April 25, 2016

Ms. Rajinder Sahota
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Dear Ms. Sahota:

Subject: Los Angeles Department of Water and Power
Comments on California Air Resources Board
Cap-and-Trade Regulation Post-2020 Emissions Caps and Allowance Allocation

The LADWP appreciates the opportunity to provide comments on California Air Resources Board (CARB) staff presentations and discussion at the March 29, 2016 workshop related to setting post-2020 greenhouse (GHG) emissions caps and allowance allocations for the cap-and-trade program.

Serving approximately 1.4 million customers in Los Angeles with a generating capacity of over 7,300 megawatts, LADWP is the largest municipal electric utility in the nation, and the third largest electric utility in California. LADWP is a vertically integrated utility, owning and operating a diverse portfolio of generation, transmission, and distribution assets spanning several states. LADWP is making unprecedented investments in the following areas that will result in significant CO_2 emissions reductions on a LADWP system-wide basis:

- Replacement of coal resources
- Renewable energy
- Modernizing power plants in the South Coast Air Basin
- Energy efficiency
- Electric transportation
- Energy storage

111 N. Hope Street, Los Angeles, California 90012-2607 *Mailing address:* Box 51111, Los Angeles, CA 90051-5700
Telephone: (213) 367-4211 www.LADWP.com

LADWP is committed to complying with the cap-and-trade program and appreciates CARB's sharing of its initial proposals as it moves through the rulemaking process. As CARB moves toward this next post-2020 phase of the program, we believe that it will be important to have a comprehensive understanding of the issues to ensure that the program is fair, allows for price discovery, and protects ratepayers, including low income customers. We recommend that CARB release its modeling run results, industry leakage study, and benchmarks as soon as the information is available so that stakeholders can most effectively work with CARB in development of a program that addresses these issues. LADWP believes that consideration of this important information in cap-setting and allowance allocation will yield development of an effective program. Thus, LADWP recommends that CARB not rush into rule amendments that may result in serious impacts to the state's electric utilities.

Cap setting Post-2020

CARB is proposing two cap setting options: 1) linear decline between current 2020 and expected 2030 cap levels; and 2) linear decline from estimated 2020 covered GHG emissions (adjusted downward to reflect *estimated actual* GHG emissions below the current cap) and estimated 2030 cap.

Based on the limited information provided at the workshop, LADWP recommends option 1 as it is based on a known, regulatory-adopted number. In other words, if the linear decline starts from the current 2020 cap, there would be certainty. As of the date of the workshop, CARB did not have the estimated actual 2020 covered entity GHG emissions; thus, there are uncertainties with respect to the following:

- Impact on allowance supply related to CARB's proposed industrial and EDU allowance allocation if EDUs continue to bear the compliance obligation as currently required.
- Impact on allowance supply related to CARB's proposal to provide incentive allowances for industrial entities that install zero-emitting technology.

We understand that there is a balance between maintaining incentives for emissions reductions and containing program costs. However, since the forecast 2020 GHG emissions data is not available, there is uncertainty whether there would be adequate supply of allowances to provide for uncertainties in the modeling analyses.

Post 2020 allocation to EDUs

LADWP understands the concern to protect leakage-exposed industrial entities but actions to protect them should not be at the expense of low income customers and customer in disadvantaged communities. CARB's proposal to transfer allowances from

EDUs to industrial customers while continuing to require that EDUs have the current compliance obligation raises concerns for LADWP as a publicly owned utility (POU).

CARB proposes to directly allocate allowances to industrial entities for electricity purchased/obtained because it believes it would ensure equitable treatment of leakage-exposed industries that are customers of POUs and those that are customers of investor-owned utilities (IOUs). LADWP believes that this proposal would not accomplish what CARB intends and recommends that CARB keep its current allocation approach (e.g. based on EDU cost burden, recognition of early investments in clean energy) with consideration of how treatment of imports would be addressed as it develops its state plan for compliance with US Environmental Protection Agency's (EPA) Clean Power Plan. There should be a better way to assist leakage-exposed industrial facilities that is fair and less administratively burdensome.

