proposals for: Electric Distribution Utility (EDU) allowance allocation, cost containment, emissions accounting in the California Independent System Operator (CAISO) Energy Imbalance Market (EIM), and market data transparency.

Post-2020 EDU Allowance Allocation

MID has several concerns with Staff's latest proposal for EDU allowance allocation. MID echoes the concerns of the M-S-R Public Power Agency (M-S-R), as addressed in their comments, and further stresses the following points:

1. The percentage of Renewable Portfolio Standard (RPS) energy factored into the cost burden calculation for determining EDU allocation should apply to retail load instead of net energy for load. This change would help align the cap-and-trade program with the RPS program, which is codified as state law. The RPS program requires procurement of eligible renewable energy based on each load serving entity's retail sales (Public Utilities Code §§399.13 and 399.30). This conflicts with Staff's proposal for the calculation of EDU allowance allocation based on net energy for load. As presented in Staff's EDU allowance allocation proposal, Staff assumes more energy from renewable resources than the RPS program requires, which understates the cost burden that EDUs will face from other generation.

2. Staff proposes too steep of a decline in allocated allowances to EDUs over the period of 2021-2030. Under Staff's allocation proposal, MID would experience an immediate decline in allowance allocation of 45% from 2020 to 2021. On top of this drastic reduction of allowances, EDUs would be forced to absorb a roughly 15% decrease in allocated allowances from 2021-2030 due to the increase of RPS-eligible renewable energy targets from 33% to 50%, and would absorb a further 40% decrease in allocated allowances from 2021-2030 because of the additional application of the cap adjustment factor (~3.4% per year).

   Because of the decline in allocated allowances, the electricity sector (i.e. the ratepayers) will be responsible for reducing emissions by approximately 50% from 2021 to 2030, which is more than the State's goal of 40% below 2020 emissions levels. The added cost of compliance from electric ratepayers, who will bear an unequally high share of emissions reductions compared to other sectors, is compounded by the cost of procuring increasing amounts of RPS-eligible energy to achieve those emission reductions. MID urges Staff to reconsider applying both the RPS target increases and cap adjustment factor to the EDU cost burden calculation, and instead work with EDU stakeholders to select a less severe decline factor.

3. MID appreciates Staff's recommendation to retain the RPS adjustment post-2020. The alternative proposal to replace the RPS adjustment with an allowance allocation that did not account for the full amount of MID's RPS-eligible resources would have cost MID's ratepayers millions of dollars per year in additional compliance costs. However, MID is concerned that a portion of energy from the specified renewable facility that is sold as unspecified energy to a third party will be directly delivered to California without MID's knowledge. Such transactions diminish the value of MID's RPS-eligible resources by precluding usage of the RPS adjustment. MID looks forward to continued cooperation with Staff on this issue.

4. MID continues to oppose allocation of allowances directly to covered industrial entities for their electricity use. MID uses the value of its allocated allowances to protect its ratepayers from increases in electricity rates, and as such has not increased its rates since 2011. Allocating allowances directly to covered industrial entities is unnecessary and provides no real benefit to the industrial entity since their electricity costs will increase commensurate with the value of their electricity use allocation. ARB states that entities have complained of unfair treatment of receipt of allowance value in POU territories, but has provided no evidence or analysis to show that the difficulties experienced by these entities outweigh the detrimental effects to all other POU customers. Furthermore, this allocation methodology change allows covered industrial

entities to receive a double-benefit from allocated allowances. They would receive allowances directly from ARB and also receive the benefit of programs that benefit all POU customers (such as procurement of renewable resources) but that would be funded by allowances meant to mitigate the remaining customers' compliance cost. MID strongly urges Staff to remove the proposal to allocate directly to covered industrial entities for their electricity use.

Cost Containment

MID believes that changes to cost containment provisions of the cap-and-trade program would be premature responses to temporary conditions that are causing market uncertainty. The cap-and-trade program is still young and a pioneering endeavor in the United States. Any changes that could cause costs to balloon sends the wrong signal to other states that may seek to establish their own market-based emissions trading programs. MID does not support Staff's proposal to retire some or all unsold State-owned allowances of pre-2020 vintages. The program's caps will ensure that the covered portions of the economy meet the mandated emissions reductions goal. Having a surplus of allowances available for purchase at auction, or even in the Allowance Price Containment Reserve (APCR), simply ensures that the aggressive decline in emissions required from 2021 to 2030 does not result in a price spike that could stall the market and put the 2030 target in jeopardy.

MID is also opposed to the possibility of decreasing the offset credit usage limit of 8%. The offset program is an integral part of the program's cost containment provisions, in that it provides flexibility for how entities can satisfy their compliance obligation. Furthermore, the continuation of thriving offset programs allows the State to reach entities that are not covered under the cap-and-trade program and incentivize them to affect real, positive and verifiable change for the benefit of the environment. ARB should not truncate the source of funding that allows these types of offset-generating projects to continue operating.

