COMMENTS OF
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
ON THE
PROPOSED AMENDMENTS
TO THE CALIFORNIA GREENHOUSE GAS CAP-AND-TRADE REGULATION

October 22, 2013

Arizona Electric Power Cooperative, Inc. (AEPCO) respectfully submits the following comments on the Sept. 4, 2013 proposed amendments to the California Air Resources Board (ARB) Greenhouse Gas Cap-and-Trade Regulation. We restrict our comments to the proposed amendments to 1) the resource shuffling rules and 2) the allowance allocations for electric distribution utilities.

I. CHANGES TO THE RESOURCE SHUFFLING DEFINITION AND SAFE HARBORS

A. Proposed Changes to the Resource Shuffling Definition – Offsetting Increase Requirement

AEPCO's first comment relates to the proposed change to the resource shuffling definition in Section 95802(a) of the Cap-and-Trade Regulation (Appendix E, Proposed Regulation Order at 47). As proposed, the revised definition would read:

> (317) "Resource Shuffling" means any plan, scheme, or artifice undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation. Resource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A).

As ARB's Initial Statement of Reasons (ISOR) explains, resource shuffling is a form of leakage, which is defined in the California Health and Safety Code as "a reduction in emissions of greenhouse gases within the state *that is offset by an increase in emissions of greenhouse gases outside the state*." ISOR at 30 (quoting Cal. Health & Safety Code § 38505(j)) (emphasis added). The ISOR also recognizes that "[r]esource shuffling always involves such a substitution *that would result in an apparent emissions reduction in California that is offset by an increase in emission outside of California* where the electricity from the higher emission resource is deemed to be consumed." ISOR at 30 (emphasis added).

However, the proposed revisions to the resource shuffling definition omit the element of an offsetting increase in emissions outside of California. Because of this omission, the amended provision, if read literally, could prohibit activities that are not leakage or resource shuffling. The lack of any requirement that substitutions must be associated with offsetting increases in emissions outside of the state to be considered resource shuffling could prohibit legitimate, beneficial emission-reducing activities.

For example, if a first deliverer were to substitute natural gas for coal at an electric boiler unit that is capable of burning both fuels (*i.e.*, "fuel switch") in order to reduce the GHG emission rate for electricity delivered to California (thereby reducing the first deliverer's compliance obligation), this activity could be considered a "plan, scheme, or artifice undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation." In other words, this substitution of low-emitting power for high-emitting power could constitute "resource shuffling" under the proposed definition—even though the overall level of GHGs would be reduced, and even though this reduction in emissions would not be "*offset by an increase in emissions of greenhouse gases outside the state*." Similarly, the substitution by a first deliverer of zero-emitting power from a new (greenfield) zero-emission facility for electricity deliveries from a high-emitting fossil-fueled source could be considered a "plan, scheme, or artifice . . . to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation" even if the substitution resulted in an overall *reduction* in overall emissions from the fossil-fueled source.

Neither of the above examples would constitute "leakage" as defined by the A.B. 32 statute, because neither example would lead to "a reduction in emissions of greenhouse gases within the state that is offset by an increase in emissions of greenhouse gases outside the state." Cal. Health & Safety Code § 38505(j). Furthermore, both examples would advance one of the primary goals of AB 32, *i.e.*, "to reduce emissions of greenhouse gases." *See* Cal. Health & Safety Code § 38501(c). Consequently, the proposed definition appears to prohibit activities that 1) are not leakage, and 2) would further the goals of AB 32.

PROPOSED SOLUTION: We propose that ARB modify the definition of "resource shuffling" to conform with the Health and Safety Code's definition of leakage and ARB's stated understanding of the concept of "resource shuffling." Specifically, ARB should clarify, consistent with its statement in the ISOR, that substitutions that do not result in an offsetting increase in emissions outside of California are not resource shuffling. This clarification could either be inserted into the amended definition of resource shuffling in section 95802, or as an additional enumerated "safe harbor" in section 95852(b)(2)(A) (see below).

