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January 20, 2017

Submitted electronically

Mary Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: **Comments on 15-Day Changes to Cap-and-Trade Program Regulation**

Dear Ms. Nichols:

The M-S-R Public Power Agency (M-S-R)[1] provides these comments to the California Air Resources Board (CARB) regarding proposed amendments to the Cap-and-Trade Program Regulation. In these comments, M-S-R addresses the additional modified text and materials that were released on December 21, 2016 (15-Day Changes). Each of M-S-R's member agencies are covered entities under the Cap-and-Trade Program Regulation (Regulation), and are directly impacted by the requirements set forth therein. As electrical distribution utilities (EDUs), M-S-R's members are also subject to additional programs and mandates administered by other state agencies as part of the California's greenhouse gas (GHG) emission reduction strategy, including the Renewable Portfolio Standard (RPS) program.[2]

M-S-R and its member agencies each support continuation of the cap-and-trade program as a key element of the state's overall emission reduction plan, and a vital tool for compliance entities to achieve the mandated reductions in the most cost-effective means possible. M-S-R has worked with CARB staff and other affected stakeholders during the course of this rulemaking in an effort to ensure that the proposed changes to the cap-and-trade program do not adversely impact the electricity ratepayers of California, especially at a time when those customers are called upon to effect greater emissions reductions than any other sector of the economy.[3]

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1 Created in 1980, the M-S-R Public Power Agency is a public agency formed by the Modesto Irrigation District, the City of Santa Clara, and the City of Redding.
2 M-S-R is authorized to acquire, construct, maintain, and operate facilities for the generation and transmission of electric power and to enter into contractual agreements for the benefit of any of its members. Currently, M-S-R and its members have contractual arrangements for over 625 megawatts of California Energy Commission (CEC) RPS-certified renewable energy.
3 M-S-R also supports the comments submitted by the California Municipal Utilities Association. The cities of Redding and Santa Clara are also members of the Northern California Power Agency (NCPA) and support the comments submitted to CARB by NCPA, as well.

In these comments, M-S-R addresses the following additional proposed changes to the cap-and-trade program regulation raised in the 15-Day Changes:

- Proposal for allocation of allowances to electrical distribution utilities;
- Retaining the RPS adjustment;
- Proposed amendments to track greenhouse gas emission in the California Independent System Operator energy imbalance market;
- Suggested amendments to EDU consignment provisions and rules for use of allowance value;
- Unsold state allowances should not be consigned to the Allowance Price Containment Reserve; and
- Linkages with other GHG programs are properly subject to a formal stakeholder process.

1. EDU Allowance Allocation

The 15-Day Changes include CARB's proposed methodology for allocating allowances to the EDUs for 2021 to 2030. As a threshold matter, M-S-R appreciates CARB's continued recognition of the importance of providing the EDUs allowances to cover their program cost burden. EDUs provide the most direct link to electricity customers and are best able to return the allowance value to those ratepayers to further the objectives of AB 32. Because the allowance value directly protects ratepayers from the impacts of sudden rate increases associated with the program, it is important that the EDUs' allocation be sufficient to cover the cost burden associated with the post 2020 cap-and-trade program. As more fully addressed below, this includes recognition of the importance and impacts that the state's RPS program has on EDUs, and the effects resulting from increases in electricity sales associated with electrification of other sectors of the economy, particularly the transportation sector.

Attachment C to the 15-Day Changes provides stakeholders with considerably more insight regarding CARB's rationale behind the proposal than was originally included in the August 2, 2016 Staff Report and Proposed Amendments. M-S-R appreciates this additional information, as it allows stakeholders to assess the presumptions and assumptions used to develop the allocation proposal. The proposal in the 15-Day Changes reflects several key adjustments to the initial drafts discussed since this rulemaking commenced.[4] These changes improve the accuracy of the final projections, more closely aligning with the expected program costs for EDUs, including a recognition that the states RPS mandates applies to retail sales and not the EDU's total load. However, there are several key elements of the allocation proposal that require further assessment and revisions; in particular, M-S-R notes the following:

- The proposed RPS linear decline to 50% overstates the quantity of zero-GHG resources in EDU portfolios;
- The proposed changes to the scope of cost burden increases customer costs;
- Reducing the allocation to EDUs for sales to covered industrial entities should be eliminated;

4 This includes the October 14, 2016 Informal Staff Proposal and October 21, 2016 Workshop slides and discussion.

- Transportation electrification must be recognized and addressed in this rulemaking.

