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CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY
AIR RESOURCES BOARD

COMMENTS, OBJECTIONS, AND RECOMMENDATIONS OF THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION ON THE NOTICE OF PROPOSED ACTION FOR ADOPTION OF THE AB 32 COST OF IMPLEMENTATION FEE

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I. Recommended alternatives for the Proposed Regulation Order

The California Municipal Utilities Association ("CMUA") files these Comments on the *Proposed AB 32 Cost of Implementation Fee Regulation.* CMUA's comments are based upon the standards for necessity,[1] clarity,[2] consistency,[3] and authority[4] as mandated for regulations by the Administrative Procedure Act ("APA"). AB 32 authorizes ARB to adopt regulations for "a schedule of fees to be paid by the sources of greenhouse gas emissions, regulated pursuant [to AB 32]."[5] ARB has no authority or necessity to adopt a schedule of fees for entities or activities that are not sources of statewide greenhouse gas emissions as that term is defined in AB 32.

CMUA and/or its member utilities met with Air Resources Board ("ARB") staff on several occasions to discuss the proposed AB 32 Cost of Implementation Fee Regulation (hereinafter called the "administration fee"). CMUA commends staff for its demonstrated interest in CMUA's concerns and for participating in the meetings with the intent to identify solutions.

A. Substitute energy has the same attribute as the underlying renewable resource and is not subject to the AB 32 administration fee.

In the CMUA-ARB meeting on June 22, 2009, CMUA's members described their concern regarding "substitute energy." It is common practice in the electric utility industry for contracted renewable energy to be "unbundled" from the Renewable Energy Credits (RECs) due to lack / uncertainty of transmission, an intermittent generation profile, economic considerations or operational constraints. The utility retains the RECs and then "substitute energy" is procured from another source. The contracted renewable energy facility output (MWh) is balanced with the substitute energy periodically.

The following example illustrates a typical transaction: A Seller sells renewable energy such as wind along with the environmental attributes (i.e., the RECs) as a bundled product. A Buyer unbundles the products by retaining the environmental attributes but sells or assigns the energy to the Seller or a third party. The Seller or third party delivers firm substitute energy as a 7 by 24, on/off peak or seasonal exchange at an acceptable delivery point and balances or trues to the original renewable energy production on a periodic, daily, weekly, monthly, or seasonal basis

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[1] "Necessity" means that "the record of the rulemaking proceeding demonstrates by substantial evidence the *need for a regulation to effectuate the purpose of the statute* . . . ." (GOV'T CODE § 11349(a) (emphasis added)).

[2] "Clarity" means that the regulation is "written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them." (GOV'T CODE § 11349(c)).

[3] "Consistency" means that the regulation is "in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law." (GOV'T CODE § 11349(d)).

[4] "Authority" shall be presumed to exist only if ARB cites a California constitutional or statutory provision which: (1) expressly permits or obligates the agency to adopt the regulation; or (2) grants a power to the agency which impliedly permits or obligates the agency to adopt the regulation in order to achieve the purpose for which the power was granted. (GOV'T CODE § 11349(b); 1 CAL. CODE REGS. § 14).

[5] HEALTH & SAFETY CODE § 38597.

(not exceeding yearly). The Buyer then rebundles the substitute energy and environmental attributes. This may involve a delivery point within or outside California to serve load in California.

Pursuant to the CMUA-ARB meeting and consistent with the principle that eligible renewable resources have zero GHG emissions, CMUA understands that the administration fee does not apply to rebundled substitute energy because it is attributed zero GHG emissions. This is true regardless of which type of generating resource is used to supply the substitute energy.

B. Null power is not subject to the AB 32 administration fee.

In the CMUA-ARB meeting on June 22, 2009, CMUA's members described their concern regarding "null power."

Pursuant to the CMUA-ARB meeting and consistent with the principle that eligible renewable resources have zero GHG emissions, CMUA understands that the AB 32 administration fee does not apply to null power.

