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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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)

ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of: AB 32 Implementation: Greenhouse Gases	Docket 07-OIIP-01

OPENING COMMENTS OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER ON THE ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT

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OPENING COMMENTS OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER ON THE ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT

In accordance with Rule 14 of the Rules of Practice and Procedure of the Public Utilities Commission ("CPUC" or "Commission") of the State of California, the Los Angeles Department of Water and Power ("LADWP") hereby files the following Opening Comments submitted in response to the "Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report," filed July 19, 2007, in CPUC Rulemaking R.06-04-009 ("Rulemaking") and CEC Docket # 07-OIIP-1.

I. INTRODUCTION

A. *Absolute emission reductions should be pursued as top priority and cap-and-trade should be treated as a backstop measure.*

The LADWP believes that the intent of AB 32 is to realize absolute greenhouse gas emission reductions for all sectors that contribute to the problem of global warming. For the electricity sector, the primary means to do this is by 1) shifting the resource mix that serves California native load from high-GHG emitting sources to low- or zero-GHG emitting sources, and 2) avoiding emissions through energy conservation and demand-side management strategies. Advanced technologies to sequester GHG emissions may be commercially available in the future, but do not appear viable in the near-term.

A cap-and-trade program as a secondary method of compliance may be acceptable, but the LADWP does not support it as a primary method of compliance. The LADWP supports the pursuit of direct reductions of GHG emissions as first priority. Lower priority should be given to emissions trading as a strategy that should only be

exercised upon exhausting all other strategies.

B. *The LADWP is committed to reducing our greenhouse gas emissions regardless of the location of generation (in-state or out-of-state) that serves our native load.*

The LADWP has made it a top priority to shift our energy resource mix to cleaner resources and thereby reduce our carbon footprint. The LADWP acknowledges its critical role in the State's efforts to address climate change. At the same time, we remain committed to our role to maintain a reliable and affordable electric power supply.

LADWP is an essential public service for the City of Los Angeles and it is our responsibility to ensure a reliable supply of electric power at all times. LADWP's generation resources are for the benefit of our customers and the City of Los Angeles and have not been developed to support a wholesale market, or a secondary market. Shifting resources from our customers and our city does not further our goals for power reliability, increased investments in emission neutral technologies and providing affordable services.

The LADWP is fully committed to reducing our greenhouse gas emissions as soon as possible. We have and will continue to aggressively increase the amount of renewable energy projects in our resource mix. We have and will continue to aggressively pursue energy and water conservation. We will continue to seek partnerships with other municipal departments to reduce our overall City emissions footprint. The LADWP accelerated its Renewable Portfolio Standard mandate from 20% by 2017 to 20% by 2010. On May 15, 2007, Mayor Antonio Villaraigosa released the "GREEN LA – An Action Plan to Lead the Nation in Fighting Global Warming" (GREEN LA Plan) that has an overall goal of reducing the City of Los Angeles' greenhouse gas emissions by 35% below 1990 levels by 2030. The cornerstone of the

GREEN LA Plan is increasing the City's use of renewable energy to 35% by 2020. The LADWP is not looking to shift its regulatory obligations under AB 32 to any other party that may otherwise be determined to be the point of regulation under a first-seller approach. Instead, the LADWP believes it is in the best position as a retail service provider to reduce or avoid emissions from both purchased and owned generation resources that serve our native load.

The LADWP serves a larger portion of low income, minority and small commercial customers than other major sector participants. Any market design must take into consideration the adverse distributional effects to our customers, including environmental justice impacts.

The LADWP supports a broad market design that includes non-utility sources – sources that make up the greatest uncontrolled block of emissions. The electricity sector is in a unique position of being able to support non-utility emission reductions locally through efforts, such as plug-in hybrids, landfill methane capture, increased efficiency of water conveyance structures, and port electrification.

It is absolutely critical that the regulatory scheme adopted for AB 32 be simply designed, easily understood, easy to administer and easy to comply with. Many entities, like LADWP, that believe they are the subject to regulatory compliance under AB 32 are making financial and budgetary commitments today, nearly five years before the compliance period for AB 32 begins in 2012. The Los Angeles Board of Water and Power Commissioners approved the Fiscal Year 2007-08 budget on June 5, 2007, calling for significant investments in, among other things, renewable energy, energy conservation and port electrification. In support of the Renewable Portfolio Standard

(RPS) goal of 20 percent renewables by 2010, the budget identifies $181 million for 2007-08, and increases to $599 million in 2009-10. The majority is for capital costs associated with building and upgrading transmission systems and development of solar, geothermal, wind and other renewable energy projects. The budget includes $30 million for LADWP's solar rebate program – more than triple the level funded in 2006-07 – reflecting a target goal of 280 megawatts of solar installations by 2017 to meet recent State legislation SB 1, also known as the Million Solar Roofs Plan. A first-seller approach should not undermine these commitments by shifting the compliance burden away from retail service providers and place that regulatory burden on other parties that, in some cases, are out-of-state generators.

C. *The LADWP cannot support any regulatory scheme that results in a wealth transfer.*

A regulatory scheme must be considered in its entirety, including how specific key elements are developed and inter-relate such as emissions inventory, mandatory compliance reporting, emissions allowance allocation, overall sector emissions target, annual declining emissions cap, and command and control regulations that may be adopted.

LADWP supports an allowance allocation methodology for the electricity sector that is not punitive and does not result in significant cost impacts to our customers. As such, we support the distribution of allowances based on actual generation emissions, not customer sales or other criteria that has no correlation to emissions burden.

Further, we do not support auctioning for our sector, as described in more detail in the response to question 32 below. Entities that have high-GHG emission resources, like LADWP, have the direct financial burden of reducing those emissions (as described

above), and would be unduly burdened it we were required to also purchase allowances through an auction to meet compliance. The LADWP cannot support any regulatory scheme that results in a wealth transfer, whether load-based or first-seller.

II. SUMMARY OF KEY COMMENTS ON FIRST-SELLER APPROACH

A. *Market Advisory Committee recommendation for first-seller is not supported.*

It is problematic to comment on the impacts of a first-seller approach without the benefit of an informational workshop in advance. As such, parties are filing comments based on very limited written reference material and no public discussion.

It appears from the Final Market Advisory Committee (MAC) Recommendations that the first-seller approach was not adequately nor fully considered as a point of regulation, from a technical, legal or regulatory perspective. Minimal discussion is available in the recommendations to allow one to fully evaluate what is meant by the first-seller approach. As such, it is not clear how the MAC was able to make its number one recommendation for the electricity sector (see Chapter 5 of the MAC recommendations) that "a first-seller approach to regulating emissions associated with all electricity delivered in the state" be pursued as the point of regulation.

The MAC report indicated that a generator-based approach was considered and rejected since it did not include out-of-state generators. This alternative is unrealistic, since approximately half of the GHG emissions for the California electricity sector come from electricity imports that are predominately from coal-fired generation. Rather than position this ruling and subsequent filings as a question of "either load-based or first-seller" as if those are the only two approaches to regulation, the LADWP recommends that the question be opened to a broader evaluation of how best to establish a clear and

consistent point of regulation that covers both in-state and out-of-state GHG emissions sources, and that can be adapted to a broader regional or national GHG reduction program in the future with minimal transitional costs to the regulated community. At this time, we are not convinced that the first-seller and/or load-based approaches are the only options for the electricity sector that should be under consideration for a California-only program like AB 32.

In fact, there is no existing example of a first-seller approach in the United States, Europe or elsewhere, and without existing experience it is difficult to effectively comment on the advantages or disadvantages of such approach. Additionally, the first-seller approach is separate, but closely tied to allowance allocation. Support or opposition to first-seller may very well depend on how allowance allocation is ultimately addressed.

LADWP recommends that the CPUC/CEC clarify how first-seller may be integrated into the existing AB 32 GHG proceeding in terms of the overall rulemaking schedule and statutory deadlines. Given the short time remaining to develop and adopt mandatory emissions reporting regulations, it would be helpful to understand how such efforts may be modified to accommodate this consideration before regulations are adopted in December 2007.

