BEFORE THE CALIFORNIA ENERGY COMMISSION

Rulemaking to Consider Modification of Regulations Establishing a Greenhouse Gases Emission Performance Standard For Baseload Generation of Local Publicly Owned Electric Utilities	Docket No. 12-OIR-1	**DOCKET** **12-OIR-1** DATE MAR 26 2012 RECD. MAR 26 2012

COMMENTS OF THE M-S-R PUBLIC POWER AGENCY ON ISSUES SET FORTH IN THE MARCH 6 NOTICE OF RULEMAKING WORKSHOP

Pursuant to the California Energy Commission (Commission or CEC) Notice of Rulemaking Workshop, dated March 6, 2012, the M-S-R Public Power Agency (M-S-R) submits these comments. This Rulemaking was initiated by the Commission in January 2012 in response to certain assertions and allegations contained in the Joint Petition of the Sierra Club and the Natural Resources Defense Council. In the Joint Petition, Petitioner's asked, among other things, that the Commission review the current emissions performance standard (EPS) regulation that was adopted by the Commission in response to Senate Bill (SB) 1368 (Perata, Chapter 598, Statutes of 2006). The *Regulations Establishing and Implementing a Greenhouse Gases Emission Performance Standard for Local Publicly Owned Electric Utilities*, Title 20, sections 2900 through 2913, (EPS Regulation) were adopted by the Commission in 2007.

I. INTRODUCTION

Created in 1980, the M-S-R Public Power Agency is a public agency formed by the Modesto Irrigation District, the City of Santa Clara, and the City of Redding. M-S-R is

authorized to acquire, construct, maintain, and operate facilities for the generation and transmission of electric power and to enter into contractual agreements for the benefit of any of its members. As such M-S-R does not serve retail load within California but supplies wholesale power under long-term contracts to its retail load-serving members. M-S-R pursues the development of energy projects and contracts within California and outside of the State, with a focus on renewable energy projects, on behalf of its member agencies who are obligated to meet the 33% renewable portfolio standard (RPS). Approximately 40 percent of M-S-R's portfolio qualifies as eligible renewable resources in California. M-S-R is also a part owner in the San Juan Generating Station. M-S-R has certain obligations and responsibilities under the various contracts that define the agency's obligations to its members, co-owners, and bond holders.

In 1982, M-S-R Public Power Agency negotiated with and acquired from Tucson Electric Power Company (TEP) an option to purchase from Public Service Company of New Mexico (PNM) a 28.8 percent ownership interest in San Juan Unit No. 4, a coal fired steam electric generating unit with a current net generating capacity of 507 MW. In 1983, M-S-R Public Power Agency exercised its option and acquired from PNM the San Juan Ownership Interest. San Juan Unit No. 4 is one of four coal-fired steam electric generating units which together make up the San Juan Generating Station. San Juan Unit No. 4 was declared commercially operable in April 1982, and is located in San Juan County, New Mexico, approximately 15 miles northwest of the City of Farmington. M-S-R also contracted to purchase or secure the rights to use necessary transmission capacity to transmit the generation from San Juan Generating Station to the M-S-R members service areas. These initial investments totaled over $385 million.

II. COMMENTS

The M-S-R Public Power Agency submits these comments in response to the issues raised in the March 6, 2012, Notice of Rulemaking Workshop. These comments are offered in the interest of furthering discussions with petitioners, Commission Staff, and other stakeholders on the issues raised in the original Petition and in the Rulemaking Notice. However, M-S-R believes it is imperative that all deliberations in this rulemaking be considered in the context of the state's current regulatory framework and the adoption and implementation of the state's Cap-and-Trade Program.

