BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	Rulemaking 06-04-009 (Filed April 13, 2006)

RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT

I. INTRODUCTION

Pursuant to the July 19, 2007 "Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report and Notice of En Banc Hearing (July 19 Ruling), the Division of Ratepayer Advocates (DRA) submits the following comments and legal arguments. The July 19 Ruling contained 53 questions about the "first seller-approach" in the June 30, 2007 Market Advisory Committee (MAC) Report. The first seller approach would be an alternate way for the California Air Resource Board (CARB) to require compliance with reporting and regulation to implement Assembly Bill (AB) 32, the California Global Warming Solutions Act of 2006.

DRA appreciates the opportunity to assess the merits of the MAC Report's recommended first-seller approach as an alternative to developing a load-based point of regulation to fulfill the mandates of AB 32. It is difficult at this time to completely ascertain the potentially far-reaching impacts of adopting the first-seller approach in terms of its influence on the policy objectives of California and neighboring states. The July 19 ruling helps to define the broad parameters of this complex policy discussion by raising numerous relevant but challenging questions. Some proponents of this alternative

have already provided comments on the record in support of the first-seller approach that unfortunately fail to fully weigh its costs and benefits. Delving further into the tradeoffs that arise in a comparison of the first seller approach to a load-based approach reveals a host of issues that may unfortunately raise more questions than they answer at this time.

DRA hopes the current comment and reply comment cycle followed by the en banc hearing August 21 will provides the opportunity to better weigh the trade-offs s between a load-based versus first-seller regulatory structure applicable to GHG emissions. DRA's initial take on the first-seller approach is that under many conditions it will probably lead to more market efficiency and lower transactions costs for load serving entities (LSEs). For imports, there will be conditions under which leakage and contract shuffling may occur under either system. Any system that is adopted will change the incentives of market players and regulated entities. DRA recommends that the Energy Division's consultant in collaboration with the California Energy Commission, the California Independent Scheduling Organization (CAISO), academic researchers and parties undertake some level of assessment of how changed incentives might affect market behavior and hence outcomes to further develop the record.

California has seen the consequences of diving into regulatory regimes inadequate analysis and assessment of possible outcomes.[1] Most recently, California has carefully scrutinized the recommendations for the Market Redesign and Technology Upgrade (MRTU) and Congestion Revenue Requirements (CRR), and has similarly weighed the consequences of moving too quickly into central capacity markets for resource adequacy, instead allowing the evolution of the bilateral market coupled with strong regulatory requirements.

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[1] AB 32 sets legislative milestones and deadlines as did AB1890. At practically the 11th hour the start dates of the ISO and PX under AB 1890 were delayed only a few months, whereas many observers believed that another year of study, development, testing, and implementation would be prudent.

DRA supports a regulatory approach that satisfies the objectives of AB 32 and maximizes benefits and minimizes costs to ratepayers. It is admittedly difficult to assess precisely what cost means when comparing a load-based system versus the first seller approach, particularly given the many competing interests in this proceeding. DRA provides the following initial observations and recommendations:

- Regardless of the regulatory approach adopted by the Commission, the CAISO will have many technical and legal obstacles to accommodate the implementation of an emissions tracking and reporting protocol. The Commission should convene a separate workshop to address the impact of a first-seller approach or load-based approach on the development and implementation of the Integrated Forward Market (IFM), the impact on the real-time market, incentives on generators to submit adjustment bids and to provide ancillary services, and the cost of reliability.
- Neither the first-seller approach nor a load-based approach ameliorate potential leakage and contract shuffling issues that arise through electricity imports. Each approach creates different incentives toward leakage and shuffling, and these incentives should be specifically considered in the context of whatever approach is adopted.
- The first-seller approach raises potential legal issues that should be carefully weighed to ensure that CARB's regulations do not run afoul of the Federal Power Act and the dormant Commerce Clause.

II. DISCUSSION

1. Is the above description of this deliverer/first-seller approach accurate? Comment on whether you agree with this description, and if not, explain how the first-seller approach should be described differently and why.

DRA's understanding of the first-seller approach is that for electricity deliveries that originate and terminate within California, the first seller is the generator. The generator would be point of regulation responsible for reporting its emissions to ARB and

obtaining allowances to cover those emissions. This source-based system within California comports with the current scheme of stationary source regulation for existing pollutants.

The first seller for imports from out-of-state would be the importer that first takes title to the power that is ultimately to be delivered to a California LSE. There are conditions under which title can be taken outside California, e.g. balancing authority that crosses state lines, or remote generators such as the Intermountain Power Project which may be radially connected to LADWP's control area and effectively be an intra-control area import. Under any circumstance, the importing/first seller/title holder is the responsible reporting entity, and would report emissions to ARB and obtain allowances to cover those emissions

2. For imports, who has ownership of electricity when it enters California? Is the "Purchasing/Selling Entity" (on the North American Electric Reliability Corporation (NERC) E-tag) listed at the first Point of Delivery in California the deliverer/first seller? If this is generally the case, are there any exceptions?

