Modesto Irrigation District
Water and Power

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Mary Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Modesto Irrigation District's Comments on the Cap-and-Trade Rulemaking 15-Day Package

Dear Chairwoman Nichols:

The Modesto Irrigation District (MID) appreciates the opportunity to submit its comments to the California Air Resources Board (ARB) regarding potential amendments to the California Cap-and-Trade Regulation that were released on December 21, 2016 (the "15-Day Changes"). MID is committed to enacting the carbon reduction targets mandated by Senate Bill (SB) 350, Assembly Bill (AB) 32, and SB 32, and sees the Cap-and-Trade program as integral to carrying out these goals in a manner that is efficient and cost-effective to California's ratepayers. As an Electric Distribution Utility (EDU), MID participates in additional programs that guide towards emissions reductions, such as the Renewable Portfolio Standard (RPS) program and energy efficiency targets. As such, MID is particularly focused on ensuring that our various targets are achieved, but without duplicating or compounding costs between programs. MID is a member of the M-S-R Public Power Agency (M-S-R) and is a participant of the Joint Utilities Group (JUG) and is signatory to the comments submitted by those agencies.

The 15-Day Changes provide greater insight to the critically important allowance allocation component of the post-2020 Cap-and-Trade program and include some helpful changes to that provision. However, the methodology proposed in the 15-Day Changes still includes aspects that will expose our ratepayers to significant cost burden. Furthermore, there are several issues that were addressed in MID's September 19, 2016 comments (and those of several other EDUs) that remain unaddressed by ARB in the 15-Day Changes.

We offer comment on the following topics:

- **The annual rate of reduction for EDU allowance allocation is too steep and would expose ratepayers to significant cost burden.**
- **Deducting emissions associated with electricity sales to covered industrial entities from EDUs' allowance allocation should not be pursued.**
- **Vehicle electrification will play a significant role in the future of the EDU sector and in achieving the state's emissions goals, and should be recognized in EDU allowance allocation.**
- **Retaining the RPS adjustment is much appreciated, but further changes would strengthen the value, accuracy, and administration of the provision.**

- **Any changes to EDU allowance consignment would be outside of the scope of the current rulemaking process.**
- **Consignment of unsold allowances to the Allowance Price Containment Reserve (APCR) should be delayed until such allowances remain unsold for much longer than eight consecutive auctions.**
- **The interim solution for accounting for Outstanding Energy Imbalance Market (EIM) Emissions could be damaging to an expanded EIM and to future regional markets and should not be implemented.**

The annual rate of reduction for EDU allowance allocation is too steep and would expose ratepayers to significant cost burden. MID appreciates that the allowance allocation calculations included in the 15-Day Changes apply the RPS program requirements to retail sales instead of total energy to serve load, which corresponds to how the RPS program works. However, certain aspects of the RPS program would make a linear ramp-up from 33% of EDU load served by renewable resources in 2020 to 50% in 2030, as shown in the calculations for allowance allocation, likely understates actual RPS program emissions reductions.

ARB's allocation methodology assumes that the RPS percentages (increasing annually in a linear fashion from 33% to 50%) of an EDU's retail electricity sales will be entirely served by non-emitting resources. In reality, the RPS program allows for several actions to be taken towards an EDU's RPS compliance that do not result in emissions reductions for that EDU; such as:

1. Ten percent of an EDU's RPS compliance can be satisfied by retiring unbundled Renewable Energy Credits (RECs), which represent emissions reductions elsewhere than the EDU's service territory.

2. The ability to bank RECs received through excess generation from RPS-eligible resources to satisfy RPS requirements in future compliance periods allows the EDU the flexibility to defer procurement of new renewable resources, providing an option for the EDU to avoid unnecessary additional costs to its ratepayers.

3. The RPS program allows firmed and shaped energy contracts, for which an out-of-state renewable facility generates energy that is blended with or replaced by unspecified energy that is then delivered to the EDU comprise up to 15% of an EDU's RPS obligation; however, grandfathered contracts of this type are also allowed by the RPS program, increasing that percentage. MID, for example, currently covers over 40% of its RPS obligation with grandfathered resources. MID and other EDUs that are parties to firmed and shaped contracts rely on the Cap-and-Trade program's RPS adjustment provision to avoid a compliance obligation for the renewable energy purchased from these facilities. The current rulemaking has introduced an increased burden of proving that the replacement energy associated with these contracts has not been delivered into California,

which is a requirement to claim an RPS adjustment. For any energy for which the EDU will be unable to claim an RPS adjustment, the EDU will have a compliance obligation that is assumed not to exist by the current allowance allocation methodology. For MID this may represent approximately 40% of the energy from our out-of-state, RPS-eligible resources.

