California Municipal Utilities Association

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January 20, 2017

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments of the California Municipal Utilities Association on the Proposed 15-Day Modifications to the Cap and Trade Program and the Mandatory Reporting Regulations

Dear Chair Nichols and Members of the Board:

The California Municipal Utilities Association ("CMUA") respectfully submits these comments to the California Air Resources Board ("ARB") on the Proposed 15-Day Modifications to the California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanisms Regulation and the Regulation for Mandatory Reporting of Greenhouse Gas Emissions, posted on December 21, 2016.

1. Comments on the EIM Outstanding Emissions Proposal

In prior comments to the ARB and to the California Independent System Operator ("CAISO"), CMUA provided principles that should guide the development of any regulation seeking to address greenhouse gas ("GHG") emissions associated with the Energy Imbalance Market ("EIM").[1] First among those principles was that any solution should accurately include carbon costs in the market optimization, so that these carbon costs are incorporated into the market and modify participant behavior accordingly. In this regard, we have indicated our preference for the two-pass "Option 2" outlined by the CAISO that attempts to include carbon costs in the overall optimization while reflecting the reality that not all resources within the EIM footprint will have Cap-and-Trade compliance obligations.

CMUA and its members continue to believe that the magnitude of this issue does not warrant extraordinary regulatory changes. While CMUA has concerns with the EIM Outstanding Emissions calculation and believes it likely overstates the potential problem, even if the calculation is correct, the amount of outstanding emissions is extraordinarily small. We urge the ARB to rethink its prioritization and to focus on other more critical matters presented within the regulation. Rather than implementing a temporary or "bridging" solution, the ARB should wait for the CAISO to craft a market-based solution that will solve this issue within the optimization. CAISO has, indeed, indicated that a solution could be available as early as the end of 2018.

[1] *See, e.g.,* Comments of the California Municipal Utilities Association on the October 21, 2016 Mandatory GHG Reporting and Cap-and-Trade Program Workshop, Nov. 4, 2016.

The Proposed 15-Day Modifications include new regulatory language to implement ARB's temporary solution to this issue:

> (D) EIM Outstanding Emissions. Beginning January 1, 2018, ARB will retire current vintage allowances designated by ARB for auction pursuant to section 95911(f)(3) that remain unsold in the Auction Holding Account for more than 24 months in the amount of EIM Outstanding Emissions as defined in section 95111(h) of MRR.
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> > 1. EIM Outstanding Emissions are equal to the annual metric tons of CO2e from electricity that is imported into California through CAISO's EIM but not otherwise accounted for by emissions reported by the EIM participating resource scheduling coordinators. These emissions are calculated pursuant to the requirements in MRR section 95111(h)(1).
> >
> > 2. On an annual basis, ARB will retire these allowances no later than the surrender deadlines specified in sections 95856(d) and (f). ARB will retire allowances starting with the earliest vintages first.
> >
> > 3. Current vintage allowances retired by ARB pursuant to this section do not include allowances consigned to auction pursuant to section 95910(d).[2]

It appears the proposed regulations account for the EIM Outstanding Emissions through a reduction in the pool that remains in the Auction Holding Account and is unsold for a specified period of time. While this approach lacks direct price signals for EIM imports, it may be an acceptable short-term bridge until a market solution is developed. However, it must be accompanied by a more rigorous examination of the details of what constitutes EIM Outstanding Emissions. We are concerned that the use of a system-wide unspecified resource emissions factor for actual GHG emissions from participating resources will not accurately capture the GHG emissions caused by California imbalances.

First, California policy should encourage low emitting resources to bid into the EIM. When lower marginal cost resources set market clearing prices, then the overall long-term effect is the creation of price pressures and the decrease of dispatch of higher marginal cost resources, including older thermal units. This effect on the markets is not likely to be offset by uncaptured emissions, or substitution of higher emitting resources to serve load that was otherwise served by lower emitting resources before the EIM optimization.

Second, CMUA believes it is likely that the Staff Analysis overstates the impact of the CAISO's deemed delivered mechanism on emissions from EIM imports. It seems logical that lower-than-system-average emitting resources would seek to sell to California, given their competitive advantage against California resources that have cap-and-trade obligations. Moreover, it seems

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[2] *See* Proposed 15-Day Modifications, § 95852(b)(D).

likely that calculation of this effect could differ greatly among subregions of the West and, further, among subregions of the EIM footprint, depending on resource portfolios of the participants and hydrological conditions in the particular year or season. In fact, it is easy to envision EIM optimization being dominated by hydroelectric dispatch in many intervals, particularly in average or above average hydro years, irrespective of any carbon policy overlay. The proposed unspecified resource solution would have to be reevaluated continually to track the system average emission calculation.