Several different entities may actually have title to imports at the first point of delivery: LSEs, generators, marketers, balancing authorities (who may be purchasing for themselves as the ISO may do or acting as an agent for an LSE). As DRA understands NERC/WECC standards, a Purchasing/Selling Entity (PSE) originates an E-tag. As DRA understands the proposals of the first seller proponents, the first entity talking title to an import has the best "line of sight" to the origin of the power and is the point of regulation. It is uncertain that entity is always a PSE.

Power brokers, for example, do not take title to power and thus may not be the appropriate reporting first seller. On the other hand, while DRA understand that brokers may be scheduling coordinators in the CAISO's markets, it is not at all certain that they can be PSEs, or act as PSEs.

3. Are there any inter-Balancing Authority imports not accounted for by E-tags? If so, describe these instances and explain how these imports can be accounted for.

The only circumstance of which DRA is aware is the Los Angeles Department of Water and Power (LADWP) control area (LADWP is its own balancing authority) and the physical configuration of transmission from the Intermountain Power Plant (IPP)units in Utah wherein IPP "imports" do not require an E-tag (interchange schedule). This does not represent a problem with LADWP reporting as the first seller, however. LADWP is a part owner of IPP and would report as if this unit were intra-state and regulated as a source. The only absent piece of data would be the E-Tag.

4. What agency could/would identify importing contractual parties? Is there already a state or federal official compilation of these market participants?

The Commission could identify "importing contractural parties" for LSEs under its jurisdiction by examining contracts. Data about other contractual parties could be compiled from FERC and CAISO sources.

5. Could the deliverer/first-seller be identified by means other than the NERC E-tag? If so, please explain.

Where an LSE has a bilateral contract with an out-of-state entity that is unit contingent, plant specific, system, or supply that may be provided under a liquidated damages contract, the LSE can easily be identified as the first seller. Of course, this identification becomes more difficult when a marketer or generator is the first seller and in these cases, E-tags can be a valuable method of added documentation to transactions that would be reported to ARB. .

6. How would a deliverer/first-seller system deal with power marketers and brokers?

See references above in DRA's answers to question 2.

7. How would treatment of imports differ in a deliverer/first-seller system compared to a load-based approach?

Under the first seller approach, the first seller is responsible for obtaining allowances for emissions associated with imports, and would be the reporting entity to

state authorities. Under the load-based approach the LSEs taking ultimate delivery of imported power are the entities responsible for obtaining allowances for the emissions of the import and would be entity responsible for reporting as well.

8. To sum up your answers to the previous questions, provide a succinct but complete definition that identifies, for each way in which electricity could be delivered to the California grid, the entities that would be responsible for compliance with AB 32 regulations under a deliverer/first-seller approach.

The first seller, defined as the importing entity first taking title to electricity is the responsible entity for compliance with AB 32. Such entities include LSEs, marketers, generators, the CAISO, any other balancing authority that buys power that is not directly acting as an agent for a member LSE, but is bought for balancing authority needs and the costs are allocated.

A. General Policy Issues

9. Compare and contrast the environmental integrity of a deliverer/first-seller and a load-based approach. How would a deliverer/first-seller approach address leakage? How would a deliverer/first-seller approach address contract shuffling?[2]

The MAC report notes that the tracking and accounting of emissions would be less precise under a load-based system. A load-based system would assign emission responsibility and reporting to LSEs. For intra-state transactions, this would be fairly accurate except for system sales and other unspecified energy. For imports, except for transactions under unit and/or plant specific contracts, emission values would need to be assigned based on estimates.

[2] In AB32, leakage is defined as "a reduction in emissions of greenhouse gases within the state that is offset by an increase in emissions of greenhouse gases outside the state." In contrast, contract shuffling refers to an accounting reallocation of a fixed quantity of GHG emissions (for example, total emissions over one year) in which emission reductions reported by one party in a capped system are achieved through the attribution of emissions to an entity outside the capped system. In the case of contract shuffling, total emissions may not increase, but they also would not decrease, as required by AB 32.

Under a 1st seller regime, more accurate stack-based emission measurements would be available due to reporting requirements for the Acid Rain Program and for in-state (and in air basin) requirements for other stationary source pollutants (i.e., NOx, particulates, and so on). This measurement advantage applies only to the in-state generator portion of emissions.

For imports under first seller, the first "importer" is responsible for emissions and reporting. Just as in the load based approach, some estimate of emission rates would need to be applied for unspecified imports and sales that are pooled in the CAISO markets.

One way leakage can occur under a source-based/first seller approach in-state is if relatively dirty existing in-state generation were to shut down or reduce production, and relocate or increase production out-of-state to take advantage of estimated emission rates on imports that will make the import look cleaner than if had been in-state where emission are directly measured. Simultaneously, in-state buyers of energy could shift purchases to dirtier and cheaper out-of-state sources.

A load-based approach, on the other hand, minimizes leakage by regulating electricity imports in the same way as in-state generation. However, a load-based approach is susceptible to contract shuffling when exporting states do not have GHG emission regulations in effect. In the absence of empirical data, it is difficult to predict whether the emissions associated with leakage is more or less than the emissions associated with contract shuffling.

