

# Memorandum

Date: October 23, 2013

To: Richard Corey, Executive Office  
California Air Resources Board  
1001 I Street  
Sacramento, CA 95814

From: Department of Water Resources

Subject: Department of Water Resources' Comments on Cap and Trade Regulations

The Department of Water Resources (DWR) respectfully submits the following comments on the proposed amendments to the Cap and Trade Regulations. DWR commends the Air Resources Board (ARB) for developing the innovative Cap and Trade program and its other actions to implement AB 32's goals for greenhouse gas reduction.

In December, 2011, the Board directed ARB staff to address impacts of the Cap and Trade program on DWR. This letter is intended to bring to your attention additional information relating to this topic. DWR would appreciate ARB's attention to this information in its consideration of pending amendments to the regulation.

DWR's mission is to manage the water resources of California in cooperation with other agencies, to benefit the State's people, and to protect, restore, and enhance the natural and human environments. DWR is charged with management of the State Water Project (SWP), the largest state-built, multi-purpose water project in the country. The SWP was designed and built to deliver water, control floods, generate power, provide recreational opportunities, and enhance habitats for fish and wildlife. DWR has contracts with 29 local water agencies for delivery of up to 4.2 million acre-feet of water per year. Water deliveries serve 24 million people and provide irrigation for 750,000 acres of farmland.

DWR operates the SWP pumping and generating facilities to (in order of importance) (1) provide for safety and flood control needs; (2) comply with environmental regulations (3) meet water supply and delivery needs; (4) minimize cost of water deliveries; (5) provide support for the electricity grid for the California Independent System Operator during periods of stress; and (6) provide for recreational opportunities. All of DWR's power activities are conducted for the purpose of making water deliveries and to support the grid. DWR is uniquely well-situated to assist in integration of renewable energy because of the SWP's ability to use electricity in the off-peak hours.

SWP power costs have ranged from \$350 million to \$600 million annually over the last few years. Approximately 96 percent of the costs of the entire SWP, including power costs, are paid by the 29 local agencies which have long-term water supply contracts with DWR.

In order to mitigate the cost impact of Cap and Trade on the State Water Project, DWR seeks to have allowances allocated to it *in the same manner as allowances are allocated to municipal utilities*. In the December 2011 Resolution, ARB recognized that cost impacts to DWR should be mitigated. The most straightforward way to mitigate the costs DWR is to allocate monetizable allowances to DWR and require the resulting funds to be used to further AB 32 goals. The rationales offered in opposition to this proposal fail to stand up under examination.

Some background is helpful to explain DWR's position. DWR's statutory authority includes the power to construct and operate power plants and buy and sell electricity (including imported electricity). DWR's power portfolio consists of self-generated hydropower and market purchases. Typically, DWR needs to purchase electricity to augment its hydropower resources; the market purchases now reflect the higher prices due to the Cap and Trade regulation. DWR currently does not generate electricity (except hydropower) and in July 2013, ceased importing electricity under a long-term contract with a coal plant owner in Nevada. DWR has contractual rights to a portion of output from the combined-cycle power plant known as the Lodi Energy Center (LEC) and must either acquire GHG allowances for delivery to the owner, Northern California Power Agency (NCPA), or pay NCPA to acquire allowances to meet NCPA's compliance obligation for LEC. DWR is expressly named in the Cap and Trade regulation. DWR has an obligation under the mandatory reporting regulation to report under Mandatory Reporting Regulation, and specifically must report the load of the SWP, even if it has no reportable emissions.

DWR currently acquires allowances to meet part of its projected requirements for the LEC power plant, based on the projected compliance obligation. DWR anticipates continuing to purchase allowances based on projected need, and may also sell allowances purchased in excess of need.

Prior to the adoption of Cap and Trade, negotiations were conducted with the IOUs and POUs to develop the allowance allocation methodology and table of allocations among IOUs and POUs. DWR asks that the same allocation methodology be applied to DWR's circumstances. That methodology allocated allowances to the utilities based on their load/resource portfolio, not on their compliance obligations. Against that background, DWR would like to provide additional information on several issues.

First, DWR's current lack of a compliance obligation under the regulation does not preclude an allocation of allowances. DWR does not seek an allocation of allowances in order to meet a compliance obligation, but to mitigate the cost impact of Cap and Trade. Allowances are allocated to IOUs and POUs without regard to whether they have a compliance obligation. A municipal utility with a portfolio consisting of hydropower supplemented with in-state market power would have no compliance obligation, yet would still receive its allocated allowances under ARB's regulation. Making a compliance obligation a prerequisite for receiving allocated allowances might lead to inverse incentives contrary to the goals of Cap and Trade.

Another additional point to consider is whether cost relief should be provided for "indirect costs." This is related to the first point, because it suggests that allowances should be provided only for "direct" costs, meaning fulfilling a compliance obligation. This distinction was not made in providing allowances to the IOUs and POUs. In fact, indirect costs are the basis for cost relief. The IOUs and POUs are allocated allowances based in large part on their market purchases, not the direct cost of their compliance obligation. As recognized by the ARB in structuring this program, the IOU's and POU's market purchases are the best measure of the impact on the utilities' ratepayers. Another issue to consider is whether DWR's status as a State agency warrants a different treatment under the Cap and Trade regulation. DWR recognizes that disbursements from the Greenhouse Gas Fund must be accomplished in the State's budget, approved by the Legislature; however, the regulation currently provides for allocation of allowances to IOUs and POUs. DWR is seeking comparable treatment.

Finally, I would like to address DWR's status as a wholesale user of electricity. DWR transacts in the wholesale electricity market and does not purchase electricity from IOU's retail service program; however, the use of the electricity purchased is put to final use as the electricity is consumed by DWR's pumping plants. DWR is both the generator/purchaser and consumer of electricity. There is no rational distinction between the consumptive use of electricity for the SWP and the utilities' provision of electricity to their customers.

In conclusion, DWR requests ARB to reiterate its support for cost relief for DWR. DWR is prepared to continue working with ARB staff to develop language for an amendment which would grant DWR, as operator of the SWP, the same cost mitigation and associated responsibilities as held by the publicly owned utilities, including the requirement to use the money for AB 32 goals. Thank you for your consideration and commitment to these issues of interest to DWR.



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