B. *The LADWP does not support the first seller approach at this point for the following reasons:*

1) The first-seller approach unnecessarily complicates the regulatory scheme for electricity imports.

A first-seller approach can include retail service providers, out-of-state generators, marketers, and possibly others that would be classified as the first seller delivering energy into California. While there may be a limited number of marketers that

actively participate in California's wholesale market, there are hundreds of marketers that participate WECC-wide (i.e., Western Electricity Coordinating Council). Any one of these entities can become a first-seller at any given time and would be subject to emissions reporting and compliance obligations. The first-seller approach can have the convoluted result of applying the point of regulation to an out-of-state generator or marketer for delivery of electricity within California, leaving the California retail service provider that caused that energy to be imported into California with no compliance obligation.

2) The first-seller approach cannot be evaluated in isolation of other key program elements, such as allowance allocation.

The point of regulation and distribution of allowance allocations are inextricably linked in an emission reduction program. If a first-seller approach requires that allowances be auctioned, that would have the effect of placing additional financial burdens on those entities that have to replace their high-GHG emission resources with low- and zero-GHG resources. Distribution of allowances to retail service providers based on anything other than actual generation emissions has the potential to over-allocate allowances to retail service providers that have significantly less emissions burdens, thereby resulting in a transfer of wealth to such retail service providers.

3) The first-seller point of regulation for marketers is problematic.

The tracking of emissions by marketers that are determined to be the first seller into California is problematic for many reasons as set forth below. Marketers do not have generation assets and do not serve native load. In a transition to a larger federal

program, it is unlikely that marketers would continue to be the point of regulation, thus bringing into question the basis for placing a compliance burden on a marketer.

4) The first-seller may be more susceptible to legal challenges than a load-based approach.

The first-seller approach is more vulnerable to Federal Power Act preemption, because it makes the wholesale power sales as a point of regulation, and therefore heightens the risk of intrusion on FERC's exclusive jurisdiction over wholesale power sales of power in interstate commerce. The first-seller is more infirm than the load-based approach under the dormant Commerce Clause in that the first-seller approach would directly attach a restriction (need for emission allowance) to imports (of power) to control commerce (power generation and emissions) elsewhere. The first seller would directly regulate a person outside the state (i.e. any out-of-state first-seller).

5) Reliance on NERC e-tags for purposes other than reliability is problematic.

The use of NERC e-tags for purposes other than reliability is problematic for many reasons as noted in several responses below. A first-seller approach will not necessarily establish a clearer line-of-site to the generator any more so than a load-based approach. It would, however, shift the compliance burden away from the California retail service provider.

6) Unspecified electricity imports are greater in the NW and could lead to gaming and market manipulation if NERC e-tags are used for source tracking.

The regional impacts of applying the point of regulation to first seller may be more pronounced in the Pacific Northwest in comparison to the Southwest. This is because while three-quarters of California's electricity imports are delivered through the

Southwest, the sources tend to be more specified (71%) than unspecified (29%) sources. However, the remaining one-quarter of California's electricity imports that are delivered through the Pacific Northwest are predominantly unspecified (88%), with only a portion actually specified (12%) wherein which the source of generation is known. Regional emission factors that are mutually agreed upon between California, Oregon and Washington would minimize the opportunity for gaming and market manipulation by market participants in comparison to the use of NERC e-tags for source tracking, as would be the case under the first-seller approach.

III. RESPONSE TO QUESTIONS

A. *Basic Definitions*

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.

Answer: The proposal defines first-seller as follows: a) for in-state California generation, the first-seller is the generator, in all cases; and b) for imported power, the first-seller is the entity that first delivers electricity at a point of delivery within California. The first-seller is both the entity that reports its GHG emissions as well as the point of regulation (entity required to comply with AB 32).

The LADWP believes that the most clear, simple and accurate regulatory structure for an emissions reduction program is one that is source-based, meaning the point of regulation is the generator source for both emissions reporting and emissions reductions. For consistency, the emissions inventory ideally includes all sources that will be subject to compliance, including both reporting and reductions. The emission allowance allocation and declining emissions cap is applied to the generator source that

has the obligation to reduce emissions. It is possible that a national GHG emission reduction program will be adopted that applies to all generation sources in the United States (i.e. federal source-based program), and this is appropriate because all sources included in the inventory will be clearly identified and subject to compliance.

However, in California, regulating GHG emissions from the electricity sector is significantly more complicated due to the fact that the electricity grid that supports California extends beyond California's borders and encompasses the Western Electricity Coordinating Council. We recognize that in California a load-based regulatory structure was pursued under AB 32 in order to address emissions from electricity imports that account for approximately 50% of the State's electricity sector GHG emissions. This approach places the point of regulation on the retail service provider that may own in-state and/or out-of-state generation assets and also purchase electricity from in-state and/or out-of-state sources or the wholesale electricity markets to meet native load requirements. While this approach is not as ideal as a national or WECC-wide source-based approach, a load-based approach can provide the correct incentives for clean energy procurement. It clearly delineates the point of regulation as the retail service provider that serves California load, and emissions can be assigned to the RSP in the baseline inventory. Additionally, a load-based approach provides the incentives to reduce load (e.g., demand-side management and energy efficiency) and, thereby, avoid emissions.

The first-seller approach for electricity imports is more complex. It appears that the first-seller approach is an alternative approach to load-based regulation that allows for source-based point of regulation in-state, and for a contractual party as the point of

regulation for electricity imports. It is clear that first-seller is neither a pure source-based or load-based approach. In the case of electricity imports, this could include marketers that: 1) do not have generation assets and 2) do not serve native load. An emissions inventory might not as clearly identify emissions associated with a marketer, particularly for a baseline inventory.

This may complicate regulatory compliance, because it is unclear how a marketer will be able to comply with AB 32 other than to obtain allowances to meet the emissions profile for electricity delivered to California. A marketer does not have the ability to reduce emissions from generation assets or to change generation resource mix unlike a retail service provider or generator that does. A marketer may, however, indirectly affect retail customer behavior through demand side management strategies to offset expected increases in the price of electricity brought about by AB 32 compliance. However, the price of electricity is expected to increase in California under either a load-based or first-seller approach. What is certain is that a marketer will not likely be the point of regulation under a federal source-based program. Retail providers will likely be the point of regulation under a federal source-based program for emissions associated with their owned generation, but not necessarily purchases as those would be covered by the generation sources supporting such purchases. In that regard, transition to a regional or federal program under a first-seller approach does not necessarily provide greater clarity or benefit as applied to marketers.

The first-seller approach may provide more direct reporting and greater accuracy for in-state sources. However, first-seller, when applied to electricity imports from marketers, may actually provide less accuracy and greater potential for gaming the

wholesale market due to the difficulty in isolating, and therefore, an increased ability to hide, the actual sources associated with a single delivery of electricity. In some instances, there could be several underlying transactions associated with a single delivery of electricity, and therefore, the first-seller may not be the appropriate point of regulation. Also, some of the electricity that is first sold into California may ultimately be received outside of California, and under those circumstances, it is unclear how the first-seller approach will enhance the accounting for emissions as compared to a load-based approach.

The potential problem with this definition as it relates to imported power is that the first-seller is likely an out of state entity. Regulating out of state entities may result in litigation over the Interstate Commerce Clause and Federal Power Act. Discussion of the dormant Commerce Clause and the Federal Power Act are included in our legal brief (response to questions 43 to 53).

The first-seller approach may have potential negative impacts on system reliability and the wholesale market. A potential difficulty may emerge for forward market transactions wherein the generation source is typically not known at the time a transaction is negotiated, and is only identified and attributed after the electricity is delivered. It is unclear how such energy will be categorized, and thus accurately priced, at such time that the transaction is entered into. This uncertainty may become a disincentive for a marketer, as a point of regulation, to enter into such transactions. This could have the unintended consequence of reducing liquidity in the forward electricity market and potentially reducing system reliability.

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?**

Answer: The first seller is the Purchasing/Selling Entity (PSE) listed on the NERC e-tag on the line that also lists the first transmission Point of Delivery (POD) within California. Ownership is dependent upon the terms of the power purchase agreement or other arrangement under which the electricity is acquired. LADWP purchases energy from out-of-state generators, but the point of delivery might be within California.

