October 23, 2013

Honorable Mary D. Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA, 95814

Re: State Water Contractors' Comments on California Air Resources Board's Proposed Amendments to the Cap-and-Trade Program

Dear Madam Chair,

The State Water Contractors (SWC) appreciates the opportunity to provide input to the California Air Resources Board (CARB) on the Proposed Amendments to the California Cap-And-Trade Regulation.

INTRODUCTION

The State Water Contractors is a non-profit, mutual benefit corporation organized under the laws of the State of California, comprised of 27 public agencies holding contracts to purchase water delivered by the State Water Project (SWP). The hydropower operations of the SWP represent about 4 percent of the state-wide use of electricity which makes the SWP the single largest end user in California. Implementing AB 32 measures will have a significant impact on the customers of the SWP. Thus, the SWC has a vested interest in the ongoing development of regulations for implementing AB 32.

SWC's public agency members are the beneficial users of the State Water Project (SWP), providing water for drinking, commercial, industrial, and agricultural purposes to a population of more than 25 million people and to over 750,000 acres of farmland throughout the San Francisco Bay Area, the Central Valley of California, and Southern California. The primary purpose of the SWP is to store and deliver water to the customers of the SWP, who pay all of its costs. A significant part of the SWP costs relate to electricity generated and purchased at wholesale for the ultimate purpose of pumping water to consumers across wide areas of the State.

Delivery of this water is vital to the health, welfare, and productivity of the State of California. But the ARB treated the SWP customers differently than the customers of the electric utilities. The difference results in the customers of the SWP incurring costs and risks that ARB mitigated for the electric utilities. That inequity led to the ARB Board Resolution 32-11 adopted in October, 2011.

This proposal provides a means for ARB to address the inequities while furthering the State's greenhouse gas (GHG) emission reduction goals. Water supply projects are an important means of achieving these goals given the significant energy use in the water sector. SWP investments will reduce GHG emissions with the additional statewide benefit of facilitating the integration of renewable power into the power grid. We are prepared to assist the ARB include this proposal into the amended Cap-and-Trade regulations.

BACKGROUND

The Department of Water Resources (DWR) and SWC have been working for nearly three years with ARB, other agencies within the Brown Administration and the Legislature to craft an appropriate accommodation to mitigate the cost burden of Cap-and-Trade electricity sector regulations on SWP customers. That cost burden arises because DWR is one of two wholesale water conveyance agencies, Metropolitan Water District of Southern California is the other, whose water operations are covered by the Cap-and-Trade regulations. ARB mitigated this cost burden that was also borne by the customers of the electric utilities.

The SWP mission is to deliver water throughout the State of California. It participates in the power market solely to supply electric power to its pumps. All of the costs of this electric power are passed through to the SWP customers. DWR acquires power from the wholesale California power market and is a partner in a new gas-fired plant in California. DWR has in the past and retains its right to import energy into California. The wholesale energy acquired by DWR supplements SWP renewable power purchases and hydroelectric generation which supplies over 50% of the energy used by the SWP pumps.

The ARB allocated emission allowances to electric utilities sufficient to offset the Cap-and-Trade costs, direct and indirect, of all the power used to serve their customers. The direct costs arise for emission allowances that must be surrendered to ARB. The allowances are surrendered for carbon emitting resources operated within California or imported from outside California. Indirect costs arise from power that is purchased inside California in which the carbon adder is imbedded. The ARB allocated allowances to the electric utilities without regard to whether the utilities have a direct or indirect cost.

The customers of the SWP and MWD have a similar direct and indirect cost burden under Cap-and-Trade. It is estimated these additional costs will exceed $220 million by 2020. Approximately 80% of the $220 million Cap-and-Trade cost burden falls into the indirect cost category. The balance is the direct costs DWR incurs for its gas-fired power plant. The customers of the SWP receive no mitigation of the Cap-and-Trade cost burden.

The amount of energy acquired by DWR varies considerably from year to year due to changes in the amount of water conveyed through the SWP. For administrative ease, CARB recommended using an approach that would not have to track yearly data and require end of year revisions. Following CARB's recommendation, DWR averaged five years of SWP data to eliminate the annual variations in the acquired energy values. DWR and SWC requested free allowances for DWR to mitigate the cost burden of acquiring higher cost energy and covering DWR's share of the gas-fired GHGs. The number of free allowances was based on the average GHG content. This is a methodology that is similar to what was applied to the electric utilities.

