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California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation

To: Air Resources Board:

In accordance with the procedure set forth in the "Notice of Public Hearing" posted on August 2, 2016 in the above-referenced matter, Shell Energy North America (US), L.P. ("Shell Energy") provides its written comments on the ARB Staff's proposal to amend the cap-and-trade regulation. Shell Energy's comments focus on the Staff's proposal (after 2020) to discontinue, for all "first deliverers of electricity," the "RPS adjustment," and to replace the RPS adjustment with an additional allocation of allowances exclusively to electric distribution utilities ("EDU").

## I.

## INTRODUCTION

The Staff proposal treats EDUs and other first deliverers differently with respect to a "credit" for imports of "PCC 2" energy or other renewable energy that cannot be delivered to California in real-time due to transmission or other constraints. If this differential treatment is adopted, retail sales customers of non-EDU load-serving entities ("LSE") will be subject to additional GHG compliance costs beyond the costs borne by EDUs' retail sales customers. For this reason, the RPS adjustment should be retained for all first deliverers of electricity, subject to a potentially revised calculation of the RPS adjustment. If the ARB is insistent upon eliminating the RPS adjustment, the allocation of additional allowances (if any) must apply equally to all importers of out-of-state electricity, and the process must be transparent.

Rather than establish a discriminatory allowance allocation protocol that disadvantages retail customers of non-EDU LSEs, the ARB should retain the RPS adjustment, but with a modified calculation of the RPS adjustment after 2020. Alternatively, if the RPS adjustment is to be eliminated, and if additional allowances are to be allocated, the ARB should allocate the additional allowances on a proportionate basis to all first deliverers of electricity.

## II.

## BACKGROUND

The current RPS adjustment (Article 5, Section 95852(b)(4)) recognizes "the compliance obligation incurred by electricity importers when procured RPS-eligible renewable generation, that is not directly delivered to California, is replaced by higher emitting electricity generation." Initial Statement of Reasons (ISOR) at p.53. The ISOR notes that "[t]his RPS adjustment is voluntary, and it is only applicable when the importer purchases both electricity and renewable energy credits (REC) together and can demonstrate that the electricity was not delivered to California." Id.

The RPS adjustment applies to the importation of out-of-state RPS-eligible generation that qualifies under P.U. Code Section 399.16(b)(2), which is one of three categories of compliant RPS products under California's RPS procurement requirement. In accordance with P.U. Code Section 399.16(c)(1), during the RPS compliance period beginning in 2021, an LSE may include any percentage up to 25 percent of its RPS procurement quantities under P.U. Code Section 399.16(b)(2) (PCC 2). This means that each LSE's percentage of PCC 2 quantities is different, based on the LSE's contracting practices and its RPS portfolio construction. RECs associated with an LSE's PCC 2 procurement are verified by the Energy Commission.

Under current rules, the RPS adjustment is available to all first deliverers of electricity. The RPS adjustment reduces a first deliverer's GHG compliance costs that are passed through to the first deliverer's wholesale and retail sales customers. The cost savings associated with the RPS adjustment benefit all retail customers, because all retail customers pay a premium for the renewable attributes of the generated energy, commensurate with the LSE's reliance upon PCC 2 procurement in its RPS portfolio. The RPS adjustment is effective in compensating all first deliverers of electricity (and their ultimate customers) for the GHG compliance obligation incurred by electricity importers for PCC 2 energy or other renewable energy that cannot be delivered to California in real-time.

## III.

## THE STAFF'S PROPOSAL TO DISCONTINUE THE RPS ADJUSTMENT AFTER 2020

The Staff proposes to discontinue the RPS adjustment after 2020. The ISOR states that the RPS adjustment has been "extremely difficult to track and enforce, in part because to avoid double counting the Regulation could only allow RPS adjustments to be taken in cases in which the electricity associated with the RECs was not directly delivered to California." ISOR at p. 53.

Discontinuance of the RPS adjustment after 2020 eliminates a cost mitigation measure for all first deliverers of electricity that import renewable energy that cannot be delivered to California on a real-time basis, including PCC 2 products. Recognizing the Staff's concern regarding verification of direct deliveries of imported energy quantities to California, there are less drastic ways to ensure that the RPS adjustment is applied exclusively to a first deliverer's PCC 2 quantities (or other renewable energy that cannot be delivered to California in real-time). As noted above, the Energy Commission verifies the eligibility of all PCC 2 quantities claimed by LSEs in California. The RPS adjustment can and should be matched against the PCC 2 quantities verified by the Energy Commission.

To the extent the ARB wishes to reflect that non-renewable energy is imported into California, the RPS adjustment calculation can be modified to reflect an emission rate that is lower than the default emission factor for unspecified sources. However, the emission factor should be sufficient to reflect ratepayers' investment, and that "but for" the PCC 2 procurement, the renewable energy production would not have displaced other generation.