These actions that are allowed by the RPS program still result in a positive effect on the environment, but may result in the EDU's load being served by emitting rather than renewable resources and would have an associated compliance obligation that is not contemplated by ARB in the allocation methodology included in the 15-Day Changes.

While this understatement of EDU emissions is harmful to ratepayers on its own, the fact that the linear increase from 33-50% RPS is combined with the Cap Adjustment Factor (CAF) creates a very damaging impact to allowance allocation for ratepayer protection. The proposed allocation calculated by ARB for MID decreases annually by 6% from 2021 to 2022 and increases each year until it reaches a significant 9% reduction from 2029 to 2030. MID recognizes ARB's desire to transmit a price signal through electricity rates to incentivize reduced consumption; however, the proposed allocation schedule would result in compliance costs that are too high. The allowance allocation calculations included with the 15-Day Changes forecast that 26% of emissions over the 2021-2030 period would be unallocated for, with those compliance costs passed through to MID's ratepayers. As the emissions cap decreases annually the uncovered cost burden increases, with 44% of the cost burden unallocated for in 2030. MID contends that this amount of uncovered cost burden goes far beyond an economic price signal and does not sufficiently meet the allowance allocation goal of protecting ratepayers from excessive and harmful compliance costs.

MID endorses the solution proposed by the Joint Utilities Group, in which the allowance allocation calculation holds the RPS requirement at 33% rather than increasing linearly from 33% in 2020 to 50% in 2030. The CAF alone sufficiently performs the function of guiding the EDU sector towards decreasing emissions and is sufficiently steep to encompass the emissions reductions realized through participation in the RPS program. There is no need to duplicate this function with the linear RPS ramp. This solution would result in a much more reasonable 2-5% annual decrease in allowances.

Deducting emissions associated with electricity sales to covered industrial entities from EDUs' allowance allocation should not be pursued. The 15-Day Changes continue to seek to reduce direct allocation to EDUs by an amount commensurate with the estimated emissions attributed to electricity purchased by Cap-and-Trade covered industrial entities, and instead supply a lesser amount of allowances directly to the covered industrial entities while the full compliance obligation for the industrial entities' electricity use remains with the EDU. Implementation of this proposal would be harmful both to the affected EDUs and to the covered industrial customers within those EDUs' service territories.

The value of MID's allocated allowances reduces the impact on its ratepayers from Cap-and-Trade compliance costs and above-market renewable energy procurement for compliance with the RPS program. Through cost control efforts and the allocated allowance value, MID has not raised its energy rates since 2011. Stable and predictive rates have been enjoyed by all of MID's customer classes and especially welcomed by the larger Industrial customers. More recent rate comparisons show that MID Industrial customers are situated at least as well as their peers within Investor Owned Utility (IOU) service territories for protection from emissions leakage.

Rate setting is a difficult and lengthy process, and the targeted nature of these rate changes could result in rate disparity among facilities producing similar products in a very close proximity, potentially inducing local economic and emissions leakage. Additionally, the changes mentioned above would require substantial changes to the POUs' electric retail rates requiring alterations that conflict with the cost-of-service methodology the utility employs. These changes would not only need to be reconciled with the cost of service methodology but would make the POU vulnerable to various commercial and regulatory risks.

Electricity sales to the three covered industrial customer facilities within MID's service territory represent approximately 10% of MID's total annual retail energy sales. In 2015, the allowance value allocated to MID in association with the covered industrial customers' electricity use was valued at $1.5 million. If this value is no longer allocated to MID in the future, it will be necessary for MID to create special rates for these three customers to collect funds to cover the compliance obligation for their electricity use and avoid having MID's other ratepayers shoulder the cost of the covered industrial customers' emissions. Additionally, since a portion of MID's allowance value is applied for purposes that provide system-wide emissions benefits, MID will need to reflect in the covered industrial entities' rates that they have not contributed towards the cost of those emissions-reducing expenditures and ensure that they do not receive a double-benefit from the combination of other ratepayers' allocated allowances and allowances directly allocated to the industrial entities by ARB.

Ratemaking would be further complicated because covered industrial facilities would only receive allocation for electricity usage related to the processes within their operations that produce on-site emissions, even if the entire facility produces only the covered product. Not only will these customers need to be treated differently from other industrial customers, but these customers' load would need to be treated differently within each customer's bill. For example, a facility may only report 50% of its electricity usage as supporting the processes that are listed in Table 9-1 of the Cap-and-Trade Regulation (i.e. excluding office load, product conveyance, facility cooling, etc.), which would mean that the Publicly Owned Utility (POU) receives allocated allowances for a portion of the covered industrial customer's load and the customer receives allocated allowances for another portion of their load. It is infeasible for the POU to separately meter the energy used for only these processes and would need to create separate rate classes and rate calculations to account for this change.