A. *RPS linear decline to 50% overstates the quantity of zero-GHG resources in EDU portfolios*.

The allocation proposal reduces EDU allowances based on the assumption that EDUs will meet their RPS mandates which moves from 33% in 2020 to 50% by 2030.[5] As justification for the proposed RPS trajectory, CARB cites to the increased RPS mandate adopted by SB 350 and the need to ensure that the cap-and-trade program compliance cost reflect the presumed decrease associated with greater quantities of renewable resources in the EDUs' portfolios. However, what the rationale in Attachment C does not recognize is the fact that EDUs can be 100% compliant with their RPS mandate in 2030 without serving 50% of their load from instant renewable resource deliveries.

The RPS mandate codified in Public Utilities Code sections 300.11, *et seq*., explicitly recognizes several instances when the amount of load served in a year by renewable resources may differ from the number of renewable energy credits (RECs) that the EDU surrenders to meet its RPS target for that same year.[6] These provisions have the practical effect of ensuring that utilities acquire the necessary quantities of renewable generation to be compliant with the RPS mandate, but acknowledge that the renewable energy credits that represent those resources may not always be retired in the same time period in which the electricity is generated. Similarly, the provisions account for financial, market, regulatory, and other vagrancies that might impact the utilities' procurement of eligible renewable energy.

For example, the RPS program allows retail sellers and POUs to meet up to 10% of their RPS mandate with unbundled RECs.[7] When a utility exercises its statutory right to do so, that 10% of their retail load would be served by resources that would incur a compliance obligation under the cap-and-trade program. By assuming a straight-line trajectory to 50% RPS without also recognizing this provision in the same statute, the CARB proposal underestimates the EDU cost burden. Similarly, the statute allows for banking of excess procurement.[8] This means that POUs that procure more RPS-eligible electricity than they need to meet their RPS mandate for any given year can bank the RECs for use in a future compliance period. The utility would be compliant with the RPS program requirements because it surrenders the banked RECs, but depending on how the excess generation was utilized, the utility may be serving retail customers in that future compliance period with non-renewable resources for which a cap-and-trade program compliance obligation would accrue. Cap-and-trade program compliance instruments would need to be surrendered for those resources, but would not be included in the calculation of cost burden used to determine the number of allowances the EDU requires. The state's RPS

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5 Attachment C, p. 5.

6 Each of the statutory exceptions discussed herein are also reflected in the rules and regulations promulgated by the California Energy Commission and California Public Utilities Commission for the POUs and retail sellers, respectively. *See* Enforcement Procedures for the Renewables Portfolio Standard for Local Publicly Owned Utilities (http://www.energy.ca.gov/2016publications/CEC-300-2016-002/CEC-300-2016-002-CMF.pdf) and CPUC Rulemaking 11-05-005.

7 Public Utilities Code (PUC) sections 399.16, 399.30.

8 PUC sections 399.13, 399.30(d)(1).

program also recognizes instances where timely compliance with the RPS mandate is delayed without penalty to the EDU.[9] Unforeseen delays associated with siting, permitting, and building renewable generation resources and the associated transmission infrastructure may delay the procurement or acquisition of renewable resources intended to meet current RPS mandates. EDU renewable procurement can also be affected by cost limitation provisions.[10] In instances where the EDU's timely compliance is delayed for these reasons, EDUs may need to purchase electricity from non-renewable sources to serve their retail customers, causing the EDU to incur a cap-and-trade program compliance cost.

Furthermore, compliance costs are also affected by the EDU's ability to utilize the RPS adjustment. The manner in which the firmed-and-shaped renewable resources are accounted for when delivered to California also impacts the cost burden of EDUs. For example, as the current application of the RPS adjustment excludes some Portfolio Content Category 2 and 0 resources from the RPS adjustment, a cap-and-trade compliance obligation is assigned to those resources, despite the fact that those same resources are included in the calculation of RPS resources for which no cost burden is assigned under the CARB proposal.

