BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions.	R.11-03-012

COMMENTS OF THE CALIFORNIA LARGE ENERGY CONSUMERS ASSOCIATION REGARDING IMPLEMENTATION OF SENATE BILL 1018 IN THE ALLOCATION OF GREENHOUSE GAS ALLOWANCE REVENUES

Evelyn Kahl
Katy Rosenberg
Alcantar & Kahl LLP
33 New Montgomery Street
Suite 1850
San Francisco, CA 94105
415.421.4143 office
415.989.1263 fax
ek@a-klaw.com
klr@a-klaw.com

Counsel to the
California Large Energy Consumers
Association

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Pursuant to the July 11, 2012 Administrative Law Judges' ruling, the California Large Energy Consumers Association (CLECA) submits these comments regarding implementation of Senate Bill 1018 in the allocation of revenues received by the investor owned utilities from the auction of greenhouse gas (GHG) allowances provided by the California Air Resources Board (CARB).

I. INTRODUCTION

Public Utilities Code §748.5(a), enacted by Senate Bill 1018, directs the Commission to ensure that GHG auction revenues received by the utilities are returned to residential, small business and emissions-intensive, trade-exposed retail customers. While the Ruling seeks comments only on the definition of "small business" under the statute, other terms would equally benefit from clarification. CLECA seeks in these comments clarification of the terms "emissions-intensive" and "trade-exposed" as they will be implemented in this proceeding. These terms should be interpreted broadly in support of the Assembly Bill 32 goal of minimizing leakage[1] and to prevent market distortions.

The interpretation of these terms should rest on CARB's explanation of "emissions intensity" and "trade exposure."[2] These terms unambiguously include energy-intensive, trade-exposed customers designated as "Industrial Covered Entities" by CARB. "Emissions-intensive" customers should include customers whose indirect emissions resulting from their purchase and use of electricity cause their manufacturing processes to be "emissions-intensive." "Trade-exposed" customers should include customers who could exacerbate the trade-exposure of "Industrial Covered Entities" as designated by CARB, as well as customers who are otherwise trade exposed as a result of GHG costs in their electricity rates. All of these customers should be entitled to mitigation of their *indirect* GHG costs reflected in utility rates through a credit of utility GHG allowance auction revenues.

II. "EMISSIONS-INTENSIVE" AND "TRADE-EXPOSED" SHOULD BE BROADLY CONSTRUED TO MINIMIZE LEAKAGE AND PREVENT MARKET DISTORTION

Section §748.5(a) directs the Commission to credit all revenue not spent for clean energy and energy efficiency projects under subpart (c)[3] directly to "*residential, small business, and emissions-intensive trade-exposed retail customers of the electrical corporation*." The meaning of "emissions-intensive, trade-exposed" is undefined and

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[1] As enacted by AB 32: Cal. Health & Safety §385262(b)(8).

[2] California Air Resources Board, California's Cap-and-Trade Program Final Statement of Reasons (FSOR), October 2011, p. 276.

[3] Under the terms of SB 1018 "the commission may allocate up to 15 percent of the revenues" to clean energy and energy efficiency projects. Cal. Pub. Util. §748.5(c).

requires clarification. CLECA recommends a broad interpretation of the term to minimize leakage.

The term "*emissions*-intensive, trade-exposed" is not defined in SB 1018, nor is it defined in AB 32. The Legislature thus has left the term open to interpretation. While the most logical place to turn for interpretation is CARB's Cap-and-Trade (C-T) regulations, the term is not expressly defined in the regulations. Neither does the regulation define the more commonly used term "*energy*-intensive, trade-exposed" (EITE). In addressing leakage for industries that are informally referred to as "EITE" industries, the C-T regulations use the term "*listed industrial sector[s]*" defined as "*covered industrial sectors that are eligible for industry assistance as specified in Table 8-1*."[4] CARB also refers to these entities as "Industrial Covered Entities."[5] The CARB Final Statement of Reasons (FSOR) for the C-T regulations uses "emissions-intensive, trade-exposed" as well as "energy-intensive, trade-exposed", but specifically defines neither.[6] Without direction from the Legislature and CARB, it falls to the Commission in this rulemaking to establish which customers fall within the meaning of this term.