C. Power that is "wheeled" through California is not subject to the AB 32 administration fee.

In the CMUA-ARB meeting on June 22, 2009, CMUA described its concern regarding the "wheeling" of power through California. The California Energy Commission Energy Glossary defines wheeling as the "transmission of electricity by an entity that does not own or directly use the power it is transmitting." However, the description of "wheeling" in ARB's Mandatory GHG Reporting regulations lacks sufficient clarity for the purpose of being used to collect the administration fee. The mandatory reporting regulations collect data for power wheeled through California (on single or chain of NERC e-tags) as two separate transactions: (1) import; and (2) export if the title of the energy is held by the entity that is wheeling power notwithstanding the evidence that the power is not consumed in California. If that interpretation were true, then the ARB methodology would impose GHG emissions and fees for energy wheeled into California but not provide equivalent relief when the same power is wheeled out of California in the same transaction.

At the CMUA-ARB meeting, CMUA provided a copy of an actual NERC e-tag for power owned by a California utility in a simultaneous energy exchange transaction. The electricity was wheeled from Utah to Oregon, via the California transmission system. Pursuant to the meeting and consistent with the principle that AB 32 does not regulate electricity that is not delivered to *and* consumed in California, CMUA understands that the administration fee does not apply to power wheeled through California. Pursuant to telephone conversations with ARB staff on June 24, 2009, CMUA understands that ARB staff will describe this issue to the Air Resources Board at the Regular Meeting on June 25, 2009. Furthermore, staff will propose new regulatory language to clearly define "wheeling" and identify that "wheeled" power is not subject to the administrative fee.

D. Biogas is an eligible renewable fuel and is not subject to the AB 32 administration fee.

In the CMUA-ARB meeting on June 22, 2009, CMUA described its concern regarding the applicability of the AB 32 administration fee to landfill or biogas that was treated to pipeline grade natural gas quality and injected into the natural gas distribution/transmission system.

Pursuant to telephone conversations with ARB staff on June 24, 2009, CMUA understands that the proposed regulations apply to "natural gas" as defined in proposed regulation § 95202(a)(59). Landfill and biogas are not included within that definition, therefore, ARB staff stated that the administration fee does not apply to landfill or biogas.

E. Energy exchange transactions promote many AB 32 policy goals and should, at most, only be subject to the AB 32 administration fee for the net amount of imported power.

In the CMUA-ARB meeting on June 22, 2009, CMUA described its concern regarding energy exchange transactions. An energy exchange agreement typically means a commitment between electricity market participants to swap energy for energy. Exchange transactions do not involve transfers of payment or receipts of money for the full market value of the energy being exchanged, but may include payment for net differences due to market price differences between the two parts of the transaction or to settle minor imbalances. Overall, energy exchange agreements are utilized to optimize the use of existing generation and transmission resources.

It has long been a common practice in the electric utility industry for entities to engage in intertemporal exchanges, i.e., the contracted energy is received in one season or during an on-peak period and returned in a different season or during off-peak periods. The energy exchange is generally performed due to generating resource limitations, economic considerations, or operational considerations. The received and returned energy amounts may vary for any particular exchange but the amounts are balanced periodically as per the energy exchange contract.

Pursuant to the CMUA-ARB meeting and a telephone conversation with ARB staff on June 24, 2009, CMUA understands that for intertemporal energy exchanges, the proposed regulations will apply the AB 32 administration fee to the *full* amounts of energy that are imported *and* exported. The proposed regulations will use the data collected by the Mandatory GHG Reporting Regulation to calculate the import/export quantities, and in many cases, using a default emission rate for imported power of 0.499 MT CO_2 per MWh. Yet, ARB has openly acknowledged in its June 5, 2009, workshops that the Mandatory GHG Reporting Regulations are not sufficient to identify the obligated entities in a cap-and-trade program *because they were not designed to do so*. It follows that if the Mandatory GHG Reporting Regulations are insufficient for use in a cap-and-trade program, then they are also insufficient for identifying the obligated sources and emissions for imposing the AB 32 administration fee.

The Mandatory GHG Reporting Regulations require annual GHG reporting from electricity generating facilities, electricity retail providers and power marketers, oil refineries,

hydrogen plants, cement plants, cogeneration facilities, and industrial sources that emit over 25,000 MT per year of CO_2 from stationary source combustion. Special requirements apply to the electric power sector and utilities and power marketers. They are required to report certain electricity transactions, including purchases, sales, imports, exports, and exchanges. The data collected is designed to be *comprehensive and overlapping* in the sense that it collects information on the same transactions (i.e., emissions) from multiple entities. In this manner, ARB may more thoroughly understand the source and flow of direct (actual emissions inside California) and indirect (electricity consumption inside California) statewide GHG emissions. On the flip side, the overlapping nature of the reporting regulations make them inadequate for use in a cap-and-trade program in which covered entities will have compliance requirements because they will result in duplicative and/or incorrect GHG emission obligations.