Under the current assumption of a 50% straight-line RPS increase to 2030, the cost burden associated with non-renewable resources directly linked to the RPS program would not be included in the calculation of allowances allocated to the EDUs, resulting in increased costs for electricity ratepayer. Equity requires the allocation proposal to recognize these important provisions in the state's RPS laws, and not just the total mandate. Taking into account the reduction in allocated allowances already imbedded in the cap decline factor and the need to fairly account for the fact that the 50% RPS mandate does not necessarily equate to 50% non-GHG emitting resources, M-S-R believes that it is more appropriate for CARB to base annual RPS requirements using a flat trajectory of 33% through to 2030.

B. *The Revised Cost Burden Results in Rate Increase for EDU Customers*

The post-2020 cap-and-trade program does not simply continue the existing program, just as the allocation proposal does not simply duplicate what was done in 2013. The increased reductions mandated post-2020, coupled with changes to the overall allocation methodology results in the potential for significant rate increases for electricity customers beginning in 2021. This is due to the fact that those changes will result in a substantial reduction in the number of allowances received by some EDUs between 2020 and 2021. M-S-R believes that this "cliff" should be adjusted to minimize the cost impacts for electricity customers. One way to address this concern is to recognize the true nature of the continuation of the cap-and-trade program, the accelerating cap decline, and post-cap-and-trade investments in expanded emission reductions (including early divestiture of coal-fired resources). M-S-R joins with the other stakeholders that urge CARB to "look at the totality of the measures EDUs are required to implement to reduce statewide emissions, and not consider the Cap-and-Trade program in a vacuum. Rather, the cost burden should be considered in the context of the Scoping Plan itself. This is critically important because EDU costs associated with these other programs have a direct impact on their

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9 PUC sections 399.15(b), 399.30(d)(2).
10 PUC sections 399.15(c), 399.30(d)(3).

compliance obligation under the Program. Reduced compliance costs associated with the Cap-and-Trade Program do not necessarily translate to a reduced cost burden for EDUs."[11]

When these costs are not accounted for, there is the potential for significant rate impacts beginning in 2021, when fewer allowances are provided to meet program costs. CARB appears to dismisses this concern, noting that POUs and electric cooperatives can "plan ahead for the decrease in allocation by banking auction proceeds, passing the GHG cost through to their customers, and returning auction proceeds to ratepayers in a non-volumetric manner."[12] This recommendation, however, does not address the fact that investments in carbon reducing measures drive the lower allocation under the current definition of cost burden. Neither does the recommendation to bank allowance value account for how existing programs and measures that were created to reduce GHG emissions will be funded. The impacts of the "cliff" and the resulting rate shock to electricity customers is better addressed by recognizing these additional costs, at least during a transition period, so that customers can be shielded from the "sudden increases in their electricity bills associated with the cap-and-trade regulation."[13]

C. *The reduction in allocation to EDUs for sales to covered industrial entities should be eliminated*

The proposal to reduce the number of allowances allocated to EDUs for industrial covered entities' purchased electricity should be removed from the EDU allocation methodology. Not only does this proposal represent a significant shift from the current policy, but the need for such a change has not been evidenced. M-S-R member agencies are concerned that the proposal results in an actual reduction in the total allowance value provided to their covered industrial customers, which could have adverse impacts on the companies and the communities they are located in. Based on the proposed allocation methodology, the covered industrial customers will not receive a 1:1 transfer of the allowances deducted from the EDU, but rather, will have that value reduced by their specific benchmarking, resulting in an actual reduction to their mitigation. This means that those customers will not be able to cover the increased electricity costs associated with the price of carbon with the allowances "transferred" from the EDUs to the industrial customers.

Additionally, M-S-R is concerned about the lack of specificity associated with the underlying justification put forth in Attachment C[14] and claims that POU customers are disadvantaged or under-compensated. If specific instances do exist, those concerns about the use of allowance value should be addressed directly with the affected entities prior to moving to a draconian alternative with potentially adverse impacts for both the EDUs and the covered industrial customers. M-S-R member utilities return the allowance value to their customers, including the industrial covered entities, in the manner that best meets the needs of the utility's customers. This is exactly what was contemplated in 2011.[15] Investments in programs and