Option 1: Amend Section 95802(a)(317) to read:

(317) "Resource Shuffling" means any plan, scheme, or artifice undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation. Resource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A)**, or when the substitution does not result in an offsetting increase in emissions outside of California.**

Option 2: Amend Section 95852(b)(2)(A) to add the following safe harbor:

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

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(b)(2)(A) The following substitutions of electricity deliveries from a lower emission resource for electricity deliveries from a higher emission resource shall not constitute resource shuffling:

(1) **Substitutions that are not the result of plans or schemes to lower California GHG compliance obligations while causing an offsetting increase in emissions outside of California.**

B. Proposed RPS "Safe Harbor"

The proposed amendments would create a "safe harbor" from allegations of resource shuffling for: "Electricity deliveries that are caused by the procurement of electricity eligible to be counted towards and purchased for Renewable Portfolio Standard (RPS) compliance in California." Draft Amendments at 84. AEPCO supports this safe harbor. However, AEPCO believes it should also apply to entities that deliver power to electric distribution utilities that are **exempt** from the RPS, but whose allowance allocation was calculated on the assumption that those entities would be required to meet the renewable energy targets embodied in California's RPS.

For example, certain electric distribution utilities (*e.g.*, electric cooperatives) are exempt from the requirements of the RPS. However, these entities' annual allowance allocations—which are to be used for protecting ratepayers from dramatic increases in electricity prices that could be caused by the cap-and-trade program—were determined using a formula that assumed that these entities would have to comply with the RPS, thereby lowering the

allocations they might otherwise receive. *See* Appendix A to the ISOR for the 2010 Proposed Amendments to the Cap and Trade Regulation.[1]

The RPS safe harbor correctly provides relief from the resource shuffling rules to those utilities that have an RPS obligation. However, the safe harbor currently does not permit RPS-exempt entities to reduce their compliance obligation to match their allowance allocation by substituting purchases of additional renewable energy for deliveries of higher-emitting electricity. As discussed above, it is possible that under the regulation as written, an RPS-exempt entity that purchases up to 33% renewable energy would be deemed to be resource shuffling, even though the entity was merely doing what ARB staff assumed it would do when ARB calculated that entity's allocation.

PROPOSED SOLUTION: ARB should clarify that the RPS safe harbor also applies to the procurement of RPS-eligible renewable energy by the small number of RPS-exempt load-serving entities.

In the alternative, ARB should modify these entities' allowance allocations to remedy ARB's incorrect assumption that these entities would be subject to the RPS.

Proposed Changes to Regulatory Language:

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

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(b)(2)(A)The following substitutions of electricity deliveries from a lower emission resource for electricity deliveries from a higher emission resource shall not constitute resource shuffling:

(1) Electricity deliveries that are caused by the procurement of electricity eligible to be counted towards and purchased for Renewable Portfolio Standard (RPS) compliance in California **or, in the case of a first deliverer that delivers electricity to an electric distribution utility that is exempt from complying with the California RPS, deliveries of electricity that would otherwise be eligible for compliance with the California RPS.**

[1] Appendix A is available at http://www.arb.ca.gov/regact/2010/capandtrade10/candtappa2.pdf. In that document, ARB staff explains that "[t]o accurately reflect the expected level of renewable resources utilized by each utility, staff imposed a constraint on all utilities requiring compliance with a 33% Renewable Portfolio Standard (RPS). This constraint begins at 20% compliance in 2012 and increases linearly to 33% in 2020." Appendix A at 4.

C. New Safe Harbor for Greenfield Zero-Emission Facilities

ARB should consider adding an additional safe harbor for the substitution of zero-emitting electricity from *new, greenfield* facilities for higher-emitting electricity. Unlike the "facility-swapping" that is possible among *existing* facilities, there is no basis for assuming that the addition of a new zero-emission facility to the grid will cause an offsetting increase in GHGs elsewhere in the western interconnect. Rather, the addition of new renewable generation to the grid displaces other existing generation (typically marginal fossil-fuel generation) or meets wholly new demand. Therefore, the substitution of power from a new greenfield zero-emission sources such as a wind farm or solar facility for higher-emitting power should not be considered resource shuffling, because it is not associated with leakage. However, ARB's current and proposed resource shuffling regulations could be interpreted to prohibit such transactions because such transactions could be viewed as plans or schemes "to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce [an] emissions compliance obligation."

Absent an amendment, uncertainty about the scope of the "resource shuffling" prohibition will discourage investment in new zero-emitting generation sources, which can reduce overall emissions throughout the Western interconnect without leakage.

PROPOSED SOLUTION: ARB should add an additional safe harbor for "substitutions of zero-emission electricity from new greenfield sources that replaces deliveries of higher-emission electricity from existing sources."