It is well know that the EPS mandate was always intended to serve as a temporary measure while the provisions of AB 32 were developed. Now, not only does the State have an extensive Scoping Plan (California Air Resources Board, Climate Change Scoping Plan, December 2008) and several legislative mandates regarding measures aimed at reducing the state's greenhouse gas (GHG) emissions, but California also has a lawful and comprehensive Cap-and-Trade Program. Such a milestone was specifically called out in SB 1368. Public Utilities Code § 8641(f)[1] provides that the Commission, in consultation with the California Public Utilities Commission (CPUC) and California Air Resources Board (CARB), "shall reevaluate and continue, modify, or replace the greenhouse gas emission performance standard when an enforceable greenhouse gas emissions limit is established and in operation, that is applicable to the local publicly owned electric utilities."

Since SB 1368 clearly contemplated the potential for an end to the EPS, M-S-R urges the Commission to review the ongoing need and efficacy of the EPS prior to engaging in a review of its current form and making any recommended changes. A market based cap on emissions will

[1] Unless otherwise specified, all references shall be to the California Public Utilities Code.

force all covered entities – which includes California's publicly owned utilities to which the EPS Regulation applies – to come up with the most cost-effective emissions reductions possible. M-S-R believes that with the implementation of the Cap-and-Trade Program Regulation on January 1, 2012, and with the imposition of penalties for non-compliance commencing on January 1, 2013, that the EPS Regulation should be revised to specifically include a sunset provision on that same date.

III. RESONSES TO QUESTIONS SET FORTH IN THE NOTICE

> ***1.*** *Whether to establish a filing/reporting requirement for local publicly owned electric utilities' (POU) investments in non-deemed compliant powerplants, regardless of whether the investment comes within the meaning of "covered procurement." (See Regs., §§ 2901, subd. (d), 2907.)*

A reporting or filing requirement for all POU transactions will be costly, is not authorized under the provisions of SB 1368, and serves no public purpose whatsoever. Failing a demonstrable and statutorily supported need for the submission of any additional information to the CEC, no such requirement should be adopted. Any reporting or filing requirement for all POU investments is not necessary and would be administratively burdensome for both the POUs and the CEC. No party has provided a clear articulation of exactly what information is needed and why it is necessary for the CEC to compile and review it; merely requiring the POUs to submit and the CEC to collect additional information has no value whatsoever, and an unbounded requirement to submit all investments could result in hundreds, if not thousands, of annual filings to be made by POUs. This ministerial task would have a significant economic impact on the public agencies at issue, and all without an articulated need. No additional reporting is necessary.

Furthermore, M-S-R is concerned that reporting advocates are seeking to expand the mandates of SB 1368 to include a "CEC review and approval" process for all POU transactions. Such a requirement would go beyond the scope of the legislation and should be avoided. It is important to keep in mind that POU transactions are carried out in public and by those that have been duly elected or appointed by the public to do so. POUs hold open-meetings and provide notice of these meetings in compliance with applicable laws; vast amounts of information regarding the operations of the POU are made available to the public, including information that is posted on the POU websites.

Aside from the extra-statutory implications of any additional reporting and filing mandates, the practical implications should also be considered. Any additional requirements would increase compliance costs for public agencies and their customers who are already sharing in the state's financial hardships, and would create even more administrative requirements on the CEC itself.

2. *Whether to establish additional criteria for a "covered procurement." (Regs., § 2901, subd. (d).)*

The regulation already includes a definition of covered procurements that clearly reflects the statutory language, and no additional criteria are necessary. This definition was developed as part of an extensive stakeholder process and underwent strict scrutiny from stakeholders, the Commission, and the state's Office of Administrative Law (OAL). Indeed, section 2901(j)(4)(B) was originally rejected by OAL for failure to meet the clarity standard, but was subsequently amended to the OAL's satisfaction. However, the point is clear that when the Regulation was

reviewed in its entirety, the definition of a "covered procurement" was not found to lack clarity and did not require any further explanation or clarification.

M-S-R believes that the existing definition and the statutory intent must be considered and applied to all potential procurements to determine which procurements are in fact "covered procurements" and subject to the regulation. An attempt at this late date to add criteria to the term "covered procurement" is essentially an attempt to redefine the term itself beyond the clear meaning of the language of the statute.