Additionally, this proposed change would be harmful to the covered industrial entities. For every one allowance taken from their EDU, the covered industrial entity would receive less than one allowance. This disparity will necessarily be much less than the allowances taken from the EDU. The level of disparity would be contingent upon: a) the emissions profile of the EDU in whose territory the industrial customer is situated, b) each customer's energy efficiency relative to the other entities within their industry, and c) the assistance factor for their industry. In the meantime, the EDU still receives the full cost burden of the covered industrial customers' emissions, and will need to pass those costs through to each covered industrial customer. Therefore, under this change the costs of the covered industrial customer's emissions will remain relatively stable, but the amount of allowance value available to them to cover those costs will be drastically reduced. MID recommends that the resulting cost disparity be more widely communicated to affected entities through a series of workshops dedicated to the issue to ensure that all affected entities have the same understanding of the impacts. Any potential implementation of this change should be delayed until the affected parties have enough information to fully assess its implications.

This change remains unwarranted and MID recommends that ARB not proceed with it so that EDUs may still receive allocation to reduce the cost burden for all load for which they generate electricity, including load from covered industrial entities.

Vehicle electrification will play a significant role in the future of the EDU sector and in achieving the state's emissions goals, and should be recognized in EDU allowance allocation. ARB continues to recognize that allowance allocation for electrification of vehicles and other sources of emissions remains an important issue and that the agency will work with EDUs to address it. However, the proposed allocation methodology is still devoid of any recognition of the issue. In Attachment C to the 15-Day Changes ARB states that, "it is important to ensure that any method used to calculate any allocation for increased electrification is as accurate and verifiable as the methods used to allocate for industrial sectors for product-based allocation." However, it is not feasible for EDUs to meter all load from electric vehicles. EDUs have no authority to require our customers to install or use separate metering equipment for their vehicles or electrified appliances. Vehicle electrification will play a large role in achieving the state's emissions reduction goals, and MID fears that additional cost burden for the emissions associated with increased load from electrification could increase electricity prices and result in a downward effect on demand of zero emission vehicles. An ideal solution would involve an after-the-fact allocation that closely estimates the additional load within each EDU's service territory, using information similar to that currently used by the Low Carbon Fuel Standard (LCFS) program. Many elements of the Cap-and-Trade program are estimated, and MID remains willing to work with ARB and other EDUs and stakeholders to develop a thoughtful method of estimating electrified load as well.

Retaining the RPS adjustment is much appreciated, but further changes would strengthen the value, accuracy, and administration of the provision. MID strongly supports that the 15-Day Changes eliminate language that would have discontinued the RPS adjustment post-2020. The RPS adjustment provision protects our ratepayers from millions of dollars in compliance costs for investments in firmed-and-shaped renewable energy contracts that were made prior to the inception of the Cap-and-Trade program. There are, however, additional changes that could be made to the regulation that would ensure that our ratepayers receive the full value of their investment, increase the accuracy of the ARB's emissions reporting, and make it easier than before for the ARB to implement and enforce the RPS adjustment provision. For the full details, please refer to the comments submitted by the utilities, including MID, that are most impacted by this provision, titled "Utility Recommendations to Improve Implementation of the Renewable Portfolio Standard Adjustment Under the Cap-and-Trade Program" submitted on January 20, 2017. Our proposal to enhance the RPS adjustment consists of three complementary components:

1. <u>Revise Section 95852(b)(4)(D) of the Cap-and-Trade regulation to exclude RPS adjustment claims for specified imports rather than directly delivered electricity</u>. Double-counting of zero-emission benefits only occurs when energy is imported by one entity as a specified import and another entity claims an RPS adjustment for that same energy. A specified import is easy to track and the EDU that originally purchased the renewable energy and is entitled to the RPS adjustment or the Generation Providing Entity (GPE) has reasonable control over what energy is sold as a specified product. As the regulation is currently written, any energy produced by the renewable resource, whether sold as specified or unspecified, that sinks (i.e. is directly delivered) to California cannot be claimed as an RPS adjustment. This is a much higher bar and the GPE or EDU have little control over direct deliveries, which occur in much greater amounts than specified imports. The existing language also has negative implications for emissions accounting. In an instance where the GPE sells unspecified energy from the renewable resource to a third party (unspecified because the EDU originally purchased the emissions attribute) and directly delivers the energy to California as an unspecified import, the ARB would record twice the amount of emissions than it should (the original EDU's redelivered energy at the unspecified rate plus the unspecified energy imported by the third party from the renewable facility). One of those entities should receive the zero-emission benefit of the energy, and it should be the EDU that paid for that benefit. It is important to note that in the current regulation, electricity must be directly delivered in order to be specified, but directly delivered electricity can be unspecified.