It would be awkward for LADWP to be the California retail service provider that causes the energy to flow into California, but not be the point of regulation for a California Law. LADWP would only be the point of regulation under California Law if it took delivery of the power at a point of delivery outside of California and brought it into California, thereby becoming the first-seller.

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.**

Answer: No, all interchanges are accounted for via NERC e-tags. However, intra-changes (i.e. transactions that take place within a balancing authority) do not necessarily receive a NERC e-tag. In any event, the LADWP does not support the use of NERC e-tags for emissions or source tracking. NERC e-tags are designed for the sole purpose of ensuring grid reliability, and therefore, do not adequately or accurately track emissions or sources associated with a transaction.

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

Answer: Any agency that is given access to e-tags could identify importing contractual parties. The North American Electric Reliability Corporation's (NERC's) Master Registry has the official compilation of all market participants.

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

Answer: At this time, there is no means other than the NERC e-tag to identify sellers of energy that moves between balancing authorities. The NERC e-tag will identify the purchasing/selling entities under the market path, however it will not accurately identify the source of generation, which could be different from what is listed on the e-tag because the tag is used for transmission reliability, not source tracking. Since e-tags cannot accurately identify the source of generation, it is also not an accurate tool for identifying GHG emissions. The LADWP recommends that the State of California aggressively pursue expansion of a GHG source tracking registry that builds upon a program such as Western Renewable Energy Generation Information System (WREGIS) to accurate identify the GHG emissions associated with generators, and abandon efforts to use NERC e-tags for purposes other than reliability.

The purpose of e-tags is to communicate key information for managing the reliability of the bulk power grid. E-tags help to ensure that transmission paths are not being over utilized, communicate energy interchanges to Balancing Authorities, and provide necessary information to facilitate cutting transactions when necessary (i.e. eliminating a transaction to avoid overloading the transmission path). At the time that an electricity transaction is entered into, the generation source(s) supporting that specific transaction is not generally known. An indication of the actual source(s) is

normally available after a transaction is completed. E-tags are designed to provide information to support transmission system reliability and track the movement of electrons, but do not include all the contractual elements of a transaction. As such, LADWP does not believe that e-tags are a good source for developing an inventory or source tracking database.

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

Answer: It would appear that under either a deliverer/first-seller or a load-based system, marketers will often not be able to determine the source(s) of the energy at the time the transaction is entered into. This would also be the case under a load-based approach. However, a first-seller approach will significantly change the manner in which marketer transactions are linked. Pursuant to the deliverer/first-seller system, reporting and compliance will fall on marketers that are first sellers of energy, and as such, the marketers will need to contractually specify the source(s) and related emissions associated with each energy transaction, and specify the final destination of such energy (i.e., inside vs. outside of California) in the event that such marketer is determined to be the first-seller. As for a broker, the broker does not take possession of the energy, and therefore, would not be designated as a first-seller.

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

Answer: The burden of determining the source or composition of the sources of electricity will be placed on the first-seller (marketer, retail provider, or generator). In a load-based approach, the load-serving entity would be responsible for reporting GHG emissions associated with the load it serves. A first-seller approach would increase the total number of parties that are identified as the point of regulation.

Under a load-based approach, the LADWP would be the point of regulation 100% of the time for native load and would not be the point of regulation for our wholesale sales. With respect to LADWP, its Power System provides an essential public service to the City of Los Angeles, and has an obligation to serve its customers as set forth in the City Charter. LADWP, unlike California Investor Owned Utilities) is self sufficient from a generation resource perspective, and can fully satisfy its obligation to serve with generation resources that are either owned by or secured under long-term power purchase contracts. At times, however, LADWP purchases energy from wholesale electricity markets when the cost of such energy is less than what it would otherwise cost LADWP to generate such energy from its own generation resources. For wholesale transactions in 2006, LADWP wholesale purchases were approximately 16% of Net Energy for Load (NEL), while total wholesale sales were 6%, resulting in a net 10% wholesale market purchases for native load.

Conversely, retail service providers, such as California's investor owned utilities, that rely on the CAISO to meet a significant portion of their native load with wholesale purchases will be the point of regulation far less frequently than LADWP depending on how much electricity they purchase. Wholesale transactions inherently include, on average, several parties listed on a NERC e-tag that exchange financial ownership between the original generation source and the ultimate sink (i.e., the location where the electricity is actually consumed). Each time ownership changes hands, it would appear that additional administration by a subsequent contracting party (i.e., a marketer) will be required to track the source(s) and related emissions, since such contracting party will not necessarily know if and when they may ultimately become the first-seller into

California, by selling to either a retail service provider or a wholesale market, such as CAISO (a marketer will be a first-seller if it moves energy into California, provided that such energy is not subsequently exported to another state). The "first-seller" approach will place an additional administrative burden on each contracting party, and will require the CAISO and other balancing authorities in California to play a more significant role in monitoring GHG emissions associated with wholesale energy transactions.

It would appear that the "first-seller" approach provides a significant advantage to retail service providers that heavily rely on wholesale electricity imports to support relatively large loads as compared to retail service providers that rely less heavily on wholesale electricity markets. Further, under a "first-seller" approach, it would also appear that a significant, if not most of the responsibility for tracking California's GHG emissions will be placed on out-of-state energy sellers.

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.**

Answer:

California Grid Delivery Scenarios Under First-Seller		**Entity Responsible for AB 32 Compliance as the First-Seller**
In-State Generation	Generator is owned by the retail provider	CA retail provider as owner of generator
	Retail provider generator to CAISO to retail provider	CA retail provider as owner of generator
	Retail provider generator to marketer(s) to other retail provider	CA retail provider as owner of generator
	Retail provider generator to other retail provider	CA retail provider as owner of generator
	Independent generator to retail provider	CA independent generator
	Independent generator to marketer(s) to retail provider	CA independent generator
	Independent generator to CAISO to retail provider	CA independent generator
Out-of-State Generation	Generator is owned by the CA retail provider with delivery into California	CA Retail provider
	Generator to retail provider with delivery taken outside California (CA Retail providers is importing)	CA Retail provider
	Generator to marketer(s) to retail provider with delivery taken outside California	CA Retail provider
	Generator to retail provider with delivery taken inside California (Generator is importing)	Out-of-State Generator
	Generator to marketer(s) that deliver to retail provider outside California	CA Retail provider
	Generator to marketer(s) that deliver to retail provider inside California	Marketer
	Generator to marketer(s) or retail provider with delivery taken inside California <u>but</u> ultimately sold and consumed outside California	No reporting required

B. *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?

Answer: The LADWP believes that the first-seller approach does not significantly change the environmental integrity of regulation for retail service providers (RSPs) that are vertically integrated and are merely importing their own generation resources. However, the application of first-seller to marketers does raise questions regarding environmental integrity of wholesale transactions that by their nature pass through several owners before delivery to California. Each stop on the way presents an opportunity for error or manipulation. RSPs that rely more directly on the wholesale electricity markets to meet native load have the opportunity to benefit by gaming and manipulating the wholesale electricity markets. Without being the point of regulation, these RSPs will not be subject to penalties or corrective actions.

Marketers will have the opportunity to pool low-GHG emitting resources for import to California, while selling higher-GHG emitting resources to others outside California. Since the location of the low- and high-GHG emitting resources will not change, we would expect no "first-order" environmental impact using a "first-seller" approach or load-based approach for a California-only GHG regulation. The issue of leakage or contract shuffling appears to be more directly related to a California-only regulation that does not take into consideration that the electricity infrastructure that supports California is WECC wide.

From a regional perspective, the impacts of applying the point of regulation to

first-seller may be more pronounced in the Pacific Northwest in comparison to the Southwest. This is because while three-quarters of California's electricity imports are delivered through the Southwest, they tend to be more specified (71%) than unspecified (29%) sources. However, the remaining one-quarter of California's electricity imports that are delivered through the Pacific Northwest are predominantly unspecified (88%) with only a small amount actually specified (12%) (i.e. the source of generation is known).