Given that in-state generators supply about 68-78%[3] of the California electricity load, the opportunity for contract shuffling may be considerably less under the first-seller approach than that under the load-based approach. Under a load-based approach, in-state generators with high GHG emissions can continue to operate without emission permits by

[3] According to the May 2007 CEC Staff Paper "Revised Methodology to Estimate the Generation Resource Mix of California Electricity Imports", approximately 22 to 32 percent of electricity consumed in California is generated out-of-state with about one-quarter coming from the Northwest and three-quarters coming from the Southwest.

exporting their electricity output to states without GHG regulations. In contrast, under a first-seller approach, in-state generators are required to comply with emission regulations by obtaining emission allowances.

10. Would the scale of possible emissions leakage or contract shuffling differ under the deliverer/first-seller approach compared to a load-based approach?

See response to Question 9. These are key empirical questions that need further exploration, as discussed above. The consequences of significant leakage and/or contract shuffling is that a net reduction in emissions in the western interconnection may not occur, thus undermining the goal of AB 32 yet at the same time, increasing power costs for California ratepayers.

11. Is there any advantage to applying the deliverer/first-seller approach to reporting only, while having the retail providers be the point of regulation (as with load-based)? Why or why not?

When compared to a load-based approach, an approach that requires first-sellers to report to CARB, but leaves retail providers as point of regulation for obtaining allowances adds an extra layer of administrative burden of reporting with no obvious economic or benefits.

There would be an increase in administrative costs. (See response to Questions 13-14 for discussion of economic advantages.)

Given these disadvantages, there appears to be no reason to adopt this approach.

12. Compare and contrast the deliverer/first-seller and load-based approaches in terms of their impacts on electricity prices, costs, and reliability for consumers.

Retail **prices**: Theoretically, the net impact on retail electricity prices may be the same as between the two approaches. But, this is theoretically because as DRA stated above, incentives for market participants are going to change and be different depending on the regulatory regime. Also, transactions costs are going to differ between the approaches which ultimately could affect retail prices.

Reliability: With respect to reliability, there should be no difference between the approaches. California's Resource Adequacy (RA) requirements will be in place regardless of approach and be fully enforceable by the Commission and the CAISO. Given the Commission's requirements over LSEs and the CAISO's over generators (including must-offer or its replacement) regulators have to tolls to ensure resource adequacy. Moreover, the CAISO is currently contemplating an additional layer of insurance through an additional backstop procurement mechanism.

With regard to LSEs not under Commission and CAISO requirements, the CEC reviews their resource plans and planning reserve margins and has some degree of regulation over RA.

Under any regime, all entities are subject to NERC's and WECC's mandatory reliability standards including operating reserve requirements.

The cost of reliability is a separate issue and DRA discusses below how the cost of reliability could be higher under a load-based approach.

Transactions costs: At least for some time, DRA believes that transactions costs would be greater under the load-based approach in comparison with first seller. Under first seller with a source-based emissions cap in-state, generators will be responsible for covering their emissions and reporting directly to ARB. This added layer simply supplements reporting the genitors already do for a variety of pollutants. Many generators already engage in the permit markets as well, e.g., RECLAIM in the SCAQMD, and thus have experience with permit acquisition and trading.

LSEs, on the other hand, will take on a significant additional cost in reporting under the load-based cap and perhaps more importantly be responsible for emissions from sources they buy energy from which will include acquiring the permits and engaging in the permit market as a corollary activity to the energy market. Thus, in contrast to the first seller approach where emission costs will be incorporated (internalized) in energy transactions such that the LSE (or CAISO) will see the full cost of what it buys, under the load based approach the LSE buys energy and permits in separate markets, the latter being a new activity for LSEs and the market separation

certain to add to transactions costs. Emissions/permit transactions under the load-based system are financial whereas they are direct under the source-based in-state system under first seller.

13. Would a deliverer/first-seller approach and a load-based approach have different impacts on wholesale power prices? Which would result in higher prices? Why? Is this good or bad?

A first-seller approach would likely result in an increase of wholesale power price that internalizes the cost of emissions. This has several positive consequences: (i) generators are motivated to invest in and deploy low-cost technologies to reduce emissions; (ii) LSEs in bilateral contracts will see the cost of emissions reflected in the contract prices and not have to engage in a separate permit market. (This would be the same for an inter-state bilateral contract that is unit or plant specific). (iii) sellers bidding into the CAISO (IFM and real-time) will have internalized their emissions costs such that the market clearing prices in these markets will reflect the marginal cost of emissions. In the IFM this means there is an initial feasible and least cost dispatch, or when the ISO redispatches to relieve congestion an efficient redispatch is assured.

