M S R Public Power Agency

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October 23, 2013

Mary D. Nichols
Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: **M-S-R Comments on Amendments to the Cap-and-Trade Program Regulation**

Dear Ms. Nichols:

M-S-R Public Power Agency (M-S-R) provides these comments to the California Air Resources Board (CARB) on the September 4, 2013 Proposed Amendments to the Cap-and-Trade Program Regulation (Regulation).[1] Created in 1980, the M-S-R Public Power Agency is a public agency formed by the Modesto Irrigation District, the City of Santa Clara, and the City of Redding. M-S-R is authorized to acquire, construct, maintain, and operate facilities for the generation and transmission of electric power and to enter into contractual agreements for the benefit of any of its members. Each of M-S-R's member agencies are covered entities under the Regulation, and are directly impacted by the requirements set forth therein. M-S-R's members are members of the California Municipal Utilities Association (CMUA), and the cities of Redding and Santa Clara are also members of the Northern California Power Agency (NCPA). The individual M-S-R members support comments submitted to CARB by the organizations of which they are members. M-S-R also supports the comments submitted by the Joint Utilities.

[1] In addition to the *Notice of Public Hearing to Consider Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms*, CARB issued a *Staff Report: Initial Statement of Reasons* (ISOR), to which the proposed amendments were included as *Appendix E: Proposed Regulation Order* (Proposed Amendments).

I. SUMMARY OF RECOMMENDATIONS

As M-S-R and its members are also members of NCPA and CMUA, these comments are limited to a few distinct issues. First, M-S-R urges the Board to carefully review and examine the current provisions defining and describing resource shuffling to ensure that the definition does not inadvertently capture legitimate transactions. Second, M-S-R asks that the Board direct staff to include clarifying language to the provisions of the regulation dealing with the RPS Adjustment as it pertains to entities' with compliance obligations under both the Regulation and the Renewable Portfolio Standard (RPS) program. Third, M-S-R requests that the Regulation be revised to distinguish between freely allocated and purchased allowances to avoid inadvertent violations of the limitations on use of allowances and allowance value from freely allocated allowances. Lastly, M-S-R asks that the final statement of reasons that accompanies the regulatory amendments clarify that the allocation methodology used to freely allocate allowances to electrical distribution utilities is not subject to updating.

II. RECOMMENDED REVISIONS TO THE PROPOSED AMENDMENTS

A. Resource Shuffling Definition Should be Revised to Provide Greater Market Certainty.

Resource shuffling – any attempt to reduce a covered entity's compliance obligation under the Cap-and-Trade by intentionally reducing instate GHG emissions with a corresponding increase in out-of-state emissions – should be prohibited. It is contrary to the state's goal of reducing GHG emissions, and clearly represents a form of leakage.[2] M-S-R has worked alongside CARB staff and other stakeholders to develop definitions for "safe harbor" transactions that would not be deemed resource shuffling, and M-S-R generally supports the proposed revisions in section 95852(b)(2) that provide examples of "safe harbors" that are clearly not instances of resource shuffling. These kinds of legitimate transactions are properly acknowledged in the Regulation itself in order to give both market participants and the market itself greater certainty.

It is important that covered entities not be penalized for legitimate business transactions that merely result in a reduction in the covered entity's compliance obligation. The prohibition on resource shuffling must be carried out in a manner that does not impede other legitimate

[2] ISOR, p. 30.

transactions not specifically set forth in section 95852(b)(2)(A). To that end, M-S-R is concerned with the description of the proposed changes that is found in the ISOR wherein it is noted that "*Staff has also proposed to clearly define as resource shuffling the substitution of relatively lower emission electricity to replace electricity generated at a high emission power plant procured by a First Deliverer under a long-term contract or ownership arrangement, when the power plant does not meet California's EPS, and the substitution is made to reduce a First Deliverer's compliance obligation.*"[3] This explanation is troubling in that it fails to take into account the fact that there may be transactions not currently contemplated by the safe harbor provisions that would involve some of the factors set forth therein, but which would not be undertaken to reduce the compliance obligation. M-S-R is concerned that after-the-fact judgments as to whether the substitution was "made to reduce the First Deliverer's compliance obligation," could result in adverse consequences and needless market uncertainty. M-S-R, like many California utilities, has taken active and aggressive steps to implement early divestiture from its significant economic interests in non-EPS compliant facilities, such as its ownership interest in the San Juan Generating Station located in New Mexico.[4] However, divestiture of an investment made 30 years ago, and which is backed by municipal bonds, must be done in manner that recognizes M-S-R's fiduciary duty to its member-ratepayers and bond holders. The divestiture cannot be done in a vacuum, as the ownership interest is part of multi-state, multi-contract, and multi-party arrangements. The complexities associated with such a divestiture were recognized by CARB in Appendix A to the Regulatory Guidance Document,[5] and M-S-R wants to ensure that all steps taken by entities (such as M-S-R) that hold long-term contracts or ownership shares in facilities that do not meet the EPS and that are attempting to transition out of those contracts are not deemed resource shuffling. This statement is also not entirely consistent with the statement on the previous page of the ISOR wherein staff states that "*based on discussions with stakeholders, staff recognized that there are several situations in which substitutions of low emission electricity for higher emission electricity may occur that are not*

