COMMENTS OF TRANSCANADA'S GTN SYSTEM

AND NORTH BAJA SYSTEM

ON

CALIFORNIA AIR RESOURCES BOARD

CLIMATE CHANGE DRAFT SCOPING PLAN

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RE: TransCanada's Comments on Climate Change Draft Scoping Plan

TransCanada's GTN and North Baja Systems ("TransCanada") respectfully submit the following comments on the Climate Change Draft Scoping Plan ("Draft Plan") issued by the California Air Resources Board ("CARB") on June 26, 2008. TransCanada appreciates, and is generally supportive of, CARB's comprehensive and diligent efforts to implement the requirements set forth in Assembly Bill ("AB") 32 to reduce greenhouse gas ("GHG") emissions in the state of California. However, TransCanada has significant concerns about certain components of the Draft Plan, and the following comments address those concerns, as discussed herein.

I. Description and Interest of TransCanada's GTN and North Baja Systems

TransCanada's GTN and North Baja Systems transport Canadian and U.S. natural gas as well as regasified liquefied natural gas ("LNG") sourced from the Energia Costa Azul LNG Terminal in Baja California, Mexico. GTN owns and operates a natural gas pipeline that extends approximately 612 miles from the International Boundary at Kingsgate, British Columbia, to the Oregon-California border, where it interconnects with Tuscarora Gas Transmission Company and Pacific Gas & Electric Company. GTN utilizes this pipeline to provide firm and interruptible transportation service to numerous

shippers serving the Pacific Northwest, California and Nevada markets. GTN also interconnects with facilities of Williams' Northwest Pipeline near Spokane and Palouse, Washington and Stanfield, Oregon. GTN is capable of transporting more than 2,900 MDth/day of natural gas.

The North Baja System is a natural gas pipeline that extends approximately 79.8 miles from an interconnection with the facilities of El Paso Natural Gas Company near Ehrenberg, Arizona, extending through southeast California to a point on the international border between Yuma, Arizona and Mexicali, North Baja Mexico, where the pipeline interconnects with Gasoducto Bajanorte, a Sempra Energy pipeline located within Mexico. The North Baja System is also able to reverse the flow of gas on Gasoducto Bajanorte and the North Baja System (to west-to-east from east-to-west) to transport LNG supplies from the Energia Costa Azul LNG terminal in Baja California, Mexico to Southern California Gas Company's receipt point at Blythe, California as well as into El Paso Natural Gas Company.

As a leader in the natural gas pipeline industry, TransCanada has been actively involved on many levels to address issues surrounding climate change and GHGs, and has been recognized by Dow Jones as one of the best companies for driving global sustainability for seven years in a row. TransCanada has pursued and developed technologies to manage greenhouse gas emissions, including, among others, a Fugitive Emissions Management Program and the development and testing of high strength steels which result in more efficient pipeline operation and a resulting net decrease in fuel usage.

In addition to improving system efficiencies and assessing new processes and technologies, TransCanada also participates in key programs aimed at reducing GHG emissions and improving calculation methodologies. For example, GTN and North Baja have been members of the US Environmental Protection Agency ("EPA") Natural gas STAR Program for many years. In 2006, EPA expanded the successful U.S.-based Natural Gas STAR Program by launching Natural Gas STAR International. TransCanada was one of seven charter partners. As a Partner, TransCanada is working to identify, analyze, promote, and track methane emissions reduction projects from its operations.

Both because of TransCanada's significant involvement generally in GHG issues and because GTN and North Baja deliver gas into California, TransCanada has been closely following the present proceeding. TransCanada has a direct interest in the outcome of CARB's Climate Change Scoping Plan, particularly as the Plan affects providers of natural gas in California, and TransCanada appreciates CARB's consideration of its comments.

I. COMMENTS ON THE PROPOSED SCOPING PLAN

A. CARB Should Not Impose Carbon Fees on Interstate Natural Gas Pipelines.

In addition to numerous recommended measures in the Draft Plan, CARB has proposed several measures that it believes merit continued evaluation and study. One of these proposed measures is the implementation of "carbon fees" in order to incentivize emission reductions. *See* Draft Plan at 41-43. The Draft Plan explains that "[b]y making carbon-intensive fuels and GHG-intensive products relatively expensive compared to

low-carbon fuels and low-GHG products, carbon fees can affect consumption and investment within the economy and reduce GHG emissions." Draft Plan at 41. The Draft Plan further notes that carbon fees may also provide a source of revenue to fund other GHG-reduction measures. In the Draft Plan, CARB states that it is considering imposing carbon fees on upstream interstate natural gas pipelines and processing plants, as well as at emission sources. Draft Plan at 42 ("The fees would be levied on all natural gas processing plants, the state's seven interstate natural gas pipelines, and pipelines from Mexico.").