Under either regime, depending on the emission rates assigned to unspecified imports, there are incentives to contract shuffle or simply to avoid the CAISO's markets altogether (this is aside from the fact than all transactions of CAISO Scheduling Coordinators (SCs) are scheduled through the CAISO. Cleaner generators (and LSEs) may want to lock down their "cleanliness" through bilateral markets rather than be penalized by the likely higher emissions rate assigned to CAISO pooled energy. Dirtier generators will prefer the assigned emissions rate in the ISO pool as it will likely be lower than would be attributed to them in the bilateral market.

So either approach can have the negative side effect of thinning the ISO markets to the detriment of efficiency in these markets. Additionally, the thinning of the ISO's market could increase the cost of reliability. For example, under the load-based approach LSEs for in-state purchases could theoretically gauge the emissions of those it purchased from, even through the ISO for the ISO settlements. However, as the final settlements

lag the real-time market by weeks, LSEs may mitigate the final settlement risk by conservatively transacting through bilateral contracts. The decrease of generation in the CAISO markets, and decrease in adjustment bids reduces the liquidity in these markets and raises risks and possibly costs. Since the CAISO is obligated to meet NERC/WECC standards for operating reserves and since the RA program assures capacity is available in some form to the ISO (RA contract with LSE, RMR, backstop reservation), reliability should not be jeopardized but the cost of maintaining reliability may well increase if the CAISO has to rely more on non-market mechanisms, e.g., RMR, backstop procurement.

14. What impact would a deliverer/first-seller approach have on long-term investment in low-GHG emitting generation technologies? Is this better or worse than under a load-based cap? Why?

Please see DRA's response to question 25.

15. How would a deliverer/first-seller approach interact with an upstream program design as articulated in Chapter 4 of the Market Advisory Committee report? Explain your answer in detail.

DRA reserves the right to respond to this question in reply comments.

16. What impact would a deliverer/first-seller approach have on electricity service providers?

Since within California, generation is regulated at its source, the first seller would reduce the administrative burden and costs that a load-based cap would impose on ESPs. Some ESPs are fairly small but could but from a variety of sources imposing a difficult, expensive administrative task out of proportion to the load they serve. Similarly, for imports, making the responsible/reporting entity the "first seller" in California removes this task from the ESP.

B. Interaction with Energy Markets

17. Compare and contrast the impact that a deliverer/first-seller and a load-based system would have on the existing wholesale energy markets, both at the California Independent System Operator (CAISO) and outside of it.

DRA's answers to questions 9, 12 and 13 above partially answer this question. That the Commission and the CEC will adopt an regulatory/reporting structure and recommend it to ARB without fully understanding the impacts on the wholesale market is worrisome. As DRA stated above, incentives under any approach will significantly change incentives for buyers and sellers, and it seems that other than at a theoretical level, there will be insufficient understanding of market effects. DRA pointed out that with the use of the ED's consultant in cooperation with the CEC, CAISO and parties, some research and analysis could be done to better understand behavior in these markets and possible outcomes.

18. For those entities participating in the CAISO markets, what would be the likely differential impacts of a deliverer/first-seller versus a load-based system on the CAISO's implementation of the Market Redesign and Technology Update (MRTU) system, including day-ahead and real-time markets for energy, transmission, and reserves?

To sum up some of DRA's comments, a first seller approach is preferred for the CAISO markets in most all respects. For in-state generation scheduled into, or bid into the IFM and day-of markets emissions costs will be internalized and reflected in the schedules and/or bids. Thus, an efficient dispatch is more probable under the first seller and more compatible with the MRTU. That nodal prices also reflect emission rates and costs improves the locational aspects of where generation might locate or transmission might be built that would in part reduce emissions of CO2. Under a load-based system, the MRTU system would need to be updated to account for the cost of emissions in addition to the wholesale electricity price and congestion price. The input value of emission cost will be dependent on the permit allocation scheme and may not reflect the fluctuating market value of emission permits.

The CAISO must deal with congestion and without bids that reflect the full cost of energy coming into the IFM, the ISO's redispatch, if it has to relieve congestion will be sub-optimal which means higher dispatch costs within the IFM. Now these could be offset somewhat if LSEs under a load-based system bought some of the better low-carbon power, thus cutting the LSEs costs and exposure but it would be at the expense of liquidity in the ISO markets.

On the "pooling" aspects of power in the CAISO, it will be difficult to discern among different types of electricity generation. LSEs will purchase electricity from a sort of common pool, making it hard to differentiate between lo-carbon and hi-carbon electricity. A first seller system could help avoid this challenge.

C. PRIOR COMMENTS

The MRTU system will make it difficult to discern among different types of electricity generation. LSEs will purchase electricity from a sort of common pool, making it hard to differentiate between lo-carbon and hi-carbon electricity. A first seller system could help avoid this challenge.

Under a first-seller system, the cost of emissions is already incorporated in the wholesale price of electricity; no further changes to the MRTU system is necessary to optimize least-cost dispatch. Under a load-based system, the MRTU system needs to be updated to account for the cost of emissions in addition to the wholesale electricity price and congestion price. The input value of emission cost will be dependent on the permit allocation scheme and may not reflect the fluctuating market value of emission permits.