[3] ISOR, p. 31.
[4] The San Juan Generating Station emissions exceeds the state's emissions performance standard (EPS), and is, therefore, deemed non-compliant.
[5] http://www.arb.ca.gov/cc/capandtrade/guidance/guidance.htm.

undertaken to reduce compliance obligations."[6] The Proposed Amendments to the Regulation should be revised to reconcile these two statements. Accordingly, M-S-R recommends that section 95802(a)(252) be amended to read:

> "Resource Shuffling" means any plan, scheme, or artifice ~~to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid~~ 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. *Not all substitutions of electricity between sources with different emission levels are resource shuffling, and* ~~R~~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).

There are myriad legitimate business transactions that may result in a California entity not importing all of the electricity it contracts for out-of-state, or result in the covered entity substituting electricity from one source with electricity from another source before it reaches California's borders. These transactions may be necessitated by timing, contractual obligations, transmission availability, preexisting exchange agreements, and related electricity deliverability issues. They may also be part of larger procurement and compliance designs that implicate – but are not driven by – the covered entity's compliance obligation under the Regulation. While the safe harbor provisions of section 95852(b)(2)(A) capture *known transactions* that would reflect many kinds of legitimate situations, the list is not exhaustive, nor does it take into account new or emerging business transactions. It is imperative that the Regulation recognize as yet undefined transactions that do not fall within any of the existing safe harbors, but which should not be deemed resource shuffling, and ensure that the definition of resource shuffling found in the Regulation reflects this.

M-S-R also supports formally removing the attestation requirement as proposed in section 95852(b) of the Proposed Amendments.

B. The Regulation Should be Revised to Strike the Retirement Requirement Associated with the RPS Adjustment.

The RPS Adjustment is a necessary element to the Regulation, and M-S-R appreciates its inclusion therein. However, in order to keep from disadvantaging entities subject to compliance

[6] ISOR, p. 30.

obligations under both the State's GHG reduction and RPS programs, it is necessary for the Regulation to accurately reflect the RPS mandates imposed on load serving entities. Accordingly, M-S-R encourages the Board to direct staff to draft 15-day revisions to the Proposed Amendments clarifying section 95852(b)(4)(B) of the Regulation. Specifically, the Regulation should not place constraints on the ability of covered entities subject to the States' RPS laws to retire a renewable energy credit (REC) in order to utilize the RPS Adjustment.

The RPS mandate imposes significant renewable procurement obligations on the State's electrical distribution utilities, including restrictions on the type of renewable resources that can be procured and the timing for retiring RECs, all of which contribute the achieving the overall objectives defined in AB 32. The Regulation must take those constraints into account, and recognize the important impact that the RPS program has on covered entities that are also electric utilities required to comply with the RPS. In the October 2011 Final Statement of Reasons (FSOR), Staff noted that the "RPS adjustment provision accomplishes the purpose of reducing a deliverer's compliance obligation by accounting for renewable imports that staff previously addressed through the 'replacement electricity' requirements."[7] However, the proposed revision, while intending to clarify the original intent, fails to do so. Indeed, while the ISOR states that the proposed revision "is necessary to provide specific direction on what actually has to happen to the REC to be able to take the RPS adjustment,"[8] it does not fully acknowledge the fact that the RPS program is separately administered and tracked by other state agencies, and the REC retirement requirement is not necessary within the context of the Program. Covered entities subject to both mandates need to have the maximum flexibility within those programs. Requiring entities to retire RECs in the Cap-and-Trade program under time restraints that are not required by the RPS program will diminish the flexibility that was recognized by the RPS program authors.

