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07-OIIP-1	
DATE	AUG 06 2007
RECD.	AUG 06 2007

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)

California Energy Commission Docket #07-OIIP-01

COMMENTS OF ENVIRONMENTAL DEFENSE

August 6, 2007

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Introduction and Summary

Environmental Defense respectfully submits these comments in accordance with the "Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report and Notice of En Banc Hearing" (ALJ Ruling), dated July 17, 2007. We also respectfully submit these comments to the California Energy Commission (CEC) in Docket #07-OIIP-01.

Environmental Defense is a leading national nonprofit organization representing more than 500,000 members. Since 1967, we have linked science, economics and law to create innovative, equitable and cost-effective solutions to society's most urgent environmental problems.

We commend the Commissions for their leadership in addressing the threats to California associated with global warming through its decisions over the past several years. With the passage and signing of Assembly Bill (AB) 32, the Legislature and Governor strongly reaffirmed the Commissions' leadership in addressing global warming.

As discussed in detail below, we believe that the "first-seller" approach as outlined in the *Market Advisory Committee* report is the preferable design structure the California electricity sector under a cap-and-trade system. We further believe that if designed and

implemented properly, the “first-seller” approach will not present significant federal preemption or dormant Commerce Clause legal concerns¹.

Response to Questions Presented²:

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.

We believe that the description of the deliverer/first-seller (herein first-seller) is generally accurate. We believe that there are a number of different entities that could potentially be deemed “first-sellers” under this approach. These include, but may not be limited to, in-state generators and out-of-state generators including those owned by LSEs; power marketers, brokers, and traders; scheduling coordinators; and community choice aggregators.

If the Commissions do indeed choose to move forward with this approach, we believe it will be important to further refine the definition of “first-seller” so as to specify as precisely as possible the entities that would qualify as first-sellers and the circumstances in which they would do so.

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?

The entity that has “financial control” over the power when it enters the state is the “owner.” There can be multiple Purchasing/Selling Entities (PSEs) on an E-tag. In order to identify the first seller into California, it will be necessary to look at the particular PSE that controls the Market Segment containing the first point of interconnection in the state. For power that is delivered from within the CAISO control area (but outside of

¹ Please see “Legal Briefing” comments submitted under separate cover.

² We have responded to all questions for which we possess sufficient information to address at this time. In the future, we look forward to working with the Commission to provide additional detail for both the questions we did address and those we did not as part of our response to this Ruling.

California), it is possible that a different tracking mechanism will be needed to identify the owner of power at the first point of interconnection with the state. The developers of WREGIS have stated that they are capable of developing such a tracking mechanism.³ After MTRU is fully implemented, the CAISO may be able to extend their scheduling systems to track some of these attributes.

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

See response to *Question 2*.

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

We understand this question to be asking how a first-seller system would determine when power marketers/brokers qualify as “first-sellers.” Based on this interpretation, please see response to *Question 2*.

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

We agree with the *MAC* that the treatment of imports would differ somewhat under a load-based and first-seller system. Under the first-seller system, the compliance obligation is on the entity with “financial control” of the power when it enters the state. Under the load-based approach, the compliance obligation is on the load-serving entity, which requires an additional step or steps as the LSEs would be required to obtain emissions data associated with the imported electricity from the deliverer of that power.

Both the first-seller approach and load-based approach would allow for the reporting of specific emissions characteristics if the importer can provide such information in a credible manner. Further, both approaches would assign an emissions intensity for unspecified power (e.g., power purchased from a liquid trading point), which should be the higher of (1) the average emissions intensity for the region from which power flows or (2) the emissions intensity of the most polluting sources in the region. Because a first-

seller approach would create more direct incentives for importers of power to precisely specify the emissions data associated with that power, we believe this will result in fewer instances of unspecified power with approximated emissions data entering the state than would be the case under a load-based approach.

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

The first seller is the entity that has “financial control” over the electricity when it enters the state and is delivered at a point of delivery in California. For in-state generation, the entity responsible for compliance with AB 32 regulations under a first seller approach would be the generator. For imported power, the entities responsible for compliance with AB 32 regulations under a first-seller approach would be any of the entities mentioned in *Question 1* that first bring the power into California.

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?