2. <u>ARB would provide a supplemental allocation equivalent to any RPS adjustment within a reporting year that the EDU is unable to claim.</u> This supplemental allocation would be based on actual, verified data and would ensure that our ratepayers receive the full benefit of their investments. EDUs claiming an RPS adjustment would lag their claim by one year so that the ARB could provide a report showing any specified imports of electricity from renewable resources for

which the EDU is claiming an RPS adjustment. Such a comparison would allow for easier identification of improper specified import claims.

3. Retain the requirement in Section 95852(b)(3)(D) of the Cap-and-Trade regulation and verify REC serial numbers for quality control. By virtue of how the energy market actually operates, all purchases of specified renewable energy should be accompanied by a transfer of RECs. By retaining the requirement for importers of specified renewable energy to report REC serial numbers, ARB would retain an invaluable tool for verifying the correctness of claims of both specified renewable energy and RPS adjustments. The Mandatory Reporting Regulation (MRR) staff need only sum for each renewable facility: RECs attributed to specified imports and RECs associated with RPS adjustment claims. If the resulting sum exceeds the total facility generation, then some entity made an improper specified source claim; that entity will be the one claiming a specified renewable import without the RECs to back up its claim.

Since this proposal is linked with, and provides some benefit to, MRR staff, MID requests that ARB ensure that MRR staff reviews this proposal. If ARB does not accept this proposal and retains the direct delivery interpretation of the regulation, MID ratepayers would be excluded from claiming RPS adjustment for approximately 30-50% of the output of our renewable energy facilities for which we have firmed-and-shaped contracts. These contracts, grandfathered in the RPS program, extend past 2030 and currently comprise over 40% of MID's total RPS portfolio.

Any changes to EDU allowance consignment would be outside of the scope of the current rulemaking process. In Attachment C to the 15-Day Changes, ARB states that they are, "considering requiring POUs and co-ops to consign allocated allowances to auction and requiring that the auction proceeds be used for specific purposes." The unique, vertically integrated and locally controlled nature of POUs and co-ops led the original program to be set up so that those entities are allowed the flexibility to use allocated allowances directly towards their compliance obligations or to fund emission reduction projects. Nothing has changed in how POUs operate that would justify reducing their options for satisfying their compliance obligation in the most cost-effective manner. Furthermore, this issue has not been addressed in the rulemaking so far, and should be considered outside the scope of the rulemaking. MID requests that this issue not be included in subsequent 15-day amendments, the current rulemaking is already populated with a large amount of complicated and impactful changes and does not lack for more.

Consignment of unsold allowances to the Allowance Price Containment Reserve (APCR) should be delayed until such allowances remain unsold for much longer than eight consecutive auctions. In our September 19, 2016 comments regarding the 45-day Cap-and-Trade amendments MID suggested that eight consecutive auctions, to be applied retroactively, is not sufficient time to wait before unsold allowances are sent to the APCR. MID and many others have stated that the newness of the program, along with the chilling effect caused by the

Chamber of Commerce lawsuit challenging the legitimacy of the program have created an environment that destabilizes the operation of the Cap-and-Trade program and that any changes to its cost containment provisions in response to such an environment would be premature and detrimental to the program once its caps decline sufficiently to induce intense competition for allowances. In May 2016, just after the California Chamber of Commerce filed its lawsuit against the Cap-and-Trade program, allowances were trading on the secondary market at around $12.50 per allowance, much lower than the $12.73 auction floor price. This is indicative of marketers liquidating their positions and cannot be expected to continue once the program has stabilized. To make a far-reaching cost containment change based on such behavior would be a mistake.

The interim solution for accounting for outstanding Energy Imbalance Market (EIM) emissions could be damaging to an expanded EIM and to future regional markets and should not be implemented. MID does not support the implementation of an interim solution to account for Outstanding EIM Emissions. The solution put forth by ARB in the 15-Day Changes, in which Outstanding EIM Emissions are reported by the CAISO and covered by allowances that were offered for auction from the state pool of allowances but remain unsold, is contrary to ARB's stated desire to pass a proper price signal to reduce emissions. By drawing from unsold allowances the effect will be an overall tightening of the cap, rather than a compliance obligation for the generators that are actually producing the emissions. Furthermore, MID cautions against allowing a temporary solution to affect the development and/or operation of the expanding EIM or more importantly, a potential expanded regional market. MID urges ARB to wait for the CAISO to complete their stakeholder process to create a market-based solution before addressing this issue in the regulation.

MID thanks ARB for its consideration of our comments on these important issues and looks forward to continuing our cooperation with the Joint Utilities Group and ARB towards shaping the post-2020 Cap-and-Trade regulation to meet our 2030 goals in a way that is most cost-effective to our ratepayers.

Sincerely

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