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11 M-S-R Public Power Agency Comments on Proposed Amendments to Cap-and-Trade Program , dated September 19, 2016 (M-S-R September 19 Comments).
12 Attachment C, p. 3.
13 See October 2010 Initial Statement of Reasons, p. 11-28.
14 Attachment C, p. 5.
15 "CPUC and the POU governing boards will determine the most equal and fair way to redistribute the auction

measures that advance the intent of AB 32 are already in place; reducing allowances for one class of electricity customers could result in diminishing the benefits of the allowance proceeds to remaining customers. M-S-R remains concerned that this proposal is misguided and urges the Board to direct staff to revise their EDU allocation proposal to exclude reductions based on covered industrial customers purchased electricity. Additionally, to the extent that CARB staff has specific concerns about the return of allowance value, M-S-R urges staff to notify those entities so that the issue can be reviewed and resolved.

D. *Transportation electrification must be recognized and addressed in this rulemaking*

The allocation proposal provides no recognition of the impacts that transportation electrification will have on the EDUs and their electricity customers. Staff has committed to continuing to "assess the potential for adjusting allocation amounts to reflect emissions that result from electrification of transportation,"[16] as it committed to doing in the original Staff Report at the beginning of this rulemaking. However, this is not a matter than can continue to be deferred to future rulemakings. Indeed, if it is not addressed at this time, it will be at least a year to 18 months before any future amendments would be likely to be approved, further exacerbating the concerns that are being raised at this time; concerns that were raised and acknowledged as far back as 2010-2011.[17]

The state continues to rely on increased electrification to meet its climate objectives. As such the legislature placed an emphasis on transportation electrification and the role it will play in helping the state meets its goals, and explicitly directed CARB to consider allocating allowances to electrical distribution utilities to address the increased emissions that would result.[18] M-S-R understands that CARB is seeking a methodology to both quantify the impacts and allocate allowances commensurately. To that end, CARB has been coordinating with the energy agencies and stakeholders; that process should continue with the objective of finding a long-term methodology that will recognize how electrification of all other sectors impacts the electricity sector, and in particular, the EDUs. However, rather than defer this issue until that process has been resolved, since transportation electrification will impact the entire electricity sector, the agencies must address the immediate and near term impacts *at this time*. Ensuring that such a methodology is accurate and verifiable should not be a deterrent to also ensuring that this issue is properly and timely addressed.

2. The RPS Adjustment Should be Retained

The 15-Day Changes would retain the RPS adjustment, rather than eliminate the provision as originally proposed. M-S-R appreciates staff's responsiveness to stakeholder concerns regarding the adverse implications associated with removing the RPS adjustment, and the proposal to retain the provision. The alternate proposal that had originally been proffered to replace the RPS adjustment would have failed to account for the actual RPS-eligible deliveries

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value back to its customers." 2011 FSOR, p. 590.

16 Attachment C, p. 4.

17 2011 FSOR, p. 570.

18 Health & Safety Code section 44258.5(b).

that an EDU has invested in. This would have cost M-S-R's member agencies millions of dollars in additional compliance costs each year and depreciated the value of the RPS-eligible resources for which their ratepayers paid a premium. As addressed in the M-S-R September 19 Comments, and in subsequent comments submitted by the Joint Utilities, the RPS adjustment is an important element of the cap-and-trade program that directly acknowledges the interaction between two of the state's pivotal climate programs.

However, merely retaining the RPS adjustment, without properly administering the adjustment or requiring the reporting and verification of the associated renewable energy credits, is not enough to ensure the necessary alignment between the RPS program and the cap-and-trade program. M-S-R urges the Board to recognize the significance of this alignment and the importance of the appropriate administration of the RPS adjustment, and direct staff to include proposed modifications to the regulatory language in subsequent 15-day modifications to the cap-and-trade program regulation and the Mandatory Reporting Regulation to ensure consistency and clarity. M-S-R joins in the January 20, 2017, Utility Recommendations to Improve Implementation of the Renewable Portfolio Standard Adjustment Under the Cap-and-Trade Program, and urges CARB to work with stakeholders to incorporate the program refinements addressed therein.