However, if Staff believes that there is a need to further review this definition, any definitional changes must be carefully weighed, prospectively applied, and must be determined as part of a deliberative stakeholder process that includes input from industry experts and those individuals and entities that are familiar with powerplant operations, and compliance matters. Furthermore, regardless of the final outcome of any proposed definitional changes, it must be made clear that any revisions to the regulation are applied prospectively only.

3. *Whether to refine the meaning of "new ownership investment" by, for example, defining the phrase "designed and intended to extend the life of one or more generating units by five years or more, not including routine maintenance" or defining the term "routine maintenance." (Regs., § 2901, subd. (j)(4)(A).)*

As noted above, the various definitions and provisions of the EPS Regulation have been reviewed by multiple state agencies, and with only limited exceptions – which have since been corrected – they were not found wanting. The definitions provide adequate guidance to affected entities and are not in the least ambiguous or in need of further clarification. Indeed, M-S-R strongly cautions against such an exercise unless it is undertaken by industry experts and fully

contemplates actual operational considerations at both coal-fired electric generation facilities, as well as other electric generation facilities. Defining terms that impact the operation of multi-million dollar facilities should not be done in an academic or policy-making vacuum. It is imperative that such a process include significant industry input. Facility operators and contract administrators are best suited to provide meaningful input regarding what actually occurs in the operation of any facility, what kinds of transactions are in fact considered "routine" for ongoing plant operations, and what kinds of transactions are merely employed for the purpose of increasing efficiency and output.

4. *How and in what instances have POUs applied the terms "routine maintenance" and "designed and intended to extend the life" in deciding whether investments in non-deemed compliant powerplants are consistent with the Commission's EPS regulations and SB 1368? Is there an industry custom or practice that guides these determinations? Provide supporting documentation.*

Since adoption of the EPS Regulation, expenditures that arise must be reviewed in the context of the statutory and regulatory language to determine whether or not they are covered procurements. POUs also look to industry standards and established customs and practices, as well as the various operating agreements by which they are bound. These agreements set forth the operational and financial obligations of the POUs and their various counterparties, and also mandate the manner in which the electric generation facilities will be operated.

For example, M-S-R's obligations vis-à-vis the San Juan Generating Station are governed by numerous contracts. These include the following:

1. *Indenture Of Trust Between M-S-R Public Power Agency and First Trust of California, National Association As Trustee Relating to M-S-R Public Power*

Agency San Juan Project Subordinate Lien Revenue Bonds, dated as of June 1, 1994.

2. *Tucson/San Juan Project Power Sales Agreement Between M-S-R Public Power Agency and Modesto Irrigation District and the City of Santa Clara and the City of Redding*, dated November 29, 1982.

3. *Amended and Restated Operating Agreement Between the M-S-R Public Power Agency and the Modesto Irrigation District, the City of Santa Clara, California, the City of Redding, California*, dated February 1, 1997.

4. *Amended and Restated San Juan Project Participation Agreement Among Public Service Company Of New Mexico, Tucson Electric Power Company, the City of Farmington, New Mexico, M-S-R Public Power Agency, The Incorporated County Of Los Alamos, New Mexico, Southern California Public Power Authority, City Of Anaheim, Utah Associated Municipal Power Systems, Tri-State Generation And Transmission Association, Inc.*, dated December 20, 2005.

5. *San Juan Unit 4 Early Purchase* ~~ Participation Agreement, Dated As Of September 26, 1983, Between Public Service Company Of New Mexico And M-S-R Public Power Agency.

6. *Interconnection Agreement Between Tucson Electric Power Company and M-S-R Public Power Agency*, dated September 20, 1982.

7. *Interconnection Agreement Between Public Service Company of New Mexico and M-S-R Public Power Agency*, dated September 26, 1983.