Emissions Accounting in the CAISO EIM

At CAISO's October 13, 2016 technical workshop, CAISO described three options to help address Staff's concerns regarding unaccounted greenhouse gas (GHG) emissions. These emissions are caused by secondary dispatch within the EIM, in which an out-of-state generator serves the out-of-state load that was previously served by a generator that has been re-dispatched to serve a California energy imbalance. The analysis applied in developing the three options includes a counterfactual that if the market were run without dispatch to California load as a factor, out-of-state resources would be dispatched differently to serve out-of-state load. This counterfactual is made to reach a better understanding of how much the California market actually causes emitting resources to be ramped up, thereby increasing emissions. CAISO's three options under consideration are:

1. Option One would consist, in summary, of a balancing account run against a counterfactual on a periodic basis (e.g., monthly) used to account for proper emissions credit retirement. MID understands that Option One is not possible given ARB's policy concerning inter-temporal benefits.
2. Option Two would involve two runs of the market. The first to determine the counterfactual, showing the dispatch that would have occurred without EIM, and the second to run the market

with EIM, such that the delta between the two runs would show the change in dispatch and emissions due to the EIM for dispatch into California.
3. Option Three would develop a residual emissions rate for energy flows into California, with revenues distributed appropriately to purchase instruments to surrender to CARB.

At ARB's October 21, 2016 workshop Staff presented two options to address secondary dispatch within the EIM:

1. Incremental Deeming: equivalent to CAISO's Option Two.
2. Dynamic Hurdle Rate: similar to CAISO's Option Three with a key difference that energy procured through renewable energy contracts entered into by California load serving entities would not be subject to the emissions hurdle rate.

MID is concerned that CAISO and ARB have presented options in two unrelated forums, and urges ARB to synchronize its efforts with CAISO and merge the stakeholder processes on this issue. ARB must realize that CAISO is integral to establishing the mechanics of whichever solution to secondary dispatch in EIM, if any, is selected, and should not publish regulatory language that is not enforceable because the technology or market framework to implement it does not exist.

MID is concerned that Option Three (a.k.a. Staff's Dynamic Hurdle Rate), while perhaps simpler to implement in the short term, will lead to inefficiencies. Option Three would require "rough justice" to arrive at a hurdle rate, and would unnecessarily add costs to California load. Such costs would create a less efficient market, applying costs to generation that does not really cause such costs. While MID agrees that accurate GHG accounting is important to achieving the State's climate goals, MID does not believe that absolute accuracy should be pursued at all cost. The resulting costs of the proposed hurdle rate solution could easily outweigh the benefits of pursuing this option.

Instead, Option Two (Staff's Incremental Deeming) seems to present an opportunity to use real market data. While MID understands that the technological challenges may make the initial run of the market contemplated under Option Two less precise than the ideal situation, greater precision will be achieved over time. MID believes that Option Two represents a more efficient market-based solution as compared to Options One and Three and recommends further discussion around this option to more thoroughly consider the details and potential outcomes.

MID also recommends moving directly to a market-based solution rather than implementing Option Three which is subject to policy preferences and judgment calls in arriving at the methodology for calculating the hurdle rate and allocating the resultant revenues. In implementing Option Three to start with, it is possible that the option could remain in place longer than is necessary, or, given the press of business and unforeseen prioritization of future initiatives, be made into an essentially permanent solution. For these reasons, MID supports a solution closer to the concept outlined in Option Two, recognizing that it will be imperfect when initially implemented, but confident that it will improve over time.

MID understands that the CAISO would prefer that the option CARB implements to address concerns regarding EIM is also implemented under a Regional ISO, though allowing for the possibility of an eventual transition from an Option Three scenario to an Option Two scenario. ARB has not yet opined on the transition of this solution for EIM into the potential Regional ISO's markets; however, MID strongly recommends that ARB be mindful of the implications should the selected solution be applied to the much larger day-ahead markets of a regional ISO.

Market Data Transparency

MID opposes the suggestions of the Emissions Market Advisory Committee (EMAC) in which ARB would publish a bar graph of entity holdings versus obligations. Release of such information could be used to make inferences of individual entities' positions (even with masked identities). This will give an unfair advantage to marketers who might anticipate the strategies of compliance entities and thus alter the market in such a way as to put those strategies, and thus the State's emissions goals, at risk. MID cautions against the release of any additional information to the public that is not currently classified as available to the public.

MID appreciates the opportunity to submit these comments. We are committed to continued cooperation with ARB and our peers in the industry to lead the nation's efforts to economically reduce the impact of energy production through a healthy and well-designed cap-and-trade program.

Sincerely,

Gary Soiseth
Regulatory Administrator
Modesto Irrigation District

Cc: Greg Salyer, MID General Manager
M-S-R Public Power Agency
The Gualco Group