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Ms. Jeannie Blakeslee
Ms. Edie Chang
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 95814

**Re: Comments of the Indicated Producers on CARB AB 32 Revised Administrative Fee Draft Regulations**

Dear Ms. Blakeslee:

The Indicated Producers (IP)[1] is an *ad hoc* coalition representing the interests of in-state and other domestic natural gas producers, natural gas marketers, and large industrial end-users engaged in oil and gas production and refining. The proposed AB 32 administrative fee will impact IP members in their capacity as producers, marketers and end-users.

The revised regulations continue to make the interstate pipeline the point of regulation for natural gas end-users receiving deliveries of gas supplies directly by an interstate pipeline. While this upstream approach may seem to promote administrative efficiency and be consistent with the manner in which the administrative fee is being imposed on utilities on behalf of their end-users, this structure will:

- Not fulfill AB 32 objectives if marketers cannot pass-through their incremental costs to end-users,
- May be challenged as a state-imposed fee on FERC-jurisdictional services or facilities, and
- Lead to differential impact on marketers depending on the customers they serve.

Importantly, application of the fee directly on end-users served with natural gas supplies delivered by interstate pipelines will not significantly increase the administrative burden of this regulation. As a result, to ensure that the administrative fee structure is supportable under state law, is charged to end-users responsible for combustion of natural gas, and treats marketers of all gas supplies

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[1] The Indicated Producers is an *ad hoc* coalition which includes, for the purposes of these comments, Aera Energy LLC, BP Energy Company, BP America Inc. (including Atlantic Richfield Company), Chevron U.S.A. Inc., Midway Sunset Cogeneration Company (an affiliate of Aera Energy) and Occidental Energy Marketing Inc.

in the same manner, CARB should impose the fee directly on the end-users who receive natural gas deliveries directly from interstate supplies.

***Imposing the Administrative Fee on Interstate Pipelines Will Not Fulfill AB 32 Directives Where Natural Gas Marketers Cannot Pass Through Their Incremental Costs***

AB 32 only provides CARB with the authority to impose an administrative fee on sources of greenhouse gas emissions:

> *38597. The state board may adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001. The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division.*[2]

While this language does not require CARB to impose an administrative fee directly on those entities that are the sources of GHG emissions, it does suggest that end-users must, at a minimum, be the entities that ultimately bear the fee. CARB has chosen an upstream approach to collect the fee from end-users. While this is an administratively efficient and effective way to recover the fees from end-users served by natural gas utilities, it does not work for deliveries of natural gas by interstate natural gas pipelines.

First, the FERC-jurisdictional interstate natural gas pipeline must file for a rate increase at FERC and such rate increase would be subject to requirements of the Natural Gas Act including administrative review and protests and challenges on jurisdictional grounds. This could result in a very lengthy proceeding at FERC and potential judicial review. If the inclusion of the AB 32 administrative fee to the transportation tariff is not approved by FERC, the pipeline will not be able to charge the fee.

Second, if the interstate pipeline is able to incorporate the fee in its rate schedules, the fee will be effective on a prospective basis. The pipeline would seek to collect the fee from the shipper/marketer and the interstate pipeline would then need to submit these revenues to the California Air Pollution Control Fund.

Third, the shipper or marketer may be forced to bear a portion of this responsibility if it is unable to pass all costs through to the end-users it serves. Based on the

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[2] Ca. Health & Safety Code § 38597 (emphasis added).

explicit language of AB 32, it would be inappropriate for marketers to absorb these incremental costs.

Pass-through of the administrative fee by a marketer under these circumstances is complicated and not assured. The marketer may be selling natural gas to the end user pursuant to an existing long-term contract that does not provide for the recovery of these new costs. Typically these contracts specify a sales price, including a commodity market index price, that may not include the opportunity to incorporate these AB 32 administrative charges. If the sales price is based on a market index price, the index price will likely not reflect the full value of the administrative fee and the marketer would not be able to recover its incremental costs from its end use customer. The fact that the additional cost is a "fee", and not a "tax", also creates uncertainty as to which party should bear the cost under the terms of the contract. Additionally, it is not clear that future contracts can be structured in a manner that ensures full recovery of these costs. In short, pass-through would not be assured and would require an undue disruption in contracts between marketers and their customers, and would add regulatory uncertainty to the market.

In sum, even if the AB 32 administrative fee can be imposed on interstate natural gas pipelines, there is no guarantee that end-users served by those interstate pipelines will bear the fee. To ensure that the point of regulation for these natural gas supplies comports with the language and intent of AB 32, CARB must move the point of regulation so that it lies directly with end-users.

***Application of the Administrative Fee to Interstate Pipelines Can Result in Differential Impact on Marketers Depending on Customers Served***

If CARB imposes the administrative fee on interstate pipelines, it could lead to a differential impact on marketers. Under the regulations, where a marketer of out-of-state gas sells gas to a utility or a utility end-use customer, the utility would pay the fee and pass it through to its end-use customers in transportation fees; this structure is consistent with AB 32 and such a marketer would not bear administrative fee obligations and need not be concerned about passing these costs through to end-users. In contrast, CARB proposes that interstate pipelines bear the fees for gas supplies used to serve end-users directly and not served by a utility. In this case, the interstate pipeline will attempt to collect the fees from the party transporting gas on its system: the transporting marketer, *not* the end-use customer. If a marketer is then unable to pass through the incremental costs associated with the administrative fee, it would be differentially impacted when compared with marketers delivering to utility customers.

***Application of the Fee Directly on End-Users Served by Interstate Pipelines Will Not Significantly Increase Administrative Burden of the Regulation***

CARB has generally chosen an upstream approach to promote administrative efficiency, but the burden of imposing the administrative fee directly on end-users supplied by the interstate pipelines is minimal. There are only a select few end use customers that connect directly to an interstate pipeline. In fact, only 20-30 customers fall into this category. CARB could obtain a list of these customers from the interstate pipelines and receive monthly sales/purchase data from the end-user for volumes used for invoice/billing purposes. All other end use customers or municipalities receive natural gas through deliveries made by intrastate pipelines, and the AB 32 administrative fee can be included via in-state transportation or distribution surcharges. Given the material drawbacks of imposing the fee on interstate pipelines, there is justification to deviate from the upstream approach for this select group of end-users.

**Recommendations**

IP recommends that the following change be made to the revised regulations:

95201. Applicability
(a) This article applies to the following entities. The terms used below are defined in Section 95202.
(1) Natural Gas Utilities, Users, and Pipeline Owners and Operators.
(A) All public utility gas corporations …
(B) Any~~l~~ ~~owners or operators of interstate and intrastate pipelines~~ owner/operator or entity purchasing or consuming natural gas in California that has been transported directly by any interstate pipeline, and not otherwise included in subpart (A)~~, that distribute natural gas directly to end users~~. Fees shall be paid for each therm of natural gas directly distributed to end users by interstate or intrastate pipelines.

IP looks forward to discussing these issues further.

Very truly yours,

Evelyn Kahl

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