POUs are structured differently from IOUs in that POUs operate for the exclusive benefit of their retail ratepayers and own and operate a majority of their generation assets on behalf of their ratepayers. Vertically integrated POUs use their allocated allowances directly to cover their compliance obligation—the emissions associated with their generation of electricity--so would not consign a majority of those allowances to auction and later receive auction revenue. Thus, in general, the POUs' industrial ratepayers would not realize a climate dividend as the POUs would not be receiving auction revenues but the industrial customers would rather realize benefits from the value of the allocated allowances that POUs use to fund emission reduction programs.

If a significant portion of an EDU's allowance allocation is transferred to industrial entities and vertically integrated POUs remain responsible for all GHG emissions associated with their generation of electricity, POUs would be in varying states of a short position. The price of carbon allowances would likely significantly increase as a result as other entities (covered entities as well as others such as investors) would know that the POUs are in a perpetual "buy" position and that there would be an increased demand for allowances. While this result would certainly send a carbon price signal to POU customers as it would likely result in higher rates, it would not recognize the financial investments that POUs such as LADWP are making to reduce GHG emissions and would be difficult to pass those costs only to the covered industrial customers. It would be unfair to the EDU's other customers, especially low-income customers, to have to pay the cap-and-trade compliance cost for electricity consumed by covered industrial customers.

On March 15, 2016, the Los Angeles City Council approved LADWP's five-year water and power rate action. On the power side, the majority of the approximate $720 million in revenue from the new rates—about 80 percent—will be allocated for meeting clean energy and climate change goals and regulatory requirements. The rate increase was a two-year process consisting of over 80 citywide public outreach meetings. Given

LADWP's current rate ordinance, it is not feasible to pass down the costs of carbon allowances only to the covered industrial entities, which may change from year-to-year. Any additional costs LADWP bears with respect to this proposal would be passed on to all its customers, including over 20% of LADWP's customers on its low income and lifeline programs.

Use of Mandatory Reporting Rule (MRR) Data as the Source of Benchmarking Data

CARB's staff presentation states that it is proposing to amend the MRR to ensure that steam and electricity purchase/sales data are checked by verifiers for +/- 5% accuracy, and CARB anticipates that verifying this data will be possible because almost all steam and electricity data are reported using financial transaction records. This statement is not true for power plants operated by vertically integrated utilities. Power plants are subject to the facility reporting requirements in the MRR, including section 95104(d) *Facility Level Energy Input and Output*. However, vertically integrated utilities do not sell electricity from their own grid to their own power plants, so there is no meter at the fence line and no monthly bill for electricity taken from the grid to serve auxiliary load within the power plant when it is not producing its own power. Therefore, electricity "purchased" is zero, and electricity acquired from outside the facility boundaries can only be estimated. Another complexity is that power plants may have adjacent Receiving Stations located within the same facility boundaries, through which electricity from multiple sources flows from the grid to customers. That is why section 95104(d) includes the following sentence "For the purpose of reporting under this paragraph, the operator may exclude any electricity that is generated outside the facility and delivered into the facility with final destination outside of the facility." If CARB wants to require that facility electricity purchases/acquisitions be verified within +/- 5% accuracy, power plants should be exempted.

Incentive Allowances for Industrial Covered Entities

CARB proposes to provide incentive allowances to covered industrial entities that install zero emitting technologies. The allowance allocation would be based on the amount of net generation purchased from the EDU multiplied by either a statewide or utility-specific emission factor. LADWP believes that the concept of providing incentive allowances be applied equally to EDUs that install zero emitting technologies (e.g. rooftop solar). LADWP plans to invest roughly $25M per year in utility-owned and maintained distributed solar photovoltaic, totaling 40 MW by 2020 and 55 MW by 2030.

Allowances to account for increased electrification

An essential part of the strategy to reduce GHG emission levels in California will be to electrify the transportation sector and other source categories of GHG emissions. Specifically, the increased electricity generation will result in increases in GHG

emissions by covered EDUs but those emission increases will be more than offset by substantial GHG emission reductions achieved by the newly electrified sources.