The Mandatory GHG Reporting Regulations cannot be used to accurately calculate the covered emissions or identify the obligated entities for many energy exchange transactions because the regulations do not collect the necessary information to identify the electricity that is actually delivered to and consumed in California (i.e., the statewide greenhouse gas emissions). The broad application of the proposed AB 32 administration fee regulations will, in some cases, impose a fee on energy exchanges that include purely financial transactions in which no generation or emissions actually occur. This is inconsistent[6] with AB 32 which only authorizes ARB to collect fees from sources of *actual* statewide GHG emissions.[7]

The broad application of the AB 32 administration fee regulations will, in some cases, apply the incorrect default emission factor to imports from "zero" emission resources. This is inconsistent with AB 32 since it contradicts the express AB 32 requirements for accuracy. ARB may not supplant actual, known emissions with a default, especially when the facility is a zero-emission source. AB 32 requires ARB to develop regulations that "[e]nsure rigorous and consistent accounting of emissions . . . ."[8] The proposed administration fee regulation sections should be deleted to the extent they knowingly and expressly assign an incorrect emission rate to verifiably clean resources.

Finally, the broad application of the AB 32 administration fee regulations will, in some cases, impose fees on energy exchanges in which the electricity is being delivered to and consumed outside California. This is also inconsistent with the definition of statewide GHG emissions in AB 32. Accordingly, the proposed regulations applying the fee to imported electricity fail to meet the requirements of necessity, clarity, consistency, and authority as mandated for regulations by the APA.

The most effective alternative for ARB at this point, is to delete the application of the administration fee to imported electricity. This issue should then be properly evaluated during

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[6] The APA requirement for "consistency" means that the regulation is "in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law." (GOV'T CODE § 11349(d)). Under the proper legal standard of review, a court will determine whether the agency reasonably interpreted its legislative mandate when deciding that the challenged regulation was necessary to accomplish the purpose of the statute. In other words, "the court will determine whether the regulation is reasonably designed to aid a statutory objective." (*Benton v. Board of Supervisors*, 226 Cal.App.3d 1467, 1479 (1991)).

[7] HEALTH & SAFETY CODE § 38597.

[8] HEALTH & SAFETY CODE § 38530(b)(4).

the cap-and-trade rulemaking. At the very least, the regulations should be amended so that the AB 32 administration fee is calculated based upon the net difference in electricity for the import and export transactions that are conducted pursuant to an intertemporal energy exchange.

CMUA's Recommendation for a more effective and less burdensome alternative	
CMUA's proposed alternative language	*Preferred alternative, delete all sections related to calculating a fee on imported electricity*: §§ 95201(a)(5), 95203(g), and 95204(f) *Second alternative, amend these sections whereby the exported electricity of intertemporal energy exchanges is netted with the imported energy. The administration fee shall only be charged on the net import of electricity that is delivered to and consumed within California.*
Reference and authority	Health & Safety Code §§ 38505(m), 38562(b), 38597.
Reasoning supporting CMUA's alternative	• AB 32 requires that ARB adopt GHG emission limits and emission reduction measures by regulation to achieve the maximum technologically feasible and cost-effective reductions in GHG emissions in furtherance of achieving the statewide GHG emissions limit and the AB 32 Scoping Plan states that certain policy objectives will be incorporated into which measures are selected. (H&S Code § 38562(a)). For instance, in adopting the regulations, to the extent feasible and in furtherance of achieving the statewide GHG emissions limit of 427 MMT, AB 32 requires ARB to design the regulations in a manner that seeks to minimize costs and maximize the total benefits to California, consider the overall societal benefits, and other benefits to the economy, environment, and public health. (H&S Code § 38562(b)). Also, ARB shall evaluate the total potential costs and total potential economic and non-economic benefits of the plan for reducing greenhouse gases to California's economy, environment, and public health, using the best available economic models, emission estimation techniques, and other scientific methods. (H&S Code § 38561(d)). ARB is required to consider myriad other issues including: (1) equity; (2) no disproportionate impact on low-income communities; (3) fuel diversity; and (4) no interference with efforts to achieve and maintain federal and state ambient air quality standards and to reduce toxic air contaminant emissions. (H&S Code § 38562(b)(1), (2), (4)-(6), (9)). • ***Energy exchanges promote many of these AB 32 policy goals as listed below in the bullet points.***