If the RPS adjustment is to be eliminated, any allocation of additional allowances intended to mitigate the cost impact should be undertaken in a transparent and even-handed manner. Unfortunately, the Staff's proposal to replace the RPS adjustment with an allocation of additional allowances exclusively to EDUs is neither transparent nor even-handed. After 2020, the Staff proposes to "modify the Regulation to provide each EDU with an allowance allocation that accounts for RPS-eligible electricity that is purchased together with RECs but cannot be directly delivered to California . . . ." ISOR at p. 53. The ISOR states that "[t]his allowance allocation will serve the same purpose as the original RPS adjustment, but will alleviate the reporting and verification difficulties and the potential for double counting of zero emissions electricity." Id. Contrary to the Staff's assertion, the allocation of additional allowances exclusively to EDUs will not serve the same purpose as the RPS adjustment.

## IV.

## THE STAFF'S PROPOSAL RESULTS IN DIFFERENTIAL TREATMENT OF FIRST DELIVERERS OF IMPORTED ELECTRICITY

The allocation of additional allowances exclusively to the EDUs under the Staff's proposal -- to account for renewable electricity that is not delivered to California in real-time -- presents the potential to disadvantage non-EDU first deliverers of imported energy, as well as non-EDU LSEs and their retail customers. If the ARB allocates an additional quantity of allowances to the EDUs, but does not allocate additional allowances to non-EDU importers of PCC 2 quantities on a proportionate basis, the potential exists for retail customers of non-EDU LSEs to bear a disproportionate burden for the GHG compliance costs associated with the importation of PCC 2 energy.

An LSE that is a first deliverer (or that procures PCC 2 quantities from a first deliverer) may not be able to recover the GHG compliance costs associated with those PCC quantities from its retail customers. The reason is that these non-EDU retail customers may receive an allocation of additional allowance revenues from the EDU that is not in proportion to the percentage of PCC 2 quantities in its LSE's RPS portfolio. As noted above, a non-EDU LSE is likely to include a different percentage of PCC 2 quantities in its RPS portfolio than the percentage of PCC 2 quantities in an EDU's RPS portfolio. If an EDU's percentage of PCC 2 quantities is different from another LSE's percentage of PCC 2 quantities, the benefit of the additional allowance allocation to the EDU will be distorted in customer rates, creating a competitive disadvantage for non-EDU LSEs.

Allocating additional allowances exclusively to the EDUs would be unduly discriminatory. Owing to the discriminatory impact of the Staff's proposed approach, the ARB should retain the RPS adjustment, subject to modification of the calculation. Alternatively, if the RPS adjustment is to be discontinued after 2020, the ARB should work with stakeholders, in the period prior to discontinuance of the RPS adjustment, to develop a means by which to allocate additional allowances to, or otherwise compensate any LSE that can demonstrate importation of verified PCC 2 quantities.

## V.

## IF THE RPS ADJUSTMENT IS TO BE DISCONTINUED AFTER 2020, THE ARB SHOULD DEVELOP A TRANSPARENT AND NONDISCRIMINATORY MECHANISM FOR ALLOCATING ADDITIONAL ALLOWANCES

If the RPS adjustment is to be discontinued after 2020, and if additional allowances are to be allocated to first deliverers of electricity for imports of renewable energy that cannot be delivered to California in real-time, calculation of the additional allowance allocation must be transparent. If the allocation of additional allowances will decline over time, the ARB should publish the process for reducing the additional allowance allocation for all first deliverers of electricity. The allocation of these additional allowances should be proportional for all first deliverers of imported energy.[1] In addition, the allocation of additional allowances to all first deliverers should decline at the same rate over time, based on the amount reported in the baseline year.

[1] Elimination of the RPS adjustment without any additional allocation of allowances to mitigate the increased GHG compliance costs would at least treat all first deliverers even-handedly.

## VI.

## CONCLUSION

Owing to the disparity in treatment of first deliverers (and, by extension, retail customers) under the Staff's "additional allowance allocation" proposal, the ARB should retain the "RPS adjustment" for imports of RPS PCC 2 quantities to California (or other renewable energy that cannot be delivered to California in real-time) in compliance periods after 2020.

If the RPS adjustment is to be discontinued after 2020, the ARB either should not allocate additional allowances (to mitigate the impact of eliminating the RPS adjustment) at all, or should allocate, to all LSEs with a GHG compliance obligation under the cap and trade regulations, additional allowances equal to each LSE's verified PCC 2 quantities during the applicable period. Any step that is taken to discontinue the RPS adjustment must achieve transparency and equal treatment for all first deliverers of electricity.

Please do not hesitate to contact the undersigned with any questions you may have regarding the foregoing comments.

Sincerely,

John W. Leslie
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Attorneys for Shell Energy North America (US), L.P.