TransCanada strongly opposes any imposition of carbon fees directly on natural gas pipelines. Rather, if California ultimately adopts carbon fees on natural gas, such fees should be assessed on local distribution companies ("LDCs") within California. Policy, legal and practical considerations all support a finding that CARB should not (and, in fact, may not) levy a carbon fee directly on interstate natural gas pipelines. First, under California and federal law, CARB does not have legal authority to levy a carbon tax directly on upstream interstate natural gas pipelines. Second, even if CARB had such authority, there are numerous policy and practical considerations that weigh against this course of action. TransCanada also believes that the Draft Plan lacks sufficient detail with respect to how carbon fees would be implemented, and there are numerous issues to be resolved before any such fees could be imposed. For example, it is unclear how any carbon fee would be integrated with the proposed cap-and-trade program; whether CARB intends the pipelines to absorb the carbon fees or to be permitted to pass-through any carbon fees and, if so, how such pass-through would be accomplished; whether the fee

would be a per unit fee or a discountable fee; and whether it even makes sense to attach a carbon tax to natural gas if there are not sufficient viable, less-polluting alternatives.

Legal Considerations

CARB does not have legal authority to levy carbon fees on interstate gas pipelines. As El Paso explained in its comments, CARB's fee authority under AB 32 is limited to imposing fees to covering the administrative costs for implementing AB 32 itself. *See* El Paso's Comments, at 14-15.[1] Thus, even under California law, CARB does not have the authority to levy a broad-based fee on interstate pipelines, especially where such a fee might constitute a new tax. *Id.* at 15-16.

Importantly, TransCanada also believes that CARB would be prohibited from levying carbon fees on interstate pipelines under the Commerce Clause of the United States Constitution. While the Draft Plan is somewhat vague on its carbon fee proposal, it appears that it does not intend to impose carbon fees on *intrastate* pipelines, but rather only on *interstate* pipelines. *See* Draft Plan, at 42 (noting that the fees will be assessed "on all natural gas processing plants, the state's seven interstate natural gas pipelines, and pipelines from Mexico). The dormant commerce clause prohibits States from improperly interfering with interstate commerce, and a state may violate the Commerce Clause either by imposing an undue burden on both out-of-state and local producers engaged in interstate activities or by treating out-of-state producers less favorably than local competitors. Thus, if California imposes a carbon fee on interstate pipelines that does not apply to intrastate pipelines, it is likely to be held to violate the Commerce Clause. *See*

[1] For brevity's sake, TransCanada incorporates El Paso's comments on carbon fees by reference, rather than repeat all of its arguments. TransCanada's comments are meant to supplement those of El Paso.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 270 (1977); *see also* El Paso's Comments, at 15-16.

Policy and Practical Considerations

Even if CARB could overcome the legal hurdles, numerous policy and practical considerations also weigh against levying a carbon fee directly on interstate pipelines. Although it is not clear that any carbon tax on natural gas is advisable at this time, it is clear that any such carbon fee absolutely should not be imposed on upstream natural gas interstate pipelines.

Initially, the imposition of carbon fees on natural gas at all is likely not currently advisable. TransCanada agrees with El Paso and the California Public Utilities Commission that without a viable less-polluting substitution for natural gas, the imposition of a carbon tax would likely have the effect of increasing the cost of natural gas without a corresponding environmental benefit. That is, the pass through of carbon fees on natural gas would increase the price of natural gas to the end-user; however, these end-users will have to continue paying higher prices for natural gas – or turn to higher emitting sources of energy – if there are not sufficient less-polluting alternatives available. It does not make sense to implement a carbon fee prior to securing the availability and of these more efficient and less GHG-intensive products at a reasonable price. At the very least, CARB should explore in greater detail whether a carbon fee on natural gas is advisable at this time.

Even if CARB ultimately concludes that a carbon tax is generally advisable, there are other policy considerations that reveal why it should not assess such a fee directly on interstate pipelines. Imposing a discountable carbon fee, for example, would result in the

fees not applying to a significant amount of pipeline throughput, which currently moves at discounted rates. More importantly, however, imposing a non-discountable carbon fee directly on interstate pipelines would economically disadvantage certain natural gas interstate pipelines relative to others.

The goal of a carbon fee is to encourage the use of fuels that emit fewer GHGs through the use of economic incentives – that is, all else being equal, fuels sources that emit more carbon will cost more than those that emit less carbon. *See* Draft Plan at C-181 ("By making carbon-intensive products relatively more expensive compared to lower-carbon products, carbon fees are designed to drive consumption and investment toward more efficient and less GHG-intensive products."). The goal of a carbon fee, however, is **not** to economically disadvantage certain transporters of a particular commodity. As described below, a non-discountable carbon fee imposed directly on pipelines would have exactly that effect, and is therefore inadvisable from a policy perspective.