The Proposed Amendments would revise 95852(b)(4) to allow the RPS Adjustment to be utilized by a covered entity as long as the REC is retired (as that term is used within the context of the California RPS program) "during the same calendar year **for** which the RPS adjustment is claimed." While M-S-R prefers to strike the provisions that require the REC to be retired within

7 FSOR, p. 57.

8 ISOR, p. 125.

the language of the Regulation, M-S-R supports the proposed revision to the extent that it removes the requirement that the REC be retired "the same year **in** which" and replaces it with the text referenced above. The requirement to retire the REC *in the same year* the adjustment is claimed does not recognize that the electricity may be imported during a different year than when the associated REC is retired for compliance with the RPS program. The difficulties of matching electricity imports to REC retirement within a single calendar year are complicated by the fact that the RPS program has multi-year compliance periods through 2020, and RECs can be retired at anytime within 36 months of being generated. Requiring a REC to be retired in the same year the electricity is generated is also problematic given the fact that REC itself is not issued by WREGIS at the same time the underlying electricity is generated. Therefore, attempts to "annualize" the REC retirement requirement could dissociate the RPS Adjustment from the electricity import. M-S-R understands that the proposed changes to section 95852(b)(4) are intended to allow the RPS Adjustment to be claimed at the time the REC is retired without regard to the year in which the underlying electricity was imported/generated. While it is preferable for all matters regarding retirement of RECs to be addressed solely within the RPS program and not in the Regulation, this revision is helpful, as long as it can be reconciled with the current Mandatory Reporting Regulation (MRR). The MRR requires compliance entities to report emissions for all imports that occurred within the previous calendar year for purposes of calculating the entity's compliance obligation. This is also reflected in section 95852(b)(1)(B) of the Regulation that addresses how emissions with a compliance obligation are calculated and which reflects data reported under applicable provisions of the MRR. The Regulation needs to be consistent with the RPS program and workable within the construct of the processes employed by WREGIS for the issuance of RECs. Stakeholders need to know that the Regulation properly reflects the RPS program constraints and accurately acknowledges the associated complexities of the requirements set forth therein. If not clarified, it is possible that inadvertent restrictions on reporting the RPS Adjustment could hinder the ability of utilities that are covered entities under the Cap-and-Trade regulation *and* subject the State's RPS mandate to maximize their resource commitments in meeting the stringent requirements of both programs. To that end, M-S-R urges clarification to the Regulation that clarifies that the RPS adjustment is not intended to be associated with any specific electricity import.

C. The Regulation Should Distinguish Between Purchased and Freely Allocated Allowances.

Section 95856(h) of the Proposed Amendments specifies the order in which allowances are retired from a covered entity's compliance account. Under the proposal, the Executive Director will evaluate the number and type of compliance instruments in that account, and will retire compliance instruments in the following order: offset credits, allowances purchased from the allowance price containment reserve, allowances generally with the earliest vintages first, and finally, true-up allowances. This proposal does not distinguish between allowances that are freely allocated to electrical distribution utilities and those that are purchased (either through the auction or other sales). Because of the restriction placed on the use of allowance value from freely allocated allowances in section 95892(d)(5), allowances retired based strictly on the vintage could result in the retirement of allowances for prohibited transactions. In order to address this concern, the classification of allowances should be further defined to distinguish between freely allocated allowances and purchased allowances, and regulated entities should be allowed to specify the amount to be retired from each of these classifications, with earlier vintage allowances retired first within each classification. This change would ensure that electrical distribution utility is able to comply with the restrictions on the use of allocated allowances, such as the prohibition on the use of allowances/allowance value to meet compliance obligations for electricity sold into the CAISO markets.

D. The Regulation Should Clarify That Allocation of Allowances To Electrical Distribution Utilities Is Not Subject To Updating

The proposed revisions make changes to section 95892(a), Table 9-3, by adjusting the allocation of allowances between two electrical distribution utilities. The ISOR states that "staff proposed to change the allocation to two EDUs based on new information regarding the cost burden for Cap-and-Trade compliance faced by each EDU's ratepayers."[9] While M-S-R does not take issue with the revised allocation, it is important that the final SOR reflect the understanding that the allowance allocation methodology proposed by staff and adopted by the Board was not intended to be subject to "updating." Accordingly, M-S-R recommends that the final SOR explanation for the revised allocation reflect the fact that recalculation was based on a

[9] ISOR, p. 161.

correction made to the original cost calculation, and not on new or updated information.

III. CONCLUSION

The success of AB32 and California's landmark Cap-and-Trade Program rests on how the state's covered entities will be able to reduce their GHG emissions levels while meeting their compliance obligations under the Cap-and-Trade program, and continue to grow and prosper. Revisions to the proposed amendments addressed in these comments will help ensure that the Cap-and-Trade program regulation allows all covered entities to accomplish these objectives. M-S-R appreciates the opportunity to provide these comments to the Board, and looks forward to potential 15-day changes to the Proposed Amendments.

Respectfully submitted,

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M-S-R Public Power Agency