We agree with the Market Advisory Committee that the ability to account for and minimize leakage and to reduce the incentives for contract shuffling are similar between the load-based system and a first-seller approach. Both systems would require estimates of emissions intensity for unspecified out-of-state imports. In a load-based system, suppliers of out-of-state unspecified imports would need to make representations to LSEs regarding the GHG content of the power they are supplying. Under the first-seller approach, since the power marketer/supplier is the regulated entity and could face direct financial costs for inaccurately reporting emissions, the incentives for greater accuracy are enhanced, especially if the regulator were able to cross-check reported emissions against other data points (See *Questions 7 and 28* for additional detail).

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

See response to *Question 9*.

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?

While this scenario would potentially decrease the number of entities that would be both directly monitored and regulated, we do not see it as presenting any advantage. For the multiple reasons stated in response to the questions in the ruling, we believe the preferred approach is designating the first-seller as the responsible entity for both reporting and point of regulation.

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?

We believe that either approach will have positive impacts on long-term investment in low-GHG emitting generation technologies. Under a first-seller approach, the economic signals to generators are likely to be more direct since the first-seller would be required to directly acquire emission allowances. Under a load-based system, the first seller would be in competition with other sellers to reduce costs and, as a result, might pursue GHG reduction strategies only to the degree that it needed to do so to clear the market.

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.

Under the upstream program design as articulated by the *MAC*, the First Seller approach would not cover in-state gas-fired generators, since those generators would be covered under the upstream point of regulation on natural gas. The regulation of power marketers/importers would remain the same. Coal-fired generators (either in- or out-of-state) would continue to be accounted for as first sellers.

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

We believe that the first seller approach would interact with the CPUC's promotion of energy efficiency in a manner similar to how a load-based system would. Under either approach, LSEs will continue to have strong incentives to reduce loads and thereby purchase and supply less electricity. Under the first-seller approach, this incentive would result from the increased cost of procuring power from suppliers, and under the load-based approach the incentive would result from the requirement to hold allowances for all power sold. Another important point to consider is that the level of penetration of efficiency programs will to some degree depend upon the success of future government mandates, marketing campaigns, incentive programs, etc...

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

We believe it is important to continue efforts to increase the amount of renewable energy used to power California. Under either a first-seller or load-based system, it will be necessary to closely coordinate renewable goals with AB 32 implementation goals. Though the points of regulation for the two programs would be different under the first-seller approach, the complementary nature of such regulation could provide multiple means to help obtain GHG reductions.

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?

See response to *Question 14*.

E. Reporting, Tracking, and Verification

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

In order to maximize the environmental integrity of the system, we believe it will be crucial to obtain the most accurate emissions data possible, regardless of the approach ultimately adopted. For reasons previously stated, we think the first seller approach is advantageous in this regard as it will enable to collection of the most precise data.

For purposes of the first-seller approach, the first-seller (as describe in *Question 1*) would be responsible for reporting emissions data, holding and surrendering emissions allowances, and complying with any other necessary regulatory requirements. In terms of the administrative requirements of this approach, the designated regulatory agency/agencies would be responsible for collecting and compiling emissions data, collecting surrendered emissions allowances, and for enforcing compliance with any other regulatory requirements. See *Question 27* for additional information.

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?

It is likely that modifications would be required. For instance, under the staff reporting proposal, the “covered entities” would be all “retail-providers of electricity.” Since under a first-seller approach, the covered entities would be different, it would most likely necessary to modify the proposal so as to ensure the inclusion of all “first-sellers” within the reporting requirements. The staff proposal would also likely need modification in order to reflect the fact that under the first-seller approach emissions data will be transmitted by first-sellers directly to ARB instead of through the retail providers.

In terms of using an approximation method to account for emissions from unspecified sources, we do not believe any significant modifications would be necessitated by the first-seller approach. However, as we have noted previously, we do believe that the reporting requirements should be designed in a manner that creates the greatest incentives possible for minimizing the use of approximation factors.

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?

Complementary reporting could be very beneficial by providing an important tool for crosschecking multiple data points. Providing regulators with this information to compare should help to both enhance the overall environmental integrity of the program and illuminate any areas where further design requirements/upgrades are necessary. The only potential “con” we are able to contemplate at this time would be any added time/cost requirements that might result from establishing and maintaining the complementary reporting regimes. However, in light of our belief that