LADWP supports CARB's efforts to develop an allocation methodology to ensure that affected EDUs would not be penalized for increased GHG emissions resulting from increased demand in electricity due to increased transportation electrification.

To quantify the amount of allowances needed to support electrification, generation data and EDU emission factors could be used. The generation data could be based on an EDUs' Integrated Resource Plan developed as part of the SB 350 process or California Energy Commission electric utility data which would project expected electricity demand increase for post-2020 period associated with the utility's electrification efforts. The demand, in the case of electric vehicles, could be based on the EDU's forecast of electric vehicle penetration, average kwh/mi electric vehicle efficiency rating taken from published US Department of Energy/EPA data, and mile per year per vehicle information taken from CARB's EMFAC model. The GHG emission factor could be the EDU's system-wide emission rate (an average of previous three year period) as there currently is insufficient data on times of day that electric vehicle drivers are expected to charging their vehicles, for example.

Based on this quantification of future electricity demand and GHG emissions (which could be updated on an annual basis), CARB would allow the covered EDUs to hold in their accounts sufficient number of allowances to cover their emissions on a system-wide basis. This amount of each EDU's allowances would remain available for use in meeting its cap-and-trade program credit-holding requirements. The evidence for determining whether the forecasted electrification was realized could be extremely difficult to track and quantify; for example, electric vehicle owners residing in LADWP service territory may not be charging their vehicles at home or within LADWP's service territory. Thus, CARB should not create verification protocols that would be so difficult to meet as to result in an EDU not receiving a Mandatory Reporting Regulation positive or qualified positive verification determination. Instead, LADWP recommends that the allowances be given a "non-tradable" status such that use of the allowances do not result in increases in GHG emissions but ensure that EDUs have sufficient allowances to cover potential increases in load due to electrification and continue to be incentivized to install the necessary infrastructure to help with state and local regulatory agency electrification efforts. LADWP recommends that CARB use information from its Low Carbon Fuel Standard to help in verifying the emissions associated with increased electricity load.

<u>CARB Clarification on the use of allowance value</u>

CARB proposes to clarify the allowed uses of allowance value for the third compliance period (2018 to 2020) and beyond. During the workshop presentation, CARB stated that this clarification would be applied to proceeds obtained from allowances consigned

to CARB's auction such that non-volumetric return of allowance value and funding of GHG emissions reductions would be allowed and volumetric return of allowance value and use of allowance value for MRR reporting and verification costs and AB 32 Cost of Implementation fees would be disallowed. However, during the question/comment period, it was later implied that the clarification would apply to *all* allocated allowances. If this is the case, CARB's proposal would be a significant shift in policy and POUs such as LADWP would not be able to recover its costs.

As mentioned previously, POUs operate for the exclusive benefit of their retail ratepayers and own and operate their generation assets on behalf of their retail ratepayers.

If POUs were required to assign a value to its all of its allocated allowances and provide a non-volumetric rebate to customers, this would represent a potential outflow of hundreds of millions of dollars from LADWP with little to no revenue. Since POUs own generation and thus would not generally consign a large percentage of their allowances to auction, they would generally not receive allowance auction revenues for distribution to customers.

On the other hand, if the proposed clarification applies to the consigned allowances only, POUs would generally consign a relatively small portion of its allowances to auction. It would be administratively burdensome and costly to require develop a climate dividend program for a small percentage of its allowances and would not provide value to POU ratepayers. In clarifying the use of consigned allowances, CARB should provide POUs the choice to develop a climate dividend to customers or demonstrate that the value of the consigned allowances was used to fund energy efficiency and clean energy projects. LADWP supports CARB's proposal to disallow use of consigned allowances for mandatory reporting regulation third parties or AB 32 cost of implementation fees.

Conclusion

LADWP appreciates the opportunity to comment on these important issues related to development of CARB's post-2020 cap-and-trade program. If you have any questions or would like additional information, please contact Ms. Jodean Giese at (213) 367-0409.

Sincerely,

Mark J. Sedlacek
Director of Environmental Affairs

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