These various agreements define not only M-S-R's obligations, but also its understanding regarding operation of the San Juan Generating Station; at its most fundamental level, the operating agreements were developed to ensure that the long-term resource is maintained and operated in the most efficient manner; the contracts require that all things necessary be done to ensure this happens. Since a major coal-fired generation facility is a long-term investment, the various parties to the agreements need assurances that their investment cannot be undermined by the actions – or inactions – of other parties. To that end, the industry standard is to ensure that all maintenance is done as part of the normal operation of the plant. New technologies or non-

standard parts replacement that are designed solely to increase the generation output of a facility or increase the life of a plant would not be routine maintenance and would be identified as such in procurement decisions and budgets to be approved by the project participants.

5. *For the period of 2007 to the present and based on your understanding of existing law, identify all covered procurements for which a POU made or plans to make a "new ownership investment" in an existing, non-deemed compliant powerplant owned by the POU in whole or in part, where the investment was for "routine maintenance." For each such investment, describe the nature and scope of the maintenance.*

To clarify, since the adoption of the EPS Regulation, M-S-R has not made any investments that would constitute "covered procurements." M-S-R has always carefully reviewed the various expenditure authorizations required under the terms of its ownership agreements in the San Juan Generating Station. However, after the adoption of the EPS Regulation, those various expenditures were also scrutinized to determine whether they were "new ownership investments," as the term is defined in the EPS regulation, and therefore constituted a covered procurement. After a careful review and analysis of the expenditures in the San Juan Generating Station, it was determined that there were no expenditures that met the requirements of a covered procurement under the Regulation.

With that said, there were required expenditures that M-S-R was called upon to pay for. M-S-R carefully reviewed each of those transactions and documented its findings regarding whether or not it would constitute a covered procurement. In the end, each of those expenditures was determined to be routine maintenance, as that term is set forth in the Commission's EPS Regulations and used in the provisions of the San Juan Operating Agreements.

For example, the Amended and Restated San Juan Project Participation Agreement defines operating work as:

> *5.35 OPERATING WORK: Engineering, contract preparation and administration, purchasing, repair, supervision, training, expediting, inspection, testing, protection, operation, use, management, replacement, retirement, reconstruction and maintenance of and for the benefit of the San Juan Project pursuant to this Agreement, including the administration of this Agreement and of any other Project Agreements, environmental compliance activities and the procurement of fuel and water and other necessary materials and supplies.*

The term "routine maintenance" is not defined in the Agreement, but rather, refers to "operating and maintenance," with references to "operating work." This language is important to understand, as it defines not only the parties' obligations under the agreements, but their deliberations with regard to interpreting the provisions of the EPS Regulation. All such work is also performed pursuant to industry standards, which in this Agreement is defined as:

> *5.42 PRUDENT UTILITY PRACTICE: Any of the practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in the exercise of reasonable judgment in the light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Prudent Utility Practice is intended to be acceptable practices, methods or acts generally accepted in the industry, as such practices may be affected by special operational design characteristics of the San Juan Project, the quality and quantity of fuel delivered in accordance with the Underground Coal Sales Agreement or successor agreement, the rights and obligations of the Participants in accordance with this Agreement and any other special circumstances affecting the Operating Work.*

This is the context under which M-S-R reviews proposed expenditures and makes a determination of whether or not it is a covered procurement under the EPS Regulation. Admittedly, there may be instances where routine maintenance – by its very nature – does improve the efficiency of the plant. Such an instance, however, does not change the nature of the expenditure to a covered procurement. For example, a vehicle gets better gas mileage on

properly inflated tires; maintaining the appropriate air level in your vehicle's tires is still routine, despite the fact that you are increasing your fuel efficiency. This point was further affirmed by the Commission's Electricity Committee that stated "[r]outine maintenance may include replacing parts when they wear out. New parts are sometimes made better than previous iterations and improvements in some parts (e.g., turbine blades) can lead to an increase in efficiency and capacity," and "[t]he Energy Commission determined that it is necessary to ensure that [Publically Owned Utilities] are not prohibited from maintaining the operation of their power plants simply because there might be an incidental increase in capacity resulting from such maintenance."[2]