3. No Changes Should be Made to the Accounting of GHG Emissions from the Energy Imbalance Market

Since this rulemaking began, there has been considerable debate regarding the extent to which the cap-and-trade program regulation needs to be amended to address CARB's concern that the GHG emissions from electricity transactions in the EIM are not being properly captured. CARB and CAISO assessments of the available data have provided differing perspectives on the scope of the issue, the magnitude of the impact, and the viability of various solutions. Further complicating this matter is the fact that the existing EIM is scheduled to expand in the near future and transactions in the EIM are expected to continue to grow in the coming years. This means that any changes CARB implements supported by data and assessments based on the currently limited scope of the EIM, will have far reaching and direct impacts on the growing EIM and the future of regional transactions. This is true regardless of whether the proposed modifications are intended to merely serve as an interim solution.

Furthermore, the proposal described in Attachment F may allow for more accurate accounting of the emissions experienced by the atmosphere, but it does not necessarily assign the compliance obligation to the appropriate entity. Rather, the solution should be market-based, resting solely on the generator responsible for the emissions and not apportioned statewide. The potential implications that the proposed approach would have on a greater number of transactions would compound this inequity, imposing additional costs where they are not warranted.

CARB's proposal could also have unintended consequences for an expanded ISO. Even under the current scope of the EIM, the proposal essentially assigns a compliance obligation that is not directly linked to the responsible generator or importer of the emission. Using this basis as the precedent for a broader market is not sound policy, and should be avoided. M-S-R urges the

Board to direct staff to continue to engage with the ISO and with stakeholders, and to develop a single, uniform solution that takes into account the magnitude of the potential leakage risk and the potential to impact the entire EIM. Until that solution is fully developed, including any necessary ISO tariff amendments, the current provisions for tracking GHG emissions in the EIM should be retained.

M-S-R believes that until such time as the CAISO has completed its review of the EIM program and GHG accounting, inclusive of effecting any necessary tariff amendments, CARB should retain the provisions regarding GHG accounting in the EIM unchanged. Despite the stated need for an interim solution, CARB's proposal does not include an end date, nor address how the process may be impacted by potential tariff amendments. A subsequent rulemaking to amend the regulation to incorporate changes necessitated by any tariff amendments could take months, during which time the interim solution would continue. This has the potential to cause disruptions to the market.

4. Suggested amendments to EDU consignment provisions and rules for use of allowance value should not be changed in this rulemaking

In discussing the allocation proposal, the 15-Day Changes states that "Staff is also considering requiring POUs and co-ops to consign allocated allowances to auction and requiring that the auction proceeds be used for specific purposes" and that "[a]dditional proposed amendments would be proposed in a subsequent 15-day regulatory proposal."[19] M-S-R was surprised to see this reference in Attachment C, as there have been no market or regulatory changes that would warrant a corresponding change to the consignment provisions. Further, as this issue was not previously raised in the context of the August 2, 2016 proposed amendments, any changes to provisions regarding EDU consignment of allowances would be outside the scope of this rulemaking.

The provisions of section 95892(b) were the subject of extensive deliberations during the 2010-2011 rulemaking process. The final rule reflects the significant structural differences between the vertically integrated POUs and the IOUs, and ensures that POU electricity ratepayers would not have to incur needless administrative costs by consigning all of their allowances into an auction when they own or operate their own generation resources to provide electricity directly to their end-use customers.[20] Requiring the POUs to do so would only increase compliance costs and decrease the amount of allowance value available to directly benefit the electricity ratepayers. Since that time, there have been no changes to the regulatory structure or legislative mandates that alter the underlying rationale or justification upon which the current consignment rules are based. In the absence of such changes, M-S-R does not believe that any changes to the regulation are warranted.

Further, the scope of this rulemaking, as set forth in the August 2, 2016 Staff Report, did not raise EDU consignment in any manner. Changes to consignment provisions for gas utilities

19 Attachment C, p. 2.
20 2011 FSOR, pp. 564-565.

were proposed.[21] Accordingly, while the 15-Day Changes modify the original consignment proposal for gas utilities, that is appropriate given that the issue was raised as one being considered in this rulemaking. It would be inappropriate – and unlawful[22] – for the 15-Day Changes to include amendments to provisions that were not previously noticed. Had staff also contemplated changes to the EDU consignment provisions, they similarly could have raised the issue at that time. However, since changes to EDU consignment rules was not included in the August 2, 2016 scope of proposed amendments under consideration, any changes to the program rules in this regard would need to be taken up in a subsequent rulemaking.