19. To what extent would either approach (deliverer/first-seller or load-based) be likely to alter the dispatch of existing generation units in the near-term? Why? If there is a difference between the approaches, how significant would it be?

See answers above.

D. Interaction with ExistingPrograms and Policies

20. How would a deliverer/first-seller approach interact with the Public Utilities Commission's Resource Adequacy requirements and procurement/portfolio oversight? How would this approach affect efforts to maintain resource adequacy by the publicly-owned utilities (POUs)?

A first-seller approach to regulating GHG emissions within the electricity sector does not interfere with the PUC's Resource Adequacy requirements and procurement oversight. Under AB 57, the PUC has the authority to review and approve utility's energy procurement plans, ensure that the IOUs maintain an adequate reserve requirement, and implement a long-term resource planning process. See DRA's response to question 12 above.

21. How would a deliverer/first-seller approach interact with the Public Utilities Commission's promotion of end-use efficiency? How would this approach affect energy efficiency programs for the POUs? Under which system (deliverer/first-seller or load-based) would the penetration of end-use efficiency likely be greater? Why?

A first-seller approach to regulating GHG emissions within the electricity sector does not interfere with the CPUC and CEC promotion of end-use efficiency. The Energy Action Plan, jointly adopted by the PUC and the Energy Commission and endorsed by the Governor of California, establishes cost-effective energy efficiency as the resource of first choice for meeting the state's energy needs. Regardless of the GHG emission regulatory structure, overall retail electricity costs will reflect the cost of California's GHG program. If anything, this increases California's energy efficiency potential as more end-use efficiency measures become cost effective.

The point of regulation does not influence the penetration of end-use efficiency. Under a load-based structure, the cost of emission permits borne by an electric utility will simply be passed on to its customers. The Commission will be adopting a shareholder incentive program for energy efficiency which will provide explicit financial incentives thus augmenting the rationale for utilities to invest in energy efficiency.

The PUC currently adopts energy efficiency goals on a 3-year cycle for the investor-owned utilities; these goals are based on the economic potential of energy efficiency within each IOU's service territory. As GHG emission regulations become implemented there will be ample time to review utility performance toward meeting the state's goals.

POUs are subject to the relevant state laws affecting energy efficiency, EAP II, their own local regulators who in many case have mandated significant energy efficiency programs, and the policy oversight of their resource plans by the CEC. Regardless of whether a POU or IOU the CEC's efficiency standards affect their end-use loads.

22. How would a deliverer/first-seller approach interact with the State's Renewable Portfolio Standard requirements (both existing and proposed)?

The state's RPS requirements (both current and future) are the result of legislative mandate, are embodied in EAP II, and are embedded in the polices of the CPUC and CEC toward renewables under the RPS, overall procurement policy, and lately through several initiatives to promote transmission that access renewable sources. The legislative and regulatory mandates, and the subsidies will be available under any regulatory regime. Renewable generators which create emissions will report to ARB in the same way that fossil generators will.

The RPS programs are analogous to the mandates that apply to energy efficiency and procurement in general through AB 57. These are strong, pervasive mandates.

23. How should renewable energy generators be treated under a deliverer/first-seller system?
24. Compare and contrast the impact of a deliverer/first-seller and a load-based approach on the voluntary renewables market.
25. Would one approach (deliverer/first-seller or load-based) have an advantage over the other in producing the greatest amount of emissions reductions through modifications (*e.g.,* retrofitting, efficiency improvements, etc.) to existing power plants? Why?

A first-seller approach would likely have an advantage over the load-based approach in producing the greatest amount of emissions reductions through modifications to existing power plants. Under a first-seller approach, in-state generators and importing entities need to obtain emission permits. This may result in an overall increase in wholesale electricity price. Given that the wholesale electricity price is set at the margin including emissions costs of the marginal unit, all other generators will follow their profit-maximizing goal by minimizing production costs which include emission costs. This may include modifications to existing plants to reduce emissions. One can argue, however, that long-term substantial investments in emission reduction technology may be jeopardized if the generators perceive future changes in emission regulations. This should be taken into account by adopting a programs that is likely to be compatible with a regional or national approach to C02 reduction.

E. Reporting, Tracking, and Verification

26. What would be the data and administrative requirements of the deliverer/first-seller approach?

In its Opening Comments to the Joint Staff Proposal for an Electricity Retail Provider GHG Reporting Protocol dated July 2, 2007, DRA stated that no modifications is necessary to accommodate a first-seller structure based on a set of load-based reporting requirements. It would be useful to require the reporting party to specify the originating and delivery points, to avoid double-regulating emissions should other neighboring states adopt emissions regulations. (see response to Question 36 – 38) An electronic emissions tracking system is superior to paper submissions, to facilitate open access to the emission data and analysis of aggregate emission data.

As pointed out in the July 2, 2007 DRA comments, there appears to be a potential reporting loophole under the first seller structure. AB32 does not appear to require entities other than generators or LSEs to report emissions, so importing entities that are not LSEs, e.g. power marketers, appear unlikely to be covered by the reporting requirements.