2005 California Net Electricity Imports (GWhs)

Type	Northwest	Southwest	Total	% of Total
Specified Imports	2404	44159	46563	56%
Unspecified Imports	17882	18083	35965	44%
Total Imports	20286	62242	82528	100%
% of Total Imports	25%	75%	100%	

Source: California Energy Commission (CEC-700-2007-007, page 6).
Unspecified from South West = 29% of total Southwest imports Coal is 4% of SW unspecified with remaining 96% natural gas based on a marginal dispatch model. Unspecified imports from Northwest was 88% of total Northwest imports.

A first seller approach that relies on NERC e-tags to track sources would create an opportunity for market manipulation and gaming by market participants. A better approach would be the use of mutually agreed upon regional emissions factors (i.e. between Oregon, Washington and California). However, this raises the question of whether a first-seller approach that relies on regional emissions factors provides any greater accuracy for emissions tracking than a load-based approach that also uses the same factors. If there is no greater accuracy, the first-seller approach is not superior to a load-based approach for tracking emissions from electricity imports.

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

Answer: The first-seller approach is subject to gaming for the reason noted above. There are a limited number of sources within the WECC, and therefore, the potential for emissions leakage or contract shuffling could occur under either approach. California will be subject to an environmental dispatch model, and since it is a net importer of electricity, it will be importing relatively "cleaner" energy into California. However, the other Western States in WECC that are not subject to GHG regulations will be deemed to consume energy from the higher GHG emitting units or the Western States will impose export limitations or financially compete for the lower emitting resources.

The LADWP believes this issue needs to be addressed in more detail with further public discussion. The first-seller approach appears to only shift the point of regulation. However, it is unclear whether or not it results in greater emission reductions as compared to a load-based approach. The LADWP is aware that some parties advocate for a first-seller approach in combination with a distribution of allowance allocations to retail service providers irrespective of whether or not they are also the point of regulation as the first-seller. The LADWP believes that this added regulatory complexity is not fully understood and could cause harm to the electricity sector. The LADWP believes it is not appropriate to require emissions reductions from marketers that do not own generation assets nor serve retail load. Additionally, it is unclear how an emission allowance allocation and declining emissions cap will be applied to the first-seller that is a marketer or a California utility with a minor ownership in an imported resource.

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?

Answer: LADWP does not believe that there is an advantage to applying the first-seller approach to reporting only, while having the retail providers designated as the point of regulation. Bifurcation of reporting and compliance obligations does not appear to be consistent with good environmental policy. It is much more straightforward to track the emissions from source to load.

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.

Answer: The first-seller approach will impede the liquidity of the market, resulting in higher electricity prices and reduced reliability for consumers. As discussed previously, a potential difficulty may emerge for forward market transactions wherein the generation source is typically not known at the time a transaction is negotiated, and is only identified and attributed after the electricity is delivered. It is unclear how energy will be accurately priced at the time of transaction. Such uncertainty may become a disincentive for a marketer, as a point of regulation, to enter into such transactions. This could have the unintended consequence of reducing the liquidity of the forward market and potentially reducing system reliability. It might not provide the correct financial incentive for reducing GHG from out-of-state generation.

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?

Answer: A load-based approach has more transparency. Each long-term load-based transaction has an associated contract that can specify the source(s) of energy, thereby providing transparent reporting of GHG emissions. A load-based approach

aligns more closely with the State's energy loading order by connecting the procurement decision maker with the energy efficiency programs and load shifting programs. Short-term contracts can use a regional default emissions factor for reporting of GHG emissions when the source is unspecified.

A first-seller approach will depend on NERC e-tags that are not currently designed to track the appropriate reporting entity. Please refer to response to question 12 for impacts on wholesale prices.

The prices associated with electricity produced from low-GHG emitting sources will increase under both a load-based or first-seller approach. Conversely, the prices associated with electricity produced from high-GHG emitting sources will decline; this phenomenon is especially true as it relates to the current situation in California with the adoption of SB 1368 that limits long-term financial investments in baseload generation to sources that emit no more than the equivalent of a combined-cycle natural gas plant (i.e. 1,100 lbs/MWh). The load-based approach clearly identifies the entity responsible for reporting and compliance.

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?

Answer: A marketer of energy will not have any incentive to invest in low-GHG emitting generation technologies as it does not own generation assets. A load-serving entity under a load-based cap will have a strong incentive to invest in low-GHG emitting generation technologies, since it will be directly impacted by the requirement to track emissions, reduce its GHG footprint, and fulfill its obligation to serve.

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.

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

Answer: The LADWP does not offer service from ESPs in our retail service area.

C. *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.

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?

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?

Answer: Under either approach, the dispatch of existing generation units will likely change to a model wherein lower GHG-emitting units will be dispatched or imported into California, higher GHG-emitting units will be dispatched to other Western States that are not subject to GHG regulations. This could adversely impact reliability given that many low-GHG emitting resources (e.g. hydro, wind, and solar) are intermittent and/or seasonal by nature, and as such, cannot be reliably dispatched when compared to thermal resources (e.g. coal and natural gas). For example, these seasonal and/or intermittent renewable resources will need to be "firmed" or "backed-up" primarily by other higher GHG-emitting resources. As more renewables are placed

into service, existing hydro and natural gas generation resources will be needed to "firm up" such seasonal and/or intermittent resources.

The short-term impacts could be more severe with new dispatch protocols and attempts to implement more ramping for the existing higher GHG generating units. These operational changes will require a transition period to flush out the system limitations. This becomes more difficult with many of the utilities operating on the margin of the generation and the challenges with siting new generation and transmission.

D. *Interaction with Existing Programs 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)?

Answer: The existing generation portfolio will be subject to California environmental dispatch and may result in less available resources for reliability dispatch. To the extent that seasonal and/or intermittent renewable resources are placed into service, additional thermal, hydro and/or other dispatchable generation capacity (i.e., reserves) must be set-aside to back-up such resources and maintain system reliability. This will increase the costs to maintain Resource Adequacy for POUs.

21. How would a deliverer/first-seller approach interact with the Public Utilities Commission's promotion of end-use efficiency?

Answer: The LADWP is not subject to CPUC jurisdiction and therefore cannot comment on this question directly.

How would this approach affect energy efficiency programs for the POUs?

Answer: A first-seller approach would have less direct beneficial impacts on end-use efficiency in comparison to a load-based approach. This is because a first-seller approach creates a disconnect between the point of regulation that falls on a generator or marketer and the load center to which the energy is delivered. Under a load-based approach, the point of regulation and the opportunities to implement energy efficiency fall to the same party, the retail service provider.

The load-based approach allows the procurement decision makers a broader opportunity to evaluate all the resource options and do longer term planning. The first-seller, if it is a marketer, might end up being short-sighted chasing existing low-GHG resources and having no direct end-use relationship. Therefore, investing in efficiency might not be evaluated by a first-seller/marketer in the same way as a retail service provider that serves native load. For retail service providers that are more fully resourced, they will be more inclined to implement energy efficiency and DSM (i.e., Demand Side Management) strategies in comparison to others that are less resourced and rely on wholesale electricity markets to serve a greater portion of their native load. The more reliance on the wholesale market, the more likely the regulatory burden of compliance shifts away from the retail service provider and onto the first-seller, resulting in disincentives for supporting energy efficiency and DSM strategies.

Under which system (deliverer/first-seller or load-based) would the penetration of end-use efficiency likely be greater? Why?

Answer: The load-based approach would have greater end-use efficiency penetration due to the reasons stated above.

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

Answer: LADWP also has an RPS goal, separate from the State's RPS requirements. The RPS resources are procured using a similar process as traditional resources and it should not change with a first seller approach. In as much as renewable energy resources are located outside California and renewable energy is imported into California in increasing levels, the renewable energy generator would have a greater GHG mandatory reporting and compliance burden under AB 32 than under a load-based approach as described in the following question.