Attachment C also notes that staff is considering "requiring that the auction proceeds be used for specific purposes." To the extent that additional proposed amendments are contemplated that address "specific purposes" for the use of allowance value that are not already part of section 95892(d) or addressed in the August 2, 2016 Staff Report, those amendments are not appropriately part of the current rulemaking. Potential changes to the provisions regarding the use of allowance value included a proposed amendment to section 95892(d) adding a deadline to the use of allocated allowance value and a requirement that the allowance value be returned on a non-volumetric basis, citing consistency with the restrictions placed on natural gas suppliers.[23] Other than these explicit amendments, the Staff Report notes that "Proposed changes to the Regulation would also make several clarifications to the allowed uses of [EDU] allocated allowance values. . . . These amendments are not substantive changes, but clarifications to the meaning of benefiting ratepayers and consistency with AB 32 goals."[24] Any further revisions or changes to the regulations to restrict the use of allowance value "for specific purposes" would go beyond the scope of amendments discussed in the initial rulemaking materials and there would not be appropriate for the current rulemaking.

Had amendments to the rules governing EDU consignment and further restrictions on the use of allowance value been contemplated but not fully developed, those issues should have been referenced in the August 2, 2016 Staff Report and Initial Statement of Reasons in a similar manner as other issues were raised.[25] Absent the inclusion of these issues in the original rulemaking, or notice to stakeholders that this matter may be the subject of a subsequent 15-day regulatory proposal in the initial rulemaking materials, those matters are not properly included in the 15-Day Changes or any subsequent 15-day amendments in this current rulemaking. M-S-R urges staff not to expand the scope of this rulemaking at this time, but rather continue to work with stakeholders on resolution of the critical issues that are already being addressed.

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21 August 2, 2016 Staff Report, Initial Statement of Reasons, p. 45.
22 Government Code section 11346.8(c).
23 August 2, 2016 Staff Report, Initial Statement of Reasons, p. 40.
24 *Id.*
25 There are several references in the August 2, 2016 Staff Report to items that staff was still reviewing at that time, noting that "any proposed revisions would be circulated for a 15-day comment period." In this way, stakeholders were made aware of the scope of potential amendments, even in instances where the specific regulatory language had not yet been developed.

5. Unsold state allowances should not be consigned to the Allowance Price Containment Reserve

The August 2, 2016 Staff Report included a proposal to consign allowances that remained unsold for 24 months to the allowance price containment reserve (APCR). The 15-Day Changes modify the text in this provision, but do not respond to stakeholder concerns about the adverse impacts that could result from permanently removing these allowances from the regular market prematurely. M-S-R urges CARB to amend its recommendation to move these unsold allowances into the APCR, or at a minimum, extend the time period during which the allowances remain unsold before moving them.

6. Linkages with other GHG programs are properly subject to a formal stakeholder process

The 15-Day Changes include further modified text to proposed new section 95945. This additional language would require that the Board only approve a "retirement-only" agreement with an external GHG program after public notice and an opportunity for public comment. M-S-R supports CARB's explicit recognition that any such linkages must be part of a public process that involves affected stakeholders. M-S-R remains concerned, however, that expanded linkages could adversely impact compliance entities; to that end, linkages with other emissions-based programs that do not afford California compliance entities access to additional compliance instruments while allowing California compliance instruments to be retired for other than the cap-and-trade program should be avoided. To the extent that the 15-Day Changes do not address the remaining concerns raised by M-S-R and other stakeholders regarding these new linkage options and the importance of ensuring compliance entities in California's program have adequate access to compliance instruments, M-S-R urges the Board to direct that they be address in subsequent 15-day changes.

Conclusion

M-S-R appreciates CARB's recognition of the importance of allocating allowances to the EDUs for the benefit of their electric ratepayers. As more fully addressed herein, M-S-R urges the Board to direct further revisions to the allocation proposal to more accurately reflect the true nature of the program costs that will be borne by electricity customers. Subsequent 15-day changes should include the further modifications to the Proposed Amendments and 15-Day Changes addressed in these comments and the Joint Utility Comments Proposal on the RPS Adjustment.

Respectfully submitted,

Martin R. Hopper
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M-S-R Public Power Agency