CARB PROPOSAL/AMENDED CAP-AND-TRADE REGULATION

ARB's proposal is to make no allocation to DWR and mitigate none of the estimated $220 million Cap-and-Trade cost. The areas of disagreement with the ARB proposal are:

DWR Should Not Get Any Allowances Because SWP Does Not have a Compliance Obligation (Direct Cost): ARB contends that DWR is not eligible for emission allowances because it does not have a compliance obligation. SWC response: This position is in sharp contrast with ARB granting emission allowances sufficient to cover *all* costs of the utilities. Further, ARB mitigated the cost burden of utilities that had no compliance obligation.

SWP Not Eligible for Allowances to Offset Indirect Costs (Power Purchased Within California): Relatedly, ARB contends that emission allowances should not be used to offset indirect costs of the SWP. SWC response: ARB allocated allowances to the electric utilities without regard to direct and indirect costs. In some cases, the allocation of allowances solely offset the indirect costs.

SWP Would Use Auction Proceeds Solely for Customer Refunds*:* ARB contends that DWR will monetize all emission allowances and use the revenue to refund its customers. SWC response: DWR is transitioning with State energy and carbon policy and has already made investments in energy efficiency and renewable power. DWR has identified future investments that will also provide GHG emission reductions. Those investments will be made to offset the cost of implementing AB32 to the benefit of the customers of the SWP.

ARB Cannot Direct Funds to DWR*:* ARB contends that it cannot provide funds directly to a state agency without an appropriation from the legislature. SWC response: True as that may be, no law prohibits the ARB from allocating allowances to DWR in the same way it allocates allowances to the electric utilities.

Methodology: The methodology ARB applied to determine the number of allowances for the electric utilities took their 2009 resource plans and reduced the number of allowances to reflect utilities' obligation to go from 20% to 33% renewables. That method is consistent with the utility obligations. SWC response: The DWR Director approved and adopted a Climate Action Plan that includes a renewable acquisition schedule in May 2012. That should be reflected in the methodology, not the utility obligations.

SWC REQUESTED AMENDMENTS TO REGULATION

The SWC propose that CARB provide free GHG emission allowances to DWR that are sufficient to offset both the direct (compliance obligations) and indirect (power purchased within California) cost burden of the Cap-and-Trade program to the benefit of the SWP customers, consistent with the attached table.

The State Water Contractors appreciate the California Air Resources Board consideration of this proposal. Please contact Tim Haines, Deputy General Manager, at 916-447-7357 ext 205.

Sincerely,

Terry L. Erlewine
General Manager

Attachment 1: Allocation of Emission Allowances Per DWR Climate Action Plan

Year	2013	2014	2015	2016	2017	2018	2019	2020
SWP Energy Average 2008-2012 (MWh)	7,400,000	7,400,000	7,400,000	7,400,000	7,400,000	7,400,000	7,400,000	7,400,000
Reid Gardner (MWh)	420,000	0	0	0	0	0	0	0
Lodi Energy Center (MWh)	225,000	225,000	225,000	225,000	225,000	225,000	225,000	225,000
DWR Owned and Purchased Hydropower (MWh)	4,575,000	4,575,000	4,575,000	4,575,000	4,575,000	4,575,000	4,554,000	4,443,000
Renewables: (MWh)	108,000	144,000	180,000	216,000	252,000	288,000	324,000	360,000
Net Load: Market Energy (MWh)	2,072,000	2,456,000	2,420,000	2,384,000	2,348,000	2,312,000	2,297,000	2,372,000
Coal Emission Factor (MT/MWh)	1.116	1.116	1.116	1.116	1.116	1.116	1.116	1.116
CCCT Emission Factor (MT/MWh)	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38
Unspecified Source Emission Factor (MT/MWh)	0.428	0.428	0.428	0.428	0.428	0.428	0.428	0.428

Calculation of Emissions Burden

Net Load Market Energy	2,072,000	2,456,000	2,420,000	2,384,000	2,348,000	2,312,000	2,297,000	2,372,000
Emissions Burden (Metric ton)	**1,441,036**	**1,136,668**	**1,121,260**	**1,105,852**	**1,090,444**	**1,075,036**	**1,068,616**	**1,100,716**
Allocation to DWR (Allowances)			**3,698,964**	**1,105,852**	**1,090,444**	**1,075,036**	**1,068,616**	**1,100,716**