A. The Commission's Interpretation of "Emissions-Intensive" Should Include Customers with Either "Direct" or "Indirect" Emissions Intensity

The FSOR provides a framework for interpreting the meaning of "emissions-intensive." It defines "emissions intensity" as a "*measure of the impact that carbon pricing will have relative to a sector's economic output*."[7] The meaning of "emissions-

4 Cal. Health & Safety §95802(a)(155).
5 Cal. Health & Safety §95870(e).
6 *See* California Air Resources Board, California's Cap-and-Trade Program Final Statement of Reasons, October 2011.
7 *Id.*, p. 276.

intensive" in SB 1018 should be interpreted using these definitions in light of the underlying goals of greenhouse gas regulation.

CARB's C-T regulations recognize that emissions intensive entities -- entities with relatively higher emissions per product produced -- will bear more of the economic impact of increased greenhouse gas regulation. These regulations thus make emissions-intensive entities eligible for GHG cost mitigation. Entities designated by CARB as "Industrial Covered Entities," which are "*direct*" emissions intensive and trade-exposed, will receive mitigation of their direct GHG costs under §95870 of the C-T regulations. These entities also unambiguously fall within the definition of "emissions-intensive, trade-exposed" under §748.5, and they are entitled to an allocation of utility allowance revenues pursuant to §748.5(a) to cover their direct GHG emissions costs. The definition of "emissions intensive" should not stop, however, with direct GHG emissions. "Emissions-intensive" entities eligible for GHG cost mitigation should also include customers that are "*indirect*" emissions intensive due to the significant use of electricity in their production processes. These customers, like "Industrial Covered Entities," should be eligible for an allocation of utility allowance auction revenues.

Addressing customers with indirect emissions intensity in this proceeding is consistent with CARB's C-T framework. In establishing a framework for allowance allocation to Industrial Covered Entities, CARB looked at the direct emissions of the sectors, as only direct emissions give rise directly to a C-T compliance obligation.[8] CARB's development of the framework for "Industrial Covered Entities" did not, however, focus on indirect emissions from electricity use.[9] In fact, CARB anticipated

[8] *Id.*, p. 1303.
[9] *See, e.g.,* FSOR at 255, 263.

that the Commission would address this issue in allocating auction revenues from the allowances granted to the investor-owned utilities.[10]

> *We do not believe it is necessary to add provisions to the regulation to include indirect emissions associated with electricity at this time....In the program framework, an adjustment factor was not made for power…. It is ARB's goal to see a carbon price properly embedded in all utility rates. If and when this occurs, the compensation for these indirect carbon costs could be incorporated into the product benchmarks (or reductions in these costs created in some other fashion) to help minimize leakage. We will revisit this issue once the California Public Utilities Commission Proceeding addressing utility costs and revenue issues associated with greenhouse gas emissions concludes*.

Accordingly, in interpreting "emissions-intensive," the Commission includes not only "Industrial Covered Entities, but must look beyond direct emissions to indirect emissions from the use of electricity. After all, the free allowances to be provided to the electricity corporations that provide the revenue that this statute seeks to allocate are directly related to the indirect emissions associated with electricity consumption. Entities that are "indirect" emissions intensive should be subsumed within the scope of those customers to whom the Legislature has directed the Commission to credit auction revenues.

B. The Commission's Interpretation of "Trade-Exposed" Should Include Customers Whose Responsibility for GHG Costs Will Exacerbate the Trade Exposure of "Industrial Covered Entities" or Who Are Trade Exposed as a Result of their Indirect Emissions Costs

While SB 1018 does not define "trade-exposed," the Commission may also look to the FSOR to inform its interpretation of this term. The FSOR defines trade exposure as "*a measure of a sector's ability to pass through a cost*."[11] The more trade exposed a

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10 *Id.,* at 255.
11 *Id.*, p. 276.

sector is, the less it is able to pass through costs to customers without losing business. In addition to defining the limits of emissions intensity, the rulemaking must also determine the meaning of “trade-exposed,” recognizing trade exposure caused not only by direct GHG costs, but also by indirect GHG costs.

CLECA proposes that the Commission establish a procedure by which it can determine which customers fall within the definition of “trade-exposed” under §748.5. Any ”Industrial Covered Entity” designated by CARB as trade-exposed must be automatically included as “trade-exposed” under SB 1018; any entity within a sector identified in Table 8-1 of the CARB regulations should receive an allocation of utility allowance revenue to mitigate GHG cost increases.[12] The Commission should also establish a “safe harbor,” which would provide that any entity that sells a significant portion of its output to “Industrial Covered Entities” would automatically be categorized as trade exposed. If a customer does not fall into either of these categories, the Commission could still receive evidence of trade exposure resulting from indirect emissions cost exposure on a sector-by-sector basis.