23. How should renewable energy generators be treated under a deliverer/first-seller system?

Answer: When a renewable energy generator is designated a first-seller, they would be subject to the same requirements of all first-sellers, including reporting and compliance requirements. Some renewables have GHG emissions (e.g. landfill gas, digester gas, biomass, etc.).

24. Compare and contrast the impact of a deliverer/first-seller and a load-based approach on the voluntary renewables market.

Answer: Under both approaches, more renewables will be delivered to California, since California retail service providers will pay more for such energy given the need to achieve renewable and GHG mandates. The approaches seem to differ only in terms of the entity that is responsible for reporting and complying with AB 32.

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?

Answer: A load-based approach will likely produce a greater amount of emissions reductions in California, as the load-serving entity will be responsible for

reporting and reducing its GHG emissions. In a first-seller approach, the first-seller could be a load-serving entity, generator, or marketer of energy. A marketer of energy does not own generation assets or serve retail customers , and therefore will not have any incentive to reduce emissions.

E. *Reporting, Tracking, and Verification*

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

Answer: In a first-seller approach, there could be multiple transactions involving more than one marketer in the sale of the same energy, and as such, each marketer will need to track the emissions associated with such transactions. Each marketer involved in such energy transaction will not necessarily be in a position to identify the "first-seller" until the transaction is completed. This requirement will place a heavy administrative burden on the participants to such transactions. A load-based approach that uses regional or system-specific emission factors will reduce administrative burden and provide greater clarity with respect to regulatory emissions compliance since the responsible party is known at such time that the transaction is negotiated.

Currently, identification of a generation source (whether by generator or by producing system) is rarely a part of the transaction negotiation process. When a transaction is negotiated, the source of the energy is not typically known. After trading occurs, all energy transactions must be prescheduled. This process involves scheduling the actual flow of power across Balancing Authority tie-points ensuring that quantities, location, and transmission paths/rights are all defined. These are communicated on a North American Electric Reliability Corporation (NERC) Tag that

also defines all marketers in the path from the source (generating unit or Balancing Authority), to the sink.

It is only after this step (after the trade is completed) that there may be an indication of the actual source of the energy, but to emphasize, this source will not have been specified during the negotiation process. In fact, at certain times, the source is not connected to a mutually agreed upon unit (unit contingent). Unit contingent sales can be supplied from systems or generating units different from the unit being relied upon to make the trade. The agreement is such that the transaction is contingent upon the the availability of a specified unit, whether or not such energy is provided from such unit.

The source can be from a "system" or from a specific generating facility. However, because e-tags are designed to display information to support transmission system reliability and track electron movement and do not reflect all the elements of a transaction or add elements to the transaction that were not agreed upon, they are not a good source for developing an inventory or source tracking database. Once all transactions are NERC tagged, each Balancing Authority will generate energy and capacity schedules in their energy management systems and control their systems based on the import and export of energy across their tie-points and other reliability related inputs.

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?

Answer: To the extent that the CPUC/CEC's final decision on mandatory reporting protocols might rely on NERC e-tags for purposes other than reliability, such as source tracking, the LADWP does not support that use. We support the use of

regularly updated regional emission factors for unspecified purchases until such time that a more accurate WECC-wide emissions tracking system is brought on-line. If a first-seller approach relies upon regional emission factors for unspecified purchases, it brings into question whether a first-seller approach is any more accurate than a load-based approach to identifying the emissions and generation source.

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?

Answer: The ARB is currently proposing a dual reporting approach in their draft regulatory concepts for mandatory reporting in which in-state emissions are reported by both retail providers and generators. This approach provides retail providers with access to the repository for the facility specific information that would be used for load-based reporting. Additionally, it provides the State with an opportunity to more easily transition to a federal source-based program in the future, because it is assumed that retail provider reporting will be eliminated under a federal program. The first-seller for electricity imports may be one or two parties closer to the generation source, but it is incorrect to assume that the data reported for electricity imports will be any more accurate than that using a load-based approach.

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.

Answer: The first-seller approach relies on NERC e-tags that may accurately identify the first-seller, but are not designed or intended to track sources of power for the reasons discussed throughout this filing. As such, it is unclear how a first-seller that is a marketer will be able to accurately identify the emissions profile of the electricity being delivered into California without all the previous parties on the NERC e-tag also tracking

such emissions. Ultimately, the marketer has the discretion of assigning the source to the NERC e-tag, and therefore, under a first-seller approach, the accuracy with respect to the identification of the emissions associated with a transaction is not enhanced, whatsoever.

The load based approach relies on contractual arrangements that may in some cases specify the generation source. Short-term transactions will be negotiated with the use of default emission factors for the Northwest and Southwest. Short-term wholesale electricity import transactions, by volume, represent a relatively small percentage of California's electricity consumption. Until there is a regional program that covers the WECC, the attempt to accurately track emissions back to the source under a first-seller approach will remain problematic and subject to gaming and market manipulation.

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?

Answer: Federal Energy Regulatory Commission governs access to the purchasing/selling entity data on the NERC-e-tags. A state agency could enter into an agreement with NERC to revise its access provisions regarding e-tags in order to obtain access to e-tag data.

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

Answer: Regardless as to whether a first-seller or a load-based approach is adopted, balancing authorities including CAISO, LADWP, SMUD, Turlock and IID will have additional administrative burdens. With respect to the first-seller approach, balancing authorities will need to track the energy flowing into and out of its system and ensure that energy is dispatched in an environmentally responsible manner to achieve

the goals of AB 32. With respect to a load-based approach, Balancing Authorities will need to track each participant's GHG emissions. As discussed above, CAISO can upgrade its MRTU to track emissions. Also, although the WREGIS does not track emissions, it could be upgraded to measure the generation and emissions from all generation sources.

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?

Answer: The LADWP does not support the auction of allowances for several reasons as set forth in our comments to the Market Advisory Committee (MAC). The LADWP supports the MAC's recommendation that "[In the near-term] the State should retain flexibility to allocate a share of allowances for free to certain sectors." With respect to the electricity sector, the LADWP supports an allocation method that is not punitive and will not result in significant cost impacts to its retail customers. Some of the specific concerns related to auctions and the distribution of allowances are:

- Outstanding issues related to the first seller approach, including distribution of allowances, administration of auctions, costs and proceeds and impacts on forward energy markets (as discussed by parties in response to this ruling).
- As the MAC acknowledges, there is no experience with a 100 percent auction of allowances in previous emission trading programs. The Acid Rain program allocated almost all of its allowances for free and, as mentioned in Appendix B of the report, was implemented quickly and on schedule and achieved near 100 percent compliance. In addition, electricity sector SO2 emissions declined 35 percent from 1990 to 2005.
- If a large percentage of allowances are auctioned, there is chance of market manipulation. For example, in the case of the Acid Rain auction this past year and in the RECLAIM program, financial entities' participation has been significant. Entities that need allowances to serve native load may bid into the auction, but not be awarded sufficient allowances to meet its projected native

load and may need to later purchase allowances at significantly higher prices from entities that are speculating (e.g. financial entities).

- An auction is not needed to generate revenues to stimulate development of emerging technologies in the electric sector. California already has aggressive programs, like the Renewable Portfolio Standard, energy efficiency and the public goods charge, which promote carbon-neutral technology development. Additionally, there are various federal funds and tax incentives for clean technology. Load serving entities (LSEs) will have cost impacts as they continue to acquire resources that are GHG neutral or low-emitters. Adding costs to LSEs by requiring that they purchase allowances in addition to their investments in clean technology will only add to our customers' cost obligations.

33. If you do not 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.

Answer: The issue of first-seller is inextricably linked to how allowance allocations are distributed. The LADWP does not support the auction of allowances for the reasons stated above. Additionally, the LADWP questions the appropriateness of making one set of parties (generators and marketers) the point of regulation while providing the financial value of allowance allocations to parties that may not be the point of regulation nor have the burden of compliance (retail providers). We recognize the retail providers and generators may be one and the same in certain cases and therefore would also be the point of regulation.

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?

