Comments of the Western Power Trading Forum to the California Air Resources Board

On Allowance Allocation and use of Auction Revenue

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The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (ARB) on the distribution of allowances and auction revenue under the cap and trade system. Our comments specifically address the electricity sector; we are not providing comment at this time on allocations for other capped sectors.

WPTF has not taken a position on allocation of allowances to first jurisdictional deliverers under the cap and trade program, other than to support a gradual transition to auctioning. However, we have previously expressed our strong concerns about allocation of allowances to load-serving entities due to concern that such an approach would competitively advantage utility-owned resources, and allow the larger utilities to exert market power over the allowance market, concerns that are reiterated in these comments. WPTF understand ARB's interest in mitigating the costs of the cap and trade program to California consumers. However, we agree with the conclusions of the Economic and Allocation Advisory Committee that doing so must be structured in a way that does not compromise competitive energy markets.

More detailed comments on these issues are provided below.

<u>Distribution of allowances</u>

As we understand the ARB staff's proposed approach as outlined at the May 17th workshop, allowances would be freely allocated to electricity retail providers, based on retail sales. Retail providers would then be required to make the allowances received available for sale through a centralized auction, administered by ARB. All electricity generators and other first jurisdictional delivers (FJDs) would not receive a free allocation of allowances, but rather would acquire allowances through auction. The revenue from these auctions would then be returned to retail providers, based on their respective allowance allocation. WPTF understands the rationale for distributing auction revenue to retail providers in order to avoid issues with auction revenues in the State's General Fund. However, there must be careful attention paid to how such a mechanism is set up in order to avoid unintended impact on competitive markets, as described in the following comments:

1. If ARB does decide to distribute allowances to retail providers, then it must ensure that retail providers make *all* allowances received available through auction. For first jurisdictional deliverers, WPTF notes that CARB's proposal is essentially a 100% auction mechanism, rather than the phased in approach recommended by WPTF in earlier comments.

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[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

2. It is absolutely essential that all generators and electricity importers are treated equivalently. Since independently owned generators must acquire allowances through auction, all utility-owned generation must also acquire allowances through auction. Under no circumstances can utilities be permitted to retain allowances to cover emissions of their own assets. We believe this is the intent of the ARB proposal, but it must be explicit in the regulation.

3. The distribution of allowances to retail providers should also be equitable across retail providers. Specifically, it must not discriminate against energy service providers. Again, we belief this is ARB's intent, but wish to see it clarified.

4. ARB should recognize and address the situation of independent generators operating under long-term power purchase agreements that do not anticipate carbon prices. These generators will not be able to pass through and recover carbon costs for power delivered under these contracts.

5. Finally, as noted above, an allocation of allowances to the retail providers who must then auction all the allowances to FJDs is a program that is a 100% auction mechanism for FJDs. WPTF continues to believe that there should be a transition to 100% auction in order to mitigate the cost exposure to the entities that must made emission reduction investments, and to provide time to gain experience with the auctions.

Use of auction revenue by retail providers

In the workshop presentation, ARB staff indicated two potential uses for auction revenue by retail providers: investment in energy efficiency programs, and reduction in consumer rates to alleviate cost impacts of California's 33% Renewable Energy Standard. A third proposal was offered by the 'Joint Utilities Group'[2] seeking discretion to use auction revenue for investment in renewable generating resources, electricity transmission and electric sector research and development, in addition to consumer rate relief and energy efficiency programs.

WPTF strongly opposes allowing investor-owned utilities to use auction revenues for any purpose other than administering direct consumer rate relief applied equivalently to all its customers. In this regard, we support ARB's proposal to authorize use of auction revenue by retail providers for consumer rate relief for all customers in their franchise territory. Use of auction revenue by retail providers for capital investment in energy technologies and infrastructure, including renewable resources, or in service offerings such as energy efficiency or demand response, that are also provided by merchant generators and other independent entities, must be explicitly prohibited by the regulation. Allowing the use of auction revenue for these purposes would erode competitive markets by subsidizing utility-owned generation and transmission at the expense of independent generators and transmission developers. We also note that oversight by the California Public Utilities Commission already ensures cost-recovery and a reasonable rate of return on such investments by investor-owned utilities.

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[2] A coalition of investor-owned and municipal utilities.

On the matter of rate-relief, increases in retail electricity rates are a reasonable outcome of GHG regulation that send an important price signal for end-use efficiency. Therefore, any mechanism that returns auction revenue to consumers should do so in a way that does not discourage consumer energy efficiency. Direct return of revenue through rebate or reductions in other taxes, as recommended by the EAAC, would be preferable and should be implemented as soon as possible. Until then, ARB should ensure that retail providers' use of revenue for rate-relief and energy efficiency retain the carbon price signal to the extent possible.

Use of the auction revenue by retail providers should also be closely monitored. The Boards of the municipal utilities and the California Public Utilities Commission have ultimate authority over utility rate-making, and should also be charged with ensuring that allocated auction revenue is used appropriately and in accordance with the cap and trade regulation. Finally, we note that energy service providers (ESPs) are structured much differently than investor-owned and municipal utilities and do not have the same rate recovery mechanisms available to them. WPTF does not have specific recommendations, but urges ARB to ensure that the different business model that ESPs operate under are afforded the necessary flexibility in designing the mechanisms for distributing auction revenues.

Use of auction revenue for other purpose

ARB staff has proposed two other uses for auction revenue: investment in research and development of low emissions technologies through a California Carbon Trust and funding of mitigation and adaptation programs in disadvantaged communities via a Community Benefit Fund.

WPTF believes that the highest priority for use of auction revenue should be investment in low-emissions technology. Energy technologies to achieve long-term emission reductions do not yet exist and will be critical to reducing the long-term costs of GHG regulation. For this reason, we believe that the goal of achieving emission reduction policies at the lowest possible costs to consumers is better served by dedicating a substantial portion of the auction revenues to development and deployment of GHG control technologies, rather than providing direct or indirect short term rate relief. Both the proposed California Carbon Trust and the Community Benefit Fund may be appropriate mechanisms for deployment of such investment, including potentially for transmission investment as long as it done in a competitively neutral manner.

Moreover, in deploying the auction revenue through either a California Carbon Trust or a Community Benefit Fund, care should be taken to ensure that the programs leverage other resources and climate change programs that may already be in place, especially at the community level, and that they do not duplicate other existing programs.

ARB staff also indicated that they are exploring a mechanism to return allowance revenue directly to consumers in later years of the cap and trade program (e.g. after 2015). WPTF considers such an approach, assuming proper consideration is given to its details, to be preferable to distributing revenue to retail providers. The portion of allowance revenue earmarked for retail providers should be relatively low, decrease over time and be replaced by direct rebate to consumers in later years.