27. How would the deliverer/first-seller approach relate to the Public Utilities Commission/Energy Commission Staff reporting protocol proposal, *i.e.,* would the deliverer/first-seller approach require modifications to the Staff reporting proposal, or could it serve as an interim reporting protocol? If modifications are required, what exactly would they be?

28. If a deliverer/first-seller approach is adopted, what would be the pros and cons of requiring reporting both from deliverers/first sellers and retail providers, in order to provide ARB with multiple control data sets for comparison?

29. Compare and contrast the ability of a deliverer/first-seller and a load-based system to create confidence for investors and confidence for environmental advocates about tracking and compliance.

30. Who/what governs access to the purchasing/selling entity data on the NERC E-tags? What would a state agency need to do to obtain access to E-tag data?

31. What role would the CAISO play, if any, in the implementation and administration of a deliverer/first-seller program? What role would other control area operators or balancing authorities play?

F. GHG Emissions Allowance Allocation Issues

32. Would implementation of a deliverer/first-seller approach necessitate auctioning of GHG emissions allowances? Why or why not?

33. If you do <u>not</u> believe that an auction would be required under the deliverer/first-seller approach, explain how an emissions allocation system would work under a deliverer/first-seller approach. In doing so, answer the following:

    a. To whom would allocations be given?

    b. If you recommend allowances be given to deliverers/first sellers, on what basis would allocations be given during any particular compliance period?

    c. How would the state of California know how many allowances were needed by importers?

d. How would marketers be treated?

e. How would electricity service providers be treated?

f. Would zero-carbon generators also receive allowances?

g. What would be the likelihood of windfall profits under such a system?

h. How could such a system prevent windfall profits?

34. If you recommend allocation of allowances to retail providers, followed by an auction to deliverers/first sellers, how would such an auction be administered? What kinds of issues would such a system raise?

G. Relationship to Other Sectors Under AB 32 in California

35. Would GHG emissions allowances created under a deliverer/first-seller compliance regime in the electricity sector be compatible for trading with other sectors in the California economy, assuming a multi-sector cap–and-trade system? How?

Under a first seller regime, the electricity sector would be unique in that it addresses some GHG emissions outside of CA (from power generated in other states). For other sectors, the focus would likely be more focused on emissions actually occurring in CA. While this may complicate drawing boundaries, however, it should not preclude a multi-sector cap and trade system with a 1st seller regime. Special care would need to be taken, however, to prevent contract shuffling from undermining the whole system.

H. Relationship to a Multi-State System Such as the Western Regional Climate Action Initiative

36. Compare and contrast the ability of a deliverer/first-seller and a load-based approach to avoid double-counting of emissions between states.

Under a multi-state system, a first-seller approach can be easily modified to a source-based approach to avoid double-counting of emissions between states by lifting emission regulations on imports and continuing to regulate only in-state generators, assuming that the member states within such a multi-state system mutually agree to adopt

a source-based approach. The same cannot be accomplished as easily for a load-based approach.

If, however, the member states within a multi-state system decide to adopt a load-based approach, a first-seller approach can be adapted to avoid double-counting by requiring in-state generators and power importers to obtain emission permits only for the electricity to be delivered to an in-state LSE

> 37. How should exports from California be handled under a deliverer/first-seller approach? Would the proper treatment of exports depend on whether the receiving state has a cap-and-trade system? If so, how?

Under a first-seller approach, electricity exports from in-state generators will not be exempted from the emissions regulations, unless the importing state has adopted a load-based emission regulatory approach. In other words, if the importing state has no emissions regulations, or has adopted a source-based approach, electricity exports will remain subjected to California's emissions permit requirements

> 38. If some states in the region adopt a source-based system (or a load-based system which also regulates exports), how would the State of California verify the true source of imports in order to avoid double-regulation of power imported from other capped states?

As one solution to avoid double-regulation of power imported from other capped states, the importing party is responsible for demonstrating the originating state of the imported power. If the originating state cannot be verified, for example through contract agreements, then the imported power should be subjected to California's emissions regulations.

> 39. How would a deliverer/first-seller approach function relative to an Oregon load-based system (as currently proposed by Oregon)?

In-state generation that are contracted to be delivered to Oregon would be exempted from California's emissions regulations.

I. Interaction with Potential Federal Regulation

40. How easily could a deliverer/first-seller approach scale or link to multi-state, national, or international programs?

At first blush, it appears that the First Seller Structure would be more expandable to other states on a regional, national, and possibly international basis. First, both the Regional Greenhouse Gas Initiative (RGGI) on the East Coast and the European Union Emissions Trading System (EU-ETS) are well-established source-based programs that provide a potential foundation for a broad national and international GHG emissions reduction system. The proposed First Seller Structure more closely resembles these purely source-based programs, and as such would better integrate with them given the linkage between the points of regulation.