Third, CMUA questions the validity of the assumption that expanded EIM participation will mean an increasing problem with EIM Outstanding Emissions. Indeed, this is almost certainly wrong. The addition of NV Energy was driven by its own portfolio and level of transmission connectivity with both California and the PacifiCorp East Balancing Authority Area. This presented a particular set of facts because of NV Energy's robust transmission connectivity to both California and PacifiCorp, and its thermal dominated portfolio. Other future EIM Entities have hydro dominated portfolios, and little or no direct transfer capability into California. As such, these entities will increase the amount of zero emission resources competing to serve California load over the same amount of transmission transfer capability, and will likely lower the overall emissions because their marginal costs will be below thermal resources and they will displace those resources within the EIM optimization.

Finally, CMUA asks for clarity on how its members that may become EIM Entities will be affected by the proposed regulations. To date, the Balancing Authority of Northern California ("BANC") and the City of Los Angeles, Department of Water and Power have publicly expressed intent to explore EIM participation. BANC has completed EIM studies and further action to become an EIM Entity has been authorized by the BANC Commission, its governing body. This is a result that the State has encouraged and championed. Certain BANC members import specified renewable resources into California. These resources include wind in the Pacific Northwest, the output of which is secured under long term power purchase agreements. It would be counterproductive if these publicly owned electric utilities ("POUs"), who could potentially bring significant benefits to the EIM, were subject to adverse impacts of EIM participation to which they would not be exposed if they remained outside of the EIM footprint.

CMUA is particularly concerned and confused by the removal of EIM transactions from the exemption from resource shuffling prohibitions. EIM is simply an extension of the CAISO's Real Time Market. What is proposed in the 15-Day Modifications is not based on any supporting rationale and CMUA cannot envision a logical distinction between two California utilities, for example, where one is within the traditional CAISO footprint and submitting bids into the Real Time Market, where another similarly situated entity may also be within California and in the same real time optimization, but as an EIM Entity. CMUA urges that this distinction be removed and the proposed amended language be eliminated.

2. POUs Should Not be Required to Consign Their Allowance Allocations to Auction.

In Attachment C of the Proposed 15-Day Modifications, ARB staff notes that it is considering "requiring POUs and co-ops to consign allocated allowances to auction and requiring that the auction proceeds be used for specific purposes."[3] ARB staff asserts that such changes could be presented in future 15-day language.

This is a significant new proposal that could have wide-ranging harmful impacts, and yet, this is the first time ARB staff has raised this proposal. Such a substantial change should only be proposed in 15-Day Language if it is "sufficiently related to the original text that the public was adequately placed on notice that the change could result from the originally proposed regulatory action."[4] This proposal is likely outside the scope of this proceeding, and CMUA is not aware of any previous discussion or related proposals in the 45-day package that would have put the public on notice that it may be proposed. Furthermore, the discussion included in Attachment C does not provide adequate justification or reasoning for revisiting this impactful shift in policy.

In addition to these procedural concerns, CMUA objects to the policy and rationale for requiring POUs to consign their allowances to auction. In prior Rulemakings, ARB correctly excluded POUs from the requirement to consign allowance allocations to auction, as is required of investor owned utilities ("IOUs"), because of the fundamental differences in the way that IOUs and POUs are structured and governed. ARB noted these differences in its October 2011 Final Statement of Reasons for the Cap-and-Trade Regulations ("FSOR")[5]:

> POUs and IOUs operate differently with respect to electricity generation. POUs generally own and operate generation facilities that they use to provide electricity directly to their end-use customers. In order to minimize the administrative costs of the program to the POUs, and recognizing that directly allocating the allowances to the POUs does not distort their economic incentive to make cost-effective emissions reductions, we determined that it would be prudent to allow POUs to surrender directly allocated allowances without participating in the auction process.[6]

ARB also acknowledged that some POUs would be disproportionately impacted if they were required to participate in the quarterly auction.[7]

A requirement for POUs to consign all allocated allowances could impose significant financial risks and resource needs that cannot reasonably be addressed. This change would result in significant increases in administrative burdens. Many POUs have limited staff to participate in the resource-intensive auction process, and do not have the infrastructure or financial resources to mitigate against financial exposure in the same way that IOUs can.

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[3] Attachment C at 2.
[4] Cal. Gov. Code § 11346.8(c).
[5] *See e.g.*, October 2011 Final Statement of Reasons for the Cap and Trade Regulations, 342, 564.
[6] *Id.* at 342.
[7] *Id.* at 578-579, 580-581.

Because POUs often own and operate generation facilities, they have the direct compliance obligation for the assets under the Program. Due to long-term contracts with base-load, fossil-fueled generation including both coal and natural gas, some POUs would be required to have significant capital available to purchase sufficient allowances from auction to comply with the Regulations. These burdens would disproportionately affect some POUs more than others.