Answer: With regard to allowance allocations, the LADWP does not support the distribution of allowances in any way that results in a wealth transfer between parties. LADWP believes that the most equitable way to distribute allowances is to distribute for free based on actual emissions with a declining cap that ultimately results in the

reduction of GHG emissions to 1990 levels by 2020. Some parties have suggested that allowance allocations should be distributed to retail service providers based on customer sales, population served or other similar criterion, and then placed into an auction that all first-sellers and in-state generators would need to purchase credits from to cover emissions. This approach to distribution is blind to an entity's specific compliance burden and would result in an over-allocation to some parties and a significant under-allocation to other parties. It also adds unnecessary complexity without demonstrating any greater emission reductions than a load-based approach. For this reason and others stated throughout this filing, the LADWP questions the validity of a first-seller approach to point of regulation.

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?

Answer: If a cap-and-trade program is adopted under AB 32, it is likely that such a program will have broad coverage, by including multiple sectors and allowing the trading of credits between sectors. In as much as such a program will be fair and simple to administer and communicate, it will also need to provide consistent treatment in how the program is to be applied to each sector. Further discussions are required in order to more fully understand how the first-seller approach will be integrated into a multi-sector cap-and-trade program. Regardless, it is LADWP's position that the goal of AB 32 and any regulatory scheme to implement the law must be the reduction of GHG emissions and not the establishment of an emissions trading 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.

Answer: Double counting will not be an issue under a source-based program, but it is unclear at this time whether or not a first seller approach will eliminate the potential for double-counting electricity imports. The first-seller approach must rely on other data besides NERC e-tags to identify emissions accurately. It is not clear what that data source will be. In the absence of such data, a California-only program will continue to present a double-counting problem, regardless of whether it is a load-based or first-seller approach. The LADWP recommends that California coordinate with other states to identify a common methodology for emissions reporting to minimize double counting.

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?

Answer: Exports should be excluded from energy serving load in California under a first-seller approach consistent with the inclusion of imports in California's GHG footprint. For the most part, the emissions associated with imports and exports can be dealt with contractually. When emissions cannot be traced to a source, then a default regional or system emission factor can be used. Use of a default emission factor under a first-seller approach will not provide any greater benefits than use of a default emission factor under a load-based program.

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?

Answer: The State of California must work in coordination with other states to ensure that low/zero GHG-emitting resources are not double counted and higher-emitting GHG resources are not left unaccounted for in connection with both imports and exports between states. A first-seller approach does not adequately address this issue for electricity imports, and does not present a better approach in comparison to a load-based approach that utilizes agreed upon regional emission factors for unspecified sources. In the future, low-GHG emitting resources will likely be more closely tracked and monitored, because of their increased value under GHG regulations. Parties that procure low-GHG resources will require that those attributes be included and not double-counted elsewhere. This potential for double-counting and under-counting resources illustrates the urgent need for coordination between states. AB 32 emission reduction requirements will begin in 2012, giving California and other states the next five years to aggressively develop a better emission/source-tracking program. The inappropriate use of NERC e-tags for emission/source tracking will leave open the opportunity for market manipulation and gaming by parties.

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

Answer: The LADWP is not familiar enough with the Oregon load-based system to comment at this time.

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?

Answer: A first-seller approach can transition into a multi-state, national, or international program for in-state sources regulated under AB 32, assuming that the program is source-based. National programs such as Acid Rain have allocated allowances to generating sources based on a historical baseline and these sources have also been the point of regulation with respect to reporting and tracking of emissions. However, a first-seller approach to AB 32 for electricity imports that applies to marketers may be more difficult. This depends on how allowance allocations are distributed, and whether they are distributed to retail service providers that are not the point of regulation. This may pose additional challenges and the LADWP recommends that this be examined further.

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.

Answer: LADWP believes that a first-seller approach may provide an easier transition to a federal GHG regulatory system for <u>in-state</u> sources regulated under AB 32, assuming the federal program is source-based. If a reporting system is established in California for generators and retail service providers under a load-based approach (i.e. as is being proposed by the Air Resources Board), this will also facilitate a smoother transition to a federal program.

However, a first-seller approach to AB 32 for electricity imports that applies to marketers may be more difficult. This depends on how allowance allocations are

distributed, and whether they are distributed to retail service providers that are not the point of regulation. This may pose additional challenges and the LADWP recommends that this be examined further.

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

Answer: The LADWP cannot make a recommendation to support a first-seller approach for GHG reduction efforts at the regional or national level due to the additional complexities it introduces as an unproven regulatory model. The first-seller places the regulatory burden on marketers that do not own generation assets and do not serve native load, and will not be reflected in a baseline inventory of emissions that will be used to set emission reduction goals. It is unlikely that a marketer will be the point of regulation under a federal program for these reasons. The first seller also places the regulatory burden on out-of-state generators that deliver energy into California, while removing any regulatory obligation from the corresponding California retail service program that actually caused that energy to be delivered into California in the first place. This shift appears to provide not additional benefits in the way of greater emission reductions, which should be the primary reason for pursuing an alternative regulatory scheme.

For a broader GHG program, the LADWP supports a source-based regulatory structure for regional efforts that encompass all sources within a single electricity region (i.e. WECC wide) or federal program. A source-based program provides greatest ease of compliance for reporting and emissions reductions, as well as simplicity and clarity for inventory development, emissions tracking, allowance allocations, and declining emissions caps.

J. *Questions for Legal Briefing*

The following provides LADWP's initial response to the questions presented in Section J regarding legal issues associated with the deliverer/first seller approach. LADWP continues to evaluate the proposals, information, regulations and law that are implicated by these questions, and may update, modify or enhance its responses in future submittals.

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?

Answer: The legal issues involving preemption do not lend themselves well to an absolute conclusion or answer to this question. However, as the CPUC and the MAC both have recognized, the first seller approach raises the question of preemption under the Federal Power Act in a way that the load based approach does not.[1]

Section 201(b)(1) of the Federal Power Act describes and delimits the activities that are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC" or "Commission") as follows: ". . . the transmission of electric energy in interstate commerce and . . . the sale of electric energy at wholesale in interstate commerce . . . ." 16 U.S.C. § 824(b)(1). This section further provides that "[t]he

[1] "[A] load-based cap is the type of cap over which the CPUC has obvious authority with regard to procurement practices. Our authority to impose a GHG cap on exempt wholesale generators under the jurisdiction of the Federal Energy Commission is more questionable." *CPUC Decision 06-02-032* at p. 18. "Another potential legal challenge has to do with the Federal Power Act. Some have suggested that this Act may render substantive "first seller" obligations unenforceable by the state with respect to wholesale transactions. These issues also require further investigation." MAC Report at p 45.

Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, . . ." subject to certain exceptions that are not relevant here. *Id.*

Under the Federal Power Act, the FERC's jurisdiction to determine the reasonableness of rates and terms for electric transmission and wholesale sales of power in interstate commerce is exclusive. *See Nantahala Power & Light Co. v. Thornburgh*, 476 U.S. 953, 955, 964 (1986) (state utility commission was pre-empted by FPA as to direct regulation of allocation of wholesale power for supply to retail distribution utilities). And Supreme Court precedent establishes that the mere fact that FERC has jurisdiction to decide an issue (rather than the fact that it actually adjudicated the particular issue) within its FPA jurisdiction is the key factor in determining preemption. *See Mississippi Power & Light Co. v Mississippi ex rel. Moore*, 487 U.S. 354, 368-75 (1988).

FERC has of course recognized that the states are free to regulate on the buy side in the traditional areas of state authority such as resource portfolios:

> As a general matter, states have broad powers under state law to direct the planning and resource decisions of utilities under their jurisdiction. States may, for example, order utilities to build renewable generators themselves, or deny certification of other types of facilities if state law so permits. They also, assuming state law permits, may order utilities to purchase renewable generation.

Southern California Edison Company and San Diego Gas & Electric Company, 71 F.E.R.C. P61,269, 62,080 (1995) (order on requests for reconsideration). *See also FERC Order No. 888*, 61 Fed. Reg. 21540, 21626, n. 544 (May 10, 1996).[2]

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[2] "This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of integrated resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges."