Because natural gas pipelines typically charge different rates based in large part on market conditions (*i.e.*, discounted rates), a flat carbon fee on pipelines delivering to California will have vastly different effects on each of the pipelines. For example, market conditions may allow one pipeline at times to charge only two cents per dekatherm ("Dth") for transporting natural gas on a short or long-term basis, while another pipeline – with access to natural gas from a competing supply basin – can charge the maximum allowable rate on its pipeline, resulting in a greater recovery of fixed costs relative to the pipeline that is required to discount. If both of those pipelines are charged the same non-discountable carbon fee – *e.g.*, two cents per Dth – the first pipeline will be

economically disadvantaged because the two cents it is able to charge for transportation service would only cover the carbon fee. Under this hypothetical scenario, the first pipeline would not even transport natural gas because after paying the carbon fee, there would be nothing left to cover the pipeline's fixed or variable transportation costs. The second pipeline, however, may be able to pay the carbon fee without affecting its recovery of costs.

This hypothetical demonstrates that a non-discountable carbon fee imposed "upstream" will have the effect of stifling competition into California and unfairly disadvantaging certain pipelines that transport the same fuel sources with the same level of carbon emissions as other pipelines. This is not what the legislature intended when it enacted AB 32. Thus, if a carbon fee is imposed, it should be levied elsewhere, such as on LDCs, in order to create the proper incentives for end-users. The primary purpose of carbon fees is to affect consumer demand. Imposing a carbon fee on upstream pipelines would not be an effective way to affect end-use consumption decisions. Rather, the closer the point of regulation is to the point of combustion (i.e., at the LDC level), the more likely it is that the cost of using carbon-based fuels will be transparent to the end user and affect consumer demand.

In sum, carbon fees imposed at the LDC level would affect consumption decisions, which is consistent with the intent of imposing the fees in the first place. Imposing non-discountable carbon fees on pipeline transporters would have negative financial consequences for pipelines that provide discounted transportation service and would likely result in a reduction in overall supply to the market in instances where assessment of a carbon fee restricted pipeline cost recovery. Furthermore, to the extent that carbon

fees imposed on pipelines were discountable, discounting of the fees would likely be commonplace, therefore rendering the fees ineffective.

As alluded to above, another issue with CARB's proposal is how the pipelines would recover carbon fees through rates. Interstate gas pipelines are regulated by the FERC, and a pipeline must file all rates and terms of service with FERC. Thus, questions are raised regarding the imposition by California of carbon fees directly on FERC-regulated interstate pipelines. For example, some pipeline contracts may not allow the pipeline to seek an increase in its rates, and some companies are barred from seeking rate increases at FERC for a certain number of years. At the very least, the regulatory process is complex, and CARB has not explained the interaction between FERC regulation of interstate pipeline rates and any imposition of carbon fees on interstate pipelines.

Finally, it is not clear from the Draft Plan whether and how the proposed cap-and-trade program would be integrated with the proposed carbon fees. Interstate natural gas pipelines rely on combustion from compressors to move natural gas. This combustion is covered under Western Climate Initiative's most recent cap-and-trade draft design.[2] Therefore, it is unclear whether CARB is proposing that interstate pipelines would be subject to both the cap-and-trade program ***and*** carbon fees in order to deliver natural gas into California. TransCanada believes that if CARB does intend to implement both of these, it would significantly raise the price of natural gas to California and harm the California economy.

B. Cap-and-Trade Program

[2] Western Climate Initiative's September 23, 2008 "Design Recommendations for the WCI Regional Cap-and-Trade Program" covers emissions from combustion at industrial and commercial facilities.

The Draft Plan proposes to "[i]mplement a broad-based cap-and-trade program that links with other Western Climate Initiative Partner programs to create a regional market system." Draft Plan at 15. Although TransCanada does not oppose the concept of a cap-and-trade program, it supports a single national program implemented by the federal government. Notably, on July 30, 2008, the Environmental Protection Agency ("EPA") issued a lengthy Advance Notice of Proposed Rulemaking ("ANOPR")[3] to seek public comment on over 100 topics concerning the regulation of GHGs under the Clean Air Act. One of the multiple topics covered in the ANOPR is whether the EPA or, alternatively, Congress should implement a national cap-and-trade program. *See* ANOPR at 76. ("A number of bills [in Congress] call for reducing GHG emissions from a wide variety of sources using a 'cap-and-trade' approach). If California and the Western Climate Initiative Partners decide to implement a cap-and-trade program, they should take into account that a national program may be forthcoming. TransCanada also supports El Paso's comments on this issue, and for brevity incorporates those comments by reference. *See* El Paso's Comments, at 2-3 and Attachment 2, at 3-9.

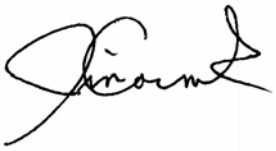
CONCLUSION

TransCanada appreciates the opportunity to provide comments on CARB's Draft Plan. As detailed above, TransCanada strongly opposes any assessment of a carbon fee/tax on upstream interstate pipelines, and TransCanada does not believe that CARB has the authority to impose any such fees. Moreover, TransCanada believes that CARB should reconsider whether the idea of imposing carbon fees on natural gas is advisable at this time.

[3] *Regulating Greenhouse Gas Emissions under the Clean Air Act*, 73 Fed. Reg. 44353 (2008).

Respectfully submitted,

TRANSCANADA'S GTN AND NORTH BAJA SYSTEMS



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