If the Cap-and-Trade auctions are undersubscribed or oversubscribed, POUs will face substantial financial risks that may impede their ability to meet compliance obligations due to the resulting financial uncertainties. Unlike the IOUs, POUs do not have shareholder funding to fall back on if there are challenges with auction participation. Any additional cost burdens incurred by POUs to manage compliance with the Cap and Trade requirements could negatively impact the ratepayers served by POUs, while achieving no measurable, incremental GHG emissions reduction benefits.

3. The Regulations Should Not be Modified to Include Further Specificity on Uses of Allowance Value.

As noted above, ARB Staff stated that they are considering "requiring that the auction proceeds be used for specific purposes."[8] The currently applicable requirements in Section 95892 provide sufficient direction on how POUs may use allowance proceeds. Further, the ARB acknowledged at the beginning of the program that it "does not have authority to appropriate funds. The use of revenue obtained from consignment of allowances is the responsibility of the California Public Utilities Commission (CPUC) for investor-owned utilities and the governing Boards of publicly owned utilities."[9] CMUA concurs that such decisions are fully under the authority of a POU's local governing board, and are not decisions to be made by ARB.

4. CMUA Opposes Direct Allocation to Industrial Entities.

CMUA opposes ARB's proposal to shift allocation value away from POUs and instead provide a direct allocation to industrial entities. Several of CMUA's members have raised this issue numerous times in past discussions with ARB staff and in formal written comments. Nonetheless, the proposal remains included in the regulation even though no robust analysis or justification for the change has been presented. In Attachment C, ARB states the following:

> This change will encourage pass through of program costs to industrial entities, thus incentivizing them to reduce emissions, while direct allocation will provide emissions leakage prevention in line with existing industrial allocation policy. This change will also remove the potential inequity between IOU-customer industrial covered entities, which already see a GHG cost and receive distribution of IOU auction proceeds to prevent against emissions leakage, and POU-customer industrial covered entities that may not be protected from emissions leakage.[10]

[8] Attachment C at 2.
[9] October 2011 Final Statement of Reasons for the Cap-and-Trade Regulations, 65-66.
[10] Attachment C at 5.

These generalizations greatly overstate any potential inequities and do not consider the significant impacts that could occur for a POU with a high portion of its load coming from industrial covered entities. For POUs with sizable industrial load, the severe reduction in allowance allocations will inhibit the ARB's intended use of allowance allocations. Further, both electric rate structures and the ratemaking process for POUs are very complex. POUs may not always be able to simply adjust rates to ensure the added costs from the loss of these allowances will be directly passed on to only the covered industrial entities. The result is that these costs could be passed on to other POU customers.

By attempting to place "emissions leakage prevention in line with existing industrial allocation policy" at the same time that material reductions are occurring in industrial allocations is counter-intuitive to the goals being presented. This policy proposal has not been supported by staff analysis, and will create loses for both the utility and its industrial customers, regardless of size. POUs will lose allocation flexibility and revenue that has historically been used to protect the very industries that this policy is stated to help. As a result, the industrial entities in POU service territories could not only see a significant increase in their rates, but will also see dramatically decreased allocations from which to draw a counter benefit.

Any concerns that exist regarding unequal treatment between industrial entities in IOU and POU service areas should be discussed in detail during a workshop with all relevant parties. ARB should not take action until such a discussion has occurred, and several solutions have been publically evaluated. When coupled with the consignment proposal, the industrial allocation shift creates a double hit to POUs that has not been adequately evaluated by ARB staff.

5. **The August 1 GHG Verification Deadline for the Mandatory Reporting Regulation is Problematic.**

CMUA concurs with comments submitted by many stakeholders, in both written and oral testimony, that the proposed one month shift of the verification deadline from September 1 to August 1 will severely hamper reporting entities' ability to comply with the regulation. This does not allow for sufficient time to review data from GHG verifiers before submitting it to ARB. While ARB notes that it may revisit the proposed modifications in 2017, CMUA believes that the change should be considered as early as possible, particularly given the strong opposition from stakeholders across-the-board during the September 19 Air Resources Board Meeting and the subsequent direction from ARB Chairman Mary Nichols, acknowledged by Executive Director Richard Corey to adopt a compromise position.[11] CMUA supports maintaining the currently effective September 1 date.

[11] As described in the transcript, pages 188-189, from the September 22, 2016 Air Resources Board meeting. https://www.arb.ca.gov/board/mt/2016/mt092216.pdf.

CMUA appreciates the opportunity to provide these comments on the Proposed 15-Day Modifications, and thanks the ARB for its review and consideration.

Respectfully submitted,

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