However, there is no precedent for allowing a state to exercise this traditional state authority by regulating the wholesale transaction itself, which would be the case under the deliverer/first seller approach, where the first wholesale seller into California would be required to hold allowances to cover its transaction or be faced with a penalty. As one commentator has noted:

> If there is a state requirement that renewable energy resources be deployed as a certain percentage or component of the portfolios of retail suppliers or sellers, then this decision is within the general authority of the state. *If this regulation reaches upstream to regulate the wholesale acquisition of this power, or wholesale prices, then it overreaches the bounds of state authority.* A New York decision held that a state cannot compel a utility to purchase . . . power from a particular wholesale source.... [A] state may control the type of retail portfolio, but not the particular wholesale acquisition, source, or wholesale price.

Steven Ferrey, *Sustainable Energy, Environmental Policy, and States' Rights: Discerning the Energy Future Through the Eye of the Dormant Commerce Clause*, 12 N.Y.U. Envtl. L.J. 507, 617 (2004) (citations omitted) (emphasis added).

The CPUC appears to recognize this distinction in its interim opinion on the emissions performance standard.[3] That FERC may do so as well is at least suggested by *Edison Electric Institute*, 69 F.E.R.C. P61,344, 62,289 (1994):

> [I]f a wholesale sale of electric energy by a public utility requires the use of an emissions allowance, that sale and the cost of allowances in connection with it, is subject to review under section 205 [of the Federal Power Act].
>
> However, when . . . the sale or transfer [of an allowance] occurs independent of a sale of electric energy for resale in interstate commerce, we also agree with EEI that [the sale] does

[3] "In CEED's comments on the Proposed Decision, it also claims that the EPS is preempted by the Federal Power Act...[pointing out] that the FERC has exclusive authority over the wholesale market under the Federal Power Act. The EPS, however, is not regulating wholesale generators or marketers. The EPS is regulating LSEs, which sell electric energy in the retail market in California. Under Section 201(b) of the Federal Power Act..., Congress preserved the State's authority over such retail sales service and the public utilities which provide such retail sales service." *Decision 07-01-039* at pp. 201-202.

not constitute a sale of electric energy for resale.

Even though the deliverer/first seller will not be required to present its allowance or pay a penalty until sometime after its wholesale transaction is complete, it is difficult to argue that the requirement for an allowance is "independent of [the] sale of electricity for resale in interstate commerce" since the requirement is specifically triggered by, and would not exist in the absence of, that transaction.

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

Answer: Changing the point of regulation would make a difference in the analysis. In particular, assuming that the reporting entity requirements were imposed on the deliverer/first-seller as a result of limitations on the in-state purchaser and/or contractual obligations imposed by the in-state purchaser, this approach would appear to separate state regulation from the sell side of wholesale transactions. As discussed in the responses to both Questions 43 and 46, the potential Federal Power Act implications of avoiding such direct regulation of wholesale transactions would appear to reduce vulnerability to preemption challenges, and is one of the reasons that the load-based approach would appear to be the better option.

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?

Answer: See Answer to 44 above.

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

Answer: A load-based regulatory approach would be less susceptible to a

challenge asserting Federal Power Act preemption, based on the states' recognized authority to regulate utility generation portfolios. state utility commissions traditionally have exercised ratemaking jurisdiction over the "prudence" of utility expenditures which are ultimately included in retail rates, such as power purchases, and two federal courts of appeals, as well as FERC, have ruled that this power is not preempted by exclusive federal jurisdiction over wholesale rates. *Public Service Company of New Hampshire v. Patch*, 167 F.3d 29, 35 (1st Cir. 1998); *Kentucky W. Va. Gas Co. v. Pennsylvania PUC*, 837 F.2d 600, 609 (3d Cir. 1988); *Palisades Generating Co.,* 48 F.E.R.C. P61,144, 61,574, n. 10 (1989). State jurisdiction over retail utility cost-inputs may well be consistent with the exercise of state jurisdiction over other (i.e., non-cost) features of inputs to retail utility services as well, and the FPA does not expressly limit state prudency determinations to economic matters only.[4]

The deliverer/first-seller approach is more vulnerable, because it makes the wholesale sale the point of regulation and thus runs the risk of intrusion on FERC's exclusive jurisdiction over wholesale sales of power in interstate commerce.[5]

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[4] Under PURPA, the FERC's exclusive regulatory jurisdiction over certain rate, corporate and financial matters has been found not to attach to purely non-regulatory disclosure and monitoring programs. See, Ind. Power Producers of N.Y., Inc., 80 F.E.R.C. P61,125 (1997), order on reh'g, 80 F.E.R.C. P61,360 (1997). Similar reasoning might apply under the FPA, particularly since it might be difficult for state regulatory commissions to exercise "prudency" regulation over retail utilities in the absence of information-gathering programs (see discussion infra).

[5] The MAC Recommendations (p.42) state that "Under the first-seller approach, the responsible entity or point of regulation is either the owner or operator of the California power plant, or the importing contractual party, depending whether the electricity involves in-state or out-of-state generation. The importing contractual party could be any wholesale power marketer (it need not be an LSE)." Whereas, as characterized in the ALJ ruling "the first-seller concept discussed in the Market Advisory Committee report can be defined in the following manner: (a) for <u>in-state</u> California generation, the first seller <u>is the generator</u>, in all cases; and (b) for <u>imported power</u>, the first seller is the entity that <u>first delivers electricity</u> at a point of delivery within California. These definitions are non-identical. These comments are based on the definition in the ALJ ruling which identifies the point of regulation for interstate transactions as the seller making the first delivery in California. Under the MAC definition, the point of regulation could be an out-of-state seller delivering out of state. If that were so, the potential legal pitfalls of the first seller

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?

Answer: It would be beyond FERC's authority to simply "waive" statutory provisions granting it exclusive regulatory jurisdiction under the FPA so as to vest California authorities with powers belonging to FERC; doing so would effectively be a FERC waiver of its jurisdiction to and for the benefit of a state, and the FERC cannot and will not waive provisions of the FPA which do not themselves expressly provide for such waiver. *See e.g., Removing Obstacles to Increased Electric and Natural Gas Supply in the Western United States*, 95 F.E.R.C. P61,225 (2001); *El Paso Elec. Co.*, 105 F.E.R.C. P61,131 (2003). Accordingly, FERC action to modify a FERC-jurisdictional tariff might not itself be sufficient to ameliorate an FPA impediment.

<u>Dormant Commerce Clause</u>

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

Answer: The chief dormant Commerce Clause problem is that the deliverer/first seller approach attaches direct restrictions to imports of electricity in order to regulate electricity production and greenhouse-gas emissions outside California. In general, "[s]tates . . . may not attach restrictions to exports or imports in order to control commerce in other States." *C&A Carbone, Inc. v. Clarkstown,* 511 U.S. 383, 392 (1994); *Healy v. Beer Institute,* 491 U.S. 324, 336 (1989); *Baldwin v. GAF Seelig, Inc.,*

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approach would be even more serious..

294 U.S. 511 (1935). However, while the deliverer/first-seller approach may raise concerns under the dormant Commerce Clause, we are hesitant to predict that any particular scheme would be struck down under the Commerce Clause.

The application of the dormant Commerce Clause is by no means inevitable whenever states restrict interstate commerce. For example, *Pharmaceutical Research and Mfrs. of America v. Walsh,* 538 U.S. 644, 668-70 (2003), upheld a state law requiring drug manufacturers to rebate part of the price received in out-of-state transactions with wholesalers, as a condition of full access to Maine's drug market. Further, a state law can survive the dormant Commerce Clause if it is viewed as merely affecting, rather than regulating, out-of-state commerce. *See, e.g., Freedom Holdings, Inc. v. Spitzer,* 357 F.3d 205 (2d Cir. 2004) (state law's practical, and allegedly intended, effect of requiring increased prices in out-of-state transactions held permissible as mere upstream effect of permissible regulation); Laurence H. Tribe, *American Constitutional Law* 1078 (3d ed. 2000) ("If a state law has the inevitable consequence of actually regulating (and not merely affecting) conduct outside the state, it runs afoul of . . . the Commerce Clause."). However, the deliverer/first-seller approach would appear to directly regulate the actions of out-of-state sellers, thus increasing the likelihood of raising dormant Commerce Clause concerns.