If GHG costs in electricity rates are not addressed by the Commission, both direct and indirect emissions-intensive, trade exposed entities would be harmed. Industrial leakage occurs when an entity or customer chooses to leave California, taking its business elsewhere, increasing greenhouse gasses overall.[13] Moreover, if a customer that that falls into the “indirect” category experiences increased GHG costs and passes them on initially, there will be leakage consequences when these costs are passed through to CARB-designated “Industrial Covered Entity” customers.

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[12] 17 CCR §95870, Table 8-1 Industry Assistance.
[13] FSOR, p. 276.

A simple example can be found in a refined products pipeline company. A pipeline company will typically rely on electricity purchases from a utility to meet its energy needs. The cost of electricity thus becomes a direct cost of service for transportation of refined products. If electricity rates increase due to GHG costs, those increases will be passed on to the pipeline's customers; in this case, the customers would be petroleum refineries, which CARB has designated as trade exposed "Industrial Covered Entities." Failing to mitigate the pipeline company's "indirect" emissions costs will exacerbate trade exposure.

A similar example can be found in an industrial gases company. An industrial gases company will typically rely on electricity purchases from a utility to meet its energy needs in producing oxygen or nitrogen for industrial use. The cost of electricity thus becomes a direct cost of service for these products. If electricity rates increase due to GHG costs, those increases will be passed on to the industrial gases company's customers. If, for example, the customer is a steel producer who uses oxygen in its process, the steel producer – again a CARB-designated "Industrial Covered Entity" – will ultimately bear the GHG costs. Failing to mitigate the indirect GHG costs will aggravate trade exposure.

Because CARB's focus in analyzing trade exposure was on direct emissions costs, it is up to this Commission to address the impact of indirect emissions on trade exposure. A failure by this Commission to address obvious downstream impacts of electricity rate increases from GHG costs, like those identified above, would exacerbate the risk of leakage, contrary to the goals of AB 32.

C. Ignoring Indirect Emissions in Statutory Interpretation Would Lead to Market Distortions

Failing to take indirect emissions into account in defining “emissions-intensive” and “trade-exposed” could lead to market distortions. The Commission has the opportunity to prevent these market distortions.

An example can be found, again, in the industrial gases industry. An industrial gases company manufacturers a number of industrial gases, including oxygen, nitrogen and hydrogen. Hydrogen production, which has a direct emissions intensive production process, has been designated as an “Industrial Covered Entity.” Oxygen and nitrogen production relies on grid electricity and thus is indirect emissions intensive. Because these processes are not direct emissions intensive, they have not been designated as “Industrial Covered Entities” by CARB. Consequently, under a narrow interpretation of “emissions-intensive,” they would not qualify to receive an allocation of utility allowance auction revenues. Basing qualification for compensation on only the direct emissions portion of the business, without consideration of the indirect GHG cost exposure, could lead to inefficient results and unintended consequences.

If a steel producer relies on oxygen in its process, it likely purchases the product from an industrial gases company, which gains efficiency from the scope and scale of its operations. Unless the Commission acts in this proceeding, the production of oxygen would fully bear the cost of GHG in its electricity rates. The steel factory would be encouraged to manufacture its own supply of oxygen in order to avoid these additional indirect costs, since it would presumptively qualify for auction revenues due to its designation as an “Industrial Covered Entity”. Under this scenario, while the steel factory would have net lower costs, not only would the supply market be harmed, but in fact emissions would actually increase overall as production efficiency is lost in the manufacturing of industrial gases at a small scale. There is extensive evidence that the current business model of multi-product, large scale production of industrial gases by industrial gases companies is the most energy and emissions efficient resulting in lower costs overall.

The Commission has the opportunity to prevent these and other market distortions resulting from the C-T program. It should, accordingly, broadly interpret "emissions-intensive" and "trade-exposed" as used in § 748.5.

III. CONCLUSION

For all of the foregoing reasons, CLECA requests that the Commission adopt an inclusive definition of emissions-intensive, and adopt a process by which entities can demonstrate they are trade exposed. These measures would address the market leakage concerns discussed in these comments and further promote AB 32 goals.

Respectfully submitted,

Evelyn Kahl

Evelyn Kahl
Katy Rosenberg

Counsel to the
California Large Energy Consumers
Association

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