In order to maximize emissions reductions while minimizing costs to ratepayers, consistency in a cooperative regional, national, and international regime must be present. Although leakage, contract shuffling, and double-counting of emissions reductions are reportedly problematic in the RGGI and the EU-ETS systems, these issues would likely be exacerbated by a national and international system comprised of inconsistent points of regulation, depending on jurisdiction. Moreover, in such a scenario, DRA assumes that the reporting and tracking of GHG emissions would be considerably more difficult to integrate and regionalize. This would add unnecessary layers of complexity and potential costs to the development of sound, coordinated interstate GHG mitigation policy and the information system(s) designed to facilitate this effort.

As discussed elsewhere in these comments, DRA believes that the First Seller approach would assist in mitigating the tracking of emissions data by establishing a consistent and direct link to the generation source. However, the extent to which the First Seller approach would mitigate leakage, contract shuffling, and other threats to program effectiveness relative to a load-based approach is uncertain. Nevertheless, any hope for devising a cohesive national and international system may rest on the fact that source-based regional systems are already in place, and may need to be continued. Expanding

this effort nationally is critical to reducing what might otherwise prove to be much more severe leakage and contract shuffling if states fail to adopt a coordinated system.

41. Would one approach (deliverer/first-seller or load-based) be easier to transition into a potential federal GHG regulatory system? If one would be superior in this respect, explain why and what assumptions you are making about the likely federal framework.

42. What are the merits of the deliverer/first-seller proposal as a model for other governments' efforts, particularly at the national level?

J. Questions for Legal Briefing

In response to each question in this section, cite relevant case law and/or Federal Energy Regulatory Commission (FERC) rules or regulations, and provide analysis.

K. Federal Power Act

43. Would the Federal Power Act preempt adoption of the deliverer/first-seller approach? Why or why not? Does it make any difference that the federal government has not issued any regulations in this specific area?

Section 201(a) of the Federal Power Act, 16 U.S.C. § 824 (a) states that

> "the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of …that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary and in the public interest" but that Federal regulation should extend "only to those matters that are not subject to regulation by the States."

In its decision implementing an Emissions Performance Standard, D.07-01-039, the Commission carefully considered FERC's exclusive authority over the wholesale market under the Federal Power Act. The Commission concluded that since the EPS would regulate LSEs, which sell electric energy in the retail market in California, rather than wholesale generators or marketers, that the EPS fell squarely within the area of

regulation of retail sales service and the public utilities providing such retail sales service that Congress preserved the States' authority.[4]

Under the first seller approach, CARB would require entities that import power into California to comply with emissions' reporting requirements and the responsibility to acquire emissions allowances for power imported from out of state. Arguably, this would be an environmental regulation unrelated to FERC's authority over wholesale sales of power but any such environmental regulation that applied to wholesale sellers of electricity would need to be carefully crafted in order to avoid conflict with FERC's authority over wholesale rates.

> 44. For purposes of your legal analysis of the previous question, would your opinion differ if the deliverer/first-seller were the reporting entity only and not also the point of regulation? Why or why not?

Requiring first sellers to report emissions information to CARB without a corresponding obligation to purchases emissions allowances might be less likely to be viewed as infringing on FERC's jurisdiction over wholesale rates. However, there appears to be little economic efficiency gained from such an approach, so there is no obvious advantage to its adoption.

> 45. Could the deliverer/first-seller approach be designed or implemented in a way that would avoid or lessen problems under the Federal Power Act? If so, how?

DRA has no specific design suggestions, but looks forward to reviewing comments submitted by other parties.

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[4] Section 201(b) of the Federal Power Act, 16 U.S.C. § 824(b); *see New York* v. *FERC* (2002) 535 U.S. 1, 20, 23, 28; *see also Connecticut Light and Power Co.* v. *FPC*, (1945) 324 U. S. 515, 523-531.

46. Compare Federal Power Act issues under a deliverer/first-seller approach and a load-based approach.

The Commission relied on its traditional authority to regulate retail sellers of electricity in enacting an EPS that applies to LSEs. D.07-01-039 pointed out that FERC has acknowledged that with regard to the retail electric market, "state regulatory commissions and state legislatures have traditionally developed social and environmental programs suited to the circumstances of their states"[5]

D.07-01-039 observed that:

> "[t]he FERC is well aware that certain states require that the resource portfolios of their state-regulated utilities include generation and procurement from sources that will cause minimal damage to the environment. For example, in *American Ref-Fuel Co., et al.,* FERC referred to 13 states that have programs with renewable energy credits (RECs) premised on promoting goals, such as improved air and water quality and reduction of greenhouse gas emissions.[6] FERC held that its avoided cost regulations for QFs under PURPA did not contemplate the existence of RECs, and, therefore, the determinations concerning state-created RECs *must be based upon state law*.[7] Thus, FERC recognized the authority of the states to regulate in the area of greenhouse gas reductions. In short, there is no implied or actual conflict between FERC and the CPUC concerning the EPS.

The Commission therefore concluded that the Federal Power Act "does not preempt state regulation of procurement choices by retail sellers of electric energy, including programs designed to reduce GHG, such as the EPS in the State of California."[8]

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[5] *See* Order No. 888, FERC Stats. & Regs., Regs. Preambles, Jan. 1991-June 1996, ¶ 31,036, p. 31,782 (1996).