6. *Is the public informed or notified about proposed POU investments that are either routine maintenance" or "designed and intended to extend the life of one or more generating units by five years of more"?*

M-S-R's deliberations are carried out in accordance with state laws, including the Brown Act,[3] which includes publicly posting agendas for each of the meetings. This applies to all meetings where the M-S-R Commission would be deliberating on the approval of expenditures. As a public agency subject to the Brown Act and other open meeting laws, M-S-R complies with all applicable noticing requirements. This includes not only posting of agendas and allowing the meetings to be open to the public, but also recent revisions requiring the posting of any materials that will be reviewed by the M-S-R Commissioners seventy-two hours in advance of the meeting.

[2] *Electricity Committee's Explanation of Changes to Regulations Establishing and Implementing a Greenhouse Gases Emission Performance Standard for Local Publicly Owned Electric Utilities in Response to the Office of Administrative Law's Disapproval Decision*, August 10, 2007, p. 6.

[3] Cal. Government Code §§54050-54963.

7. *Whether the requirements of Public Utilities Code section 8341, subdivision (f), have been triggered by the State Air Resources Board's (ARB) recent adoption of cap-and-trade regulations or whether ARB must first verify the efficacy of and compliance with its cap-and-trade regulations before Section 8341, subdivision (f) is triggered. Section 8341, subdivision (f), provides that ". . the Energy Commission, in a duly noticed public hearing and in consultation with the [California Public Utilities] commission and the State Air Resources Board, shall reevaluate and continue, modify, or replace the greenhouse gases emission performance standard when an enforceable greenhouse gases emissions limit is established and in operation, that is applicable to local publicly owned electric utilities." (Emphasis added.)*

The provisions of 8341(f) have been triggered by CARB's adoption of the Cap-and-Trade Program. There is no requirement in AB 32 itself, nor in the Public Utilities Code, for the state agency, in this case CARB, to verify the efficacy of its program in order to have a valid program. With CARB's adoption and OAL's approval of the Cap-and-Trade Regulation, the state has an enforceable cap on emissions in place. Regardless of the fact that CARB has stated that it will not impose penalties to enforce the cap in the first year of the program, an enforceable greenhouse gas emissions limit is established and in operation, and that enforceable cap is applicable to local publicly owned electric utilities. Accordingly, all of the material provisions set forth in § 8341(f) have been satisfied.

While the EPS was intended to thwart new investments in high GHG emitting facilities, as was evidenced by the mere inclusion of section 8341(f), the Legislature clearly anticipated that a statewide cap would impact the efficacy of the EPS as an emission reduction measure. In fact, the single greatest benefit of implementing a Cap-and-Trade Program, rather than using only command-and-control mandates, is the economic advantage of reducing GHG across the state in the most economic and cost-effective manner possible. The end result is cleaner air and

less economic burden. M-S-R believes that a review of the efficacy and viability of the EPS as a long-term emission reduction tool in light of the Cap-and-Trade Program can, and should be done at the very onset of this proceeding.

At a minimum, the Cap-and-Trade Program makes the EPS Regulation duplicative, as both programs are aimed at meeting the same objective – reducing greenhouse gas emissions. On the other hand, if the EPS is retained after adoption of Cap-and-Trade Program, it could be seen as an attempt to unlawfully target a single resource – out-of-state coal. Despite the fact that Cap-and-Trade Program penalties are not imposed until January 1, 2013, obligated entities, including the POUs at issue, already have a cap imposed. The POUs to which the EPS Regulation applies are also within the list of covered entities that are part of the first compliance period, and when CARB determined that the penalties would not actually be imposed until January 1, 2013, CARB *did not* make a corresponding adjustment to the emissions cap. Given the state's extensive interest in ensuring the success of the Cap-and-Trade Program, the amount of resources being deployed as part of not only the state program but further development of a regional program, and the fact that SB 1368 contemplated replacement of the EPS Regulation in the event a cap was adopted, the EPS Regulation should be revised to sunset on January 1, 2013.