To add to the complexity of the issue, in an area where two federal statutes (the Federal Power Act and, as discussed below, the Clean Air Act) may be viewed as delineating the respective federal and state roles, it is doubtful whether the dormant Commerce Clause is relevant. That is because any state action that the Federal Power Act and the Clean Air Act specifically allow is valid regardless of the dormant

Commerce Clause, and all other state action is preempted. Thus, there is some interplay between the preemption issues under the FPA and CAA, and the dormant Commerce Clause considerations associated with the deliverer/first-seller approach.

The interplay among these various legal and regulatory schemes is particularly important because greenhouse gas regulation is politically charged. The focus on pursuing regulation of greenhouse gas emissions may strongly pull different judges in different directions on preemption and dormant Commerce Clause issues.

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

Answer: Similar to the response to Question 44 above, changing the point of regulation would likely make a difference because arguably it would eliminate or reduce the direct regulation of out-of-state sellers. Again, this is one of the reasons that the load-based approach would be appear to be more sound and less vulnerable to challenge.

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.

Answer: The CPUC has determined that there is not any valid objection to the load based approach under the dormant Commerce Clause. *See Decision 06-02-032* at pp. 20-22. The analysis of the deliverer/first-seller approach is different because the approach more directly regulates conduct outside California. As stated above, states generally "may not attach restrictions to exports or imports in order to control commerce in other States." *C&A Carbone, Inc. v. Clarkstown,* 511 U.S. 383, 393 (1994) (citing *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511 (1935); *Healy v. Beer*

Institute, 491 U.S. 324, 336 (1989).

Both a first-seller and a load-based approach could potentially violate this rule. Either way, California would be attaching a restriction (the need for a California state allowance) to an import (power) in order to control commerce (power generation) in other states. "The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Healy,* 491 U.S. at 336 (emphasis added). Nevertheless, the first-seller approach is potentially more vulnerable because it attaches a direct restriction (need for emission allowance) to imports (of power) to control commerce (power generation and emissions) elsewhere. In addition, the first-seller approach will directly regulate a person outside the state (i.e. any out of state first seller). In contrast, the load-based approach formally regulates only LSE purchasers within California.

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?

Answer: It would appear that at least some of the described uses could potentially raise problems under the dormant Commerce Clause. State law generally cannot protect in-state businesses against competition from other states, or neutralize advantages of out-of-state producers. *E.g., West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 194 (1994) (citing cases); *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511 (1935). Transition assistance could easily be interpreted as an attempt to address

competitive advantages for out of state businesses.

Moreover, having enacted a law that raises in-state producers' costs, a state cannot then require out-of-state producers to abide by the same rule to neutralize their cost advantage. *E.g., Baldwin,* 294 U.S. 511 (New York, having permissibly set a floor on milk prices charged by New York farmers, could not require out-of-state milk to adhere to the same price to "keep the system unimpaired by competition from afar"). In addition, in *West Lynn Creamery,* the tax on products originating out of state was used to subsidize in-state producers. The Supreme Court invalidated the subsidy precisely because it was funded from the tax on goods originating out-of-state. *West Lynn Creamery,* 512 U.S. at 194-97, 199 ("The pricing order [subsidy] in this case, however, is funded principally from taxes on the sale of milk produced in other States . . . The pricing order thus violates the cardinal principle that a State may not "benefit in-state economic interests by burdening out-of-state competitors.").

Here, the price paid for emissions allowances (directly or indirectly) by out-of-state producers is analogous to a tax. To the extent the purpose of any charges are to prevent California's regulation of in-state emissions from driving commerce to lower-cost states lacking such regulation, it runs afoul of the principles expressed in *Baldwin*. More importantly, the proposed uses of the funds – transition assistance to cushion in-state industries and employees against competition, encouragement of innovation in California's own industry, or promotion of efficiency gains in California – are all subject to potential characterization as subsidies to California producers. The effective tax on out-of-state sources to neutralize their competitive advantage, and the use of the revenue to subsidize California competitors, both present potential problems under the

dormant Commerce Clause.

Authority to Auction

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

Answer: For the reasons stated earlier, as a policy matter, an auction of allowances raises a number of issues and would not be LADWP's preferred approach. LADWP is continuing to study whether ARB would have the authority to mandate and implement an auction if it chose to do so. However, to the extent that an auction would result in an appropriation of funds, there would appear to be an argument that AB 32 does not authorize any such appropriation. *See California Ass'n for Safety Education v. Brown*, 30 Cal. App. 4th 1264, 1282 (1994) (clear statement of legislative intent required to make an appropriation).

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.

Answer: One additional legal issue to consider is the potential for preemption under the Clean Air Act associated with the deliverer/first-seller approach. Under *Massachusetts v. EPA*, 127 S.Ct. 1438 (2007), stationary source GHG emissions almost certainly will be regulated as pollutants by EPA under the Clean Air Act[6]. While that case involved motor vehicle emissions, it hinged on the Act's definition of "air

[6] In the unlikely event that EPA decides not to regulate, at a minimum, *Massachusetts v. EPA* establishes EPA's jurisdiction to regulate GHGs. Thus, there may be an argument that EPA's jurisdiction in the area of Clean Air Act regulation is sufficient to establish federal preemption regardless of whether EPA chooses to exercise such jurisdiction.

pollutant," and that definition applies to stationary sources as well as motor vehicles. 42 U.S.C. § 7602(g) (definition of "air pollutant"); 7409(a)(1) (authorizing national ambient air quality standards for "air pollutant[s]").

The Clean Air Act allows states to impose controls on in-state emission sources that are stricter than federal controls. But the Act preempts states from applying such controls to any out-of-state source, except through participation in the federal permit procedure for the out-of-state source. That conclusion follows from *International Paper v. Ouellette*, 479 U.S. 481 (1987). *Ouellette* held that the Clean Water Act's provision for addressing interstate pollution in NPDES permit proceedings preempted any downstream state from seeking to impose its own regulation on an upstream sources in any other way. *Id.* at 489-97. The Sixth Circuit has held that *Ouellette*'s preemption ruling applies to the Clean Air Act. *Her Majesty the Queen v. Detroit*, 874 F.2d 332, 343 (6th Cir. 1989). *See also Ouellette v. International Paper Co.*, 666 F.Supp. 58 (D.Vt. 1987) (same).

The Clean Air Act, like the Clean Water Act, has a system for permitting major sources, which includes a procedure for contiguous states to seek to impose additional restrictions on the permit for an out-of-state major source. 42 U.S.C. § 7661d. Given *Ouellette*'s holding that the Clean Water Act provision is preemptive, it is difficult to avoid the conclusion that the similar Clean Air Act provision is also preemptive and thus any state wishing to impose emission controls on an out-of-state major source must do so by participating in that source's permit proceeding under Section 505 of the Clean Air Act, 42 U.S.C. § 7661d.

Thus, it may be that any scheme for implementing AB 32 with respect to limiting emissions from power generated out-of-state is preempted by the Clean Air Act. However, the deliverer/first-seller approach seems particularly vulnerable. For imported power, the entity that first delivers in California will have purchased the power in another state, in some cases directly from the out-of-state generator. A system that attaches a penalty to an out-of-state purchase of power generated out-of-state, based on the emissions of the out-of-state generator, would almost certainly be viewed as an attempt by California to regulate out-of-state emissions, subject to preemption under *Ouellette*.

By contrast, if the point of regulation is the in-state load-bearing entity, there may be a plausible argument that California is merely regulating use of power within the state, and that incidental effects on other states may be disregarded.

IV. CONCLUSION

The LADWP appreciates the opportunity to provide these opening comments to the CPUC and CEC for your consideration.

Dated: August 6, 2007 Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached:

**OPENING COMMENTS OF THE
LOS ANGELES DEPARTMENT OF WATER AND POWER
ON THE ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS
AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT**

on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list, updated August 3, 2007. See attached service list. I served a copy of the document on those without e-mail addresses by mailing the document by first-class mail addressed as follows:

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