- Most of the energy exchanges involving imports/exports of electricity are with entities in the pacific northwest. Primarily, these include the Bonneville Power Administration ("BPA"), Portland General Electric, and Seattle City Light. The BPA is a federal administration that markets, transmits, purchases, exchanges, and sells electric energy in the wholesale market. Federal dams in the Pacific Northwest generate the hydroelectric energy that BPA sells. Federal statutes govern the BPA including the Bonneville Project Act of 1937 (16 U.S.C 832), the Pacific Northwest Consumer Power Preference Act of 1964 (16 U.S.C. 837), the Pacific Northwest Federal Transmission System Act of 1974 (16 U.S.C. 838), and the Pacific Northwest Electric Power Planning and Conservation Act of 1980, 16 U.S.C. 839-839h. Many of the contractual terms for energy exchanges must follow federal law.

- Congress created the BPA primarily to serve the Pacific Northwest, however, whenever the BPA generates sufficient electric energy to satisfy the demand of its primary service area, any electric energy above this amount is defined as surplus. "Surplus energy" is electric energy that would otherwise be wasted due to lack of a market in the Pacific Northwest. BPA may sell such surplus electric energy outside of the Pacific Northwest.

- An energy exchange is a contract that BPA has with a utility that establishes an exchange of energy rather than a direct sale of energy. Exchanges have economic benefits and also have environmental advantages such as allowing for seasonal fish passage needs and lessening the use of air-polluting thermal plants.

- The Pacific Northwest-Pacific Southwest Intertie transmission system was constructed for the purpose of enabling energy exchanges between the Pacific Northwest and other states (particularly, California). Presently, the system has AC and DC lines that carry up to 4,800 MW and 3,100 MW, respectively. The AC line runs from Oregon to Lugo, California, near Los Angeles. The DC lines run from the Oregon, to Sylmar, California (also near Los Angeles).

- By integrating federal, publicly owned non-federal, and privately owned electric utility systems, the intertie permits the exchange of loads and a better utilization of *existing* generating capacity. The system directly and indirectly benefits the customers of many utilities. Benefits derived by the Northwest-Southwest Intertie include: (1) exchange of summer-winter surplus peaking capacity between the northwest and the southwest to reduce capital expenditures for new generating capacity; (2) sale of northwest secondary energy to the southwest; and (3) sale of southwest energy to the northwest to firm peaking hydroelectric sources during critical water years. The intertie also provides a means for conservation of significant amounts

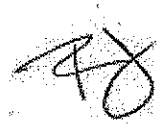
	of power plant fuels by use of the northwest's surplus hydroelectric energy in California, and increased efficiency in the operation of hydro and thermal resources. • The energy exchanges enable the northwest and California to benefit from the complementary characteristics of their respective electricity systems. California's system is principally comprised of base-loaded thermal generation and is less accommodating to large load swings than BPA's principally hydro-based system, which can accommodate rapid load swings. • Energy exchanges make full use of existing resources on both systems. Energy exchanges have the potential for avoiding substantial generation resource development by California utilities with the attendant risks, adverse rate effects on California's consumers, and adverse environmental impacts on Californians including any discriminatory impacts on disadvantaged groups. The sale of surplus capacity to California allows California utilities to defer construction of new thermal resources that they may otherwise need in the absence of exchange agreements. BPA's receipt of energy from California and California's deferral of construction/operation of additional thermal resources preclude potential impacts to air quality, water quality, and other environmental components that could otherwise occur. • Energy exchanges eliminate or reduce the need for peaking resource development by California utilities. Substantial impacts on air quality, global warming, and resource consumption (particularly natural gas) would occur from the [otherwise unnecessary] construction of combustion turbine projects to meet peaking capacity needs. .

II. Conclusion

CMUA respectfully requests the Air Resources Board to consider and incorporate CMUA's recommendations into newly revised Proposed Regulations, including CMUA's proposed alternatives identified above. Furthermore, CMUA requests responses to all Comments included herein, as required by Government Code § 11346.9(a)(3).

Dated: June 25, 2009

Respectfully submitted,



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