Alternatively, ARB should clarify in guidance that such substitutions do not meet the criteria for resource shuffling or leakage because they do not cause an offsetting increase in emissions outside the state (see our comments about this requirement in section I.A above).

Proposed Changes to Regulatory Language:

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

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(b)(2)(A) The following substitutions of electricity deliveries from a lower emission resource for electricity deliveries from a higher emission resource shall not constitute resource shuffling:

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(14) Substitutions of electricity deliveries from new, zero-emission, greenfield generation sources that replace deliveries of higher-emission electricity from existing sources.

D. Proposed Changes to the Resource Shuffling Definition – Increased Emissions Due to Demand Growth

According to ARB, the prohibition on resource shuffling is intended to forestall schemes in which a first deliverer *appears* to reduce its emissions while in actuality continuing to emit at the same rate as before. *See* ISOR at 30. One of the prime examples of resource shuffling is "facility swapping" in which a first deliverer with one customer in California and another outside the state conspires to send high-emitting power that was previously going to the in-state customer to the out-of-state customer, while simultaneously delivering low-emitting power that was previously going to the out-of-state customer to the California customer.[2]

However, it is possible that a situation could arise in which a first deliverer would attempt to reduce its overall emissions (*e.g.*, by fuel switching from coal to natural gas, or by delivering new, additional zero-carbon energy while reducing deliveries of high-emitting electricity) but the first deliverer's overall emissions would nevertheless go up on a year-over-year basis **due to increased demand for electricity from outside the state**. Accordingly, there is a risk that the first deliverer would be accused of resource shuffling due to the appearance of an "offsetting increase in emissions", even though the first deliverer did not plan or scheme to "facility swap" or resource shuffle. However, this situation does not constitute "leakage" because the increase in emissions out of state is due to an *exogenous* increase in electricity demand and not an attempt to avoid California's greenhouse gas rules.

PROPOSED SOLUTION: ARB's regulations do not adequately address this example, which could affect nearly every covered entity that sells to customers outside of California. Therefore, ARB should clarify that such a situation would not constitute resource shuffling. In particular, ARB should clarify that a "plan, scheme, or artifice" does not cover substitution scenarios in which an increase in emissions outside of California is caused by an increase in out-of-state electricity demand.

ARB should either clarify this point in future regulatory guidance, or the agency should include an additional safe harbor to make clear that substitutions that are *not designed* to lead to increases in emissions outside of California are not resource shuffling.

II. CHANGES TO THE ALLOWANCE ALLOCATIONS FOR CERTAIN ELECTRIC DISTRIBUTION UTILITIES

ARB proposes to increase the annual allowance allocation to Anza Electric Cooperative, Inc. (Anza) "because imported electricity serving Anza's ratepayers has greater emissions than

[2] *See, e.g.*, ARB Presentation: "Compliance Obligation for First Deliverers of Electricity" (Aug. 26, 2011), *available at* http://www.arb.ca.gov/cc/capandtrade/meetings/082011/cap-trade-presentation.pdf.

staff used to calculate their allocation in the original regulation." ISOR at 19. No change was made to the overall allocation to the electricity sector. Anza is a member and customer of AEPCO, and has a long-term, all-requirements contract with AEPCO for wholesale electric power supply.

AEPCO and Anza support the proposed change to Anza's allowance allocation because it would align ARB's assumptions about the carbon-intensity of the source of Anza's electricity with the actual carbon-intensity of the power that AEPCO delivers to Anza. However, the modification to Anza's allowance allocation will be for naught if AEPCO is not able to report under the MRR on the same basis. AEPCO understands that ARB may withdraw the proposed "system power" reporting option, which the agency proposed in the context of the current MRR rulemaking. AEPCO reiterates that the assumptions behind the allocation to Anza must be consistent with the assumptions that underlie the rules by which AEPCO is required to report under the MRR. For this reason, AEPCO will continue to seek further clarification from ARB on its MRR reporting.

In addition, if ARB rejects AEPCO's proposed changes to the "RPS Safe Harbor" (discussed above), ARB should adjust Anza's allocation further to correct the agency's erroneous assumption that Anza would be obligated to comply with the RPS—an assumption that resulted in a lower allocation to Anza than it would otherwise have received.

CONCLUSION

AEPCO appreciates the opportunity to comment on these important changes to ARB's cap-and-trade program, and looks forward to working with ARB to improve the cap-and-trade program during the current comment period.

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