[6] *See American Ref-Fuel Co., et al.* (2004) 107 FERC ¶ 61,016 at PP 2-3.

[7] *See ibid.* at PP 6, 16.

[8] D.07-01-039, p. 204.

The EPS was a public utility regulation explicitly designed to apply to contracts for power used in California. AB 32, in contrast to the EPS, is not a public utility regulation implemented by the Commission, but requires CARB to adopt health and safety regulations that will apply across all sectors, not just the utility sector. While it may be possible to craft regulations that would allow CARB to require wholesale power importers to report their emissions and purchase allowances without running afoul of FERC jurisdiction over wholesale rates, such regulations would likely involve a case of first impression for any reviewing court.

47. If you conclude that Federal Power Act preemption would be a problem, could FERC action (*e.g.,* approval of a CAISO tariff rule) ameliorate this problem? If so, what specifically could FERC do? Could FERC ameliorate any Federal Power Act concerns related to publicly-owned utilities?

While FERC action may be a useful avenue to explore, DRA will review opening comments filed by other parties before responding to this question.

L. Dormant Commerce Clause

48. Does the deliverer/first-seller approach raise problems under the dormant Commerce Clause?

Depending on how it is implemented, a deliverer/first seller approach raises some potential issues under the dormant Commerce Clause. It is important to ensure that any approach that CARB undertakes here does not impermissibly protect in-state actors at the expense of out-of-state actors.[9] This is a central theme in dormant Commerce Clause analysis sometimes referred to as the "anti-

[9] See City of Philadelphia v. New Jersey (1978) 437 U.S. 617, 623-624.

protectionism principle."[10] A closer examination of the exact contours and ramifications of the deliverer/first-seller approach is required before its status can be conclusively determined. Based on available facts, a court would likely find a legitimate state interest in minimizing the harmful impacts of GHG on California.[11] However, if a court concludes that utilizing a deliverer/first-seller approach, rather than an alternative approach, discriminates or impermissibly controls the actions of out-of-state actors, a first-seller approach could be struck down.[12]

49. Could the deliverer/first-seller approach be designed or implemented in a way that would avoid or lessen problems under the dormant Commerce Clause? If so, how?

It may be challenging to eliminate all potential risks of a deliverer/first seller approach. While shifting more of the regulatory burden to in-state LSEs would be helpful in this regard, it may not fully resolve the risks as to any regulatory burdens that remain on the deliverers/first sellers. Also, the precise design of a given approach could ameliorate some risk.

50. Are issues under the dormant Commerce Clause more or less serious under a deliverer/first-seller approach compared with a load-based approach? Explain.

A load-based approach would likely have a lower risk under the dormant Commerce Clause than a deliverer/first-seller approach. This is due to the fact that courts have consistently upheld the states' jurisdiction

[10] Regan, The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause (1986) 84 Mich. L.Rev. 1091, 1095.

[11] See Massachusetts v. EPA (2007) 127 S.Ct. 1438, 1455-56.

[12] See Brown-Forman Distillers Corp. v. New York State Liquor Authority (1986) 476 U.S. 573, 579.

over retail energy sales.[13] Thus, the states' jurisdiction over retail energy sales has traditionally been safe and defensible. Wholesale sales are one step removed from this "safe zone", and the situation as to state environmental regulations related to wholesale sales is less clear. Thus, a load-based approach appears safer under the dormant Commerce Clause.

51. The Market Advisory Committee report suggests that the value of GHG emission allowances "can be used to fund innovative emission reduction technologies and to focus pollution-reduction efforts in low-income and minority communities" or "can be utilized to provide transition assistance for workers and industries subject to strong market pressures from competitors operating in jurisdictions that lack similar caps on greenhouse gas emissions" (Market Advisory Committee report, at iv - v) or "should be directed to investments in end-use efficiency improvements" (*Id.*, at 54). Would these uses raise problems under the dormant Commerce Clause? Would these problems be more or less serious under a deliverer/first-seller approach compared with a load-based approach?

DRA reserves the right to comment on this question in reply comments.

M. Authority to Auction

52. Does ARB have the authority, under AB 32 or any other statute, to auction allowances to emit greenhouse gases? Explain.

DRA reserves the right to comment on this question in reply comments.

N. Other Legal Issues

53. Are there any other legal issues that the Public Utilities Commission and the Energy Commission should consider in deciding whether to investigate the deliverer/first-seller approach further? Explain.

DRA reserves the right to comment on this question in reply comments.

[13] See General Motors Corp. v. Tracy (1997) 519 U.S. 278, 290-92.

III. CONCLUSION

DRA respectfully recommends that the Commission consider the recommendations summarized in these comments.

Respectfully submitted,

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August 6, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO ADMINISTRATIVE LAW JUDGES' RULING** REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT IN **R.06-04-009 BY USING THE FOLLOWING SERVICE:**

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Executed on August 6, 2007 at San Francisco, California.

/s/ JANET V. ALVIAR
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N O T I C E

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