> *8. Whether the Petitioners' concerns regarding possible violations of the EPS would be better addressed through initiation of the Commission's complaint and investigation proceedings found at Regulations sections 1230 through 1237.*

M-S-R has followed the specific regulatory language adopted by this Commission, as well as the intent of SB 1368, and has not violated the EPS Regulation. At the same time, M-S-R has had to comply with its contractual obligations under multi-party and multi-faceted ownership and bond indenture agreements, all the while fulfilling its legal and ethical obligations

to protect the hundreds of millions of dollars invested by its member agencies. While Petitioner's raise concerns with regard to POUs' current practices, they have not alleged any violations, and therefore no such proceedings should be initiated.

It is important to note that M-S-R is required to maintain the San Juan Generating Station in good repair and working order at all times and to operate the San Juan Plant in an efficient and economical manner, and must at all times observe and perform all of its covenants under the Purchase and Participation Agreement with PNM and maintain the Purchase and Participation Agreement in full force and effect. Indeed, when taken collectively – which they must be – the agreements by which M-S-R is bound fall squarely within the provisions of § 2913 of the EPS Regulations, under which M-S-R could seek an exemption from the Commission. In order to seek a request for an exemption due to pre-existing multi-party commitments, M-S-R would need to submit supporting documentation that includes a copy of the contract(s) that commits M-S-R to participate in an investment and documentation and a summary of the provisions that (1) require M-S-R's participation in the investment, (2) establish and define a procedure that allows owners to vote for or against an investment, or nominate their level of participation in investments, and (3) establish penalties or other disincentives for non-participation, including recourse for other owners to recover associated costs. However, the fact is that none of the procurements that M-S-R has made in the San Juan Generating Station have qualified as covered procurements for which an exemption would be necessary; therefore, M-S-R has never brought such a petition before the Commission.

9. Whether any other changes to the Energy Commission's EPS regulations are necessary to carry out the requirements of SB 1368.

No additional revisions to the EPS regulation are needed to carry out the legislative intent of SB 1368. Indeed, as noted above, M-S-R believes that the EPS has done what it was intended to do – forestall new investments in high emitting resources until the implementation of a GHG reduction program by CARB. Investments in existing resources will be directed by the provisions of long-standing contracts and pure economics, which will be influenced by the price of carbon emerging from the Cap-and-Trade Program. It is also noteworthy that even the Commission's Electricity Committee acknowledged that "SB 1368 is not intended to shut down currently operating power plants or lead to their deterioration; its focus is ensuring that substantial investments are not made that would lead to further costs when AB 32, or a similar program establishing a greenhouse gases emissions limit, is implemented."[4]

IV. CONCLUSION

Despite its ownership interest in the San Juan Generating Station, since the adoption of the EPS Regulation, M-S-R has done all things necessary to comply with its mandates, and the intent of SB 1368. M-S-R appreciates the opportunity to provide these comments to the Commission and looks forward to additional opportunities to work with the Commission Staff and stakeholders to provide more information and clarification on this very important issue. M-S-R and each of its individual members remain committed to playing their part in helping the state achieve its statewide emissions reduction goals, and indeed play a large part in doing so.

[4] *Electricity Committee's Explanation of Changes to Regulations Establishing and Implementing a Greenhouse Gases Emission Performance Standard for Local Publicly Owned Electric Utilities in Response to the Office of Administrative Law's Disapproval Decision*, August 10, 2007, p. 5.

However, in doing so, M-S-R, as a public agency entrusted by its bondholders and utility ratepayers to comply with all laws, mandates, and legal agreements to which it is subject, must carry out these responsibilities in a holistic and comprehensive manner.

M-S-R has complied – and will continue to comply – with the mandates of the EPS Regulation. Regardless, M-S-R urges the Commission to look closely at the viability of these regulations consistent with the direction set forth in § 8341(f) prior to proposing any modifications to the existing rules.

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Respectfully submitted,

Martin Hopper
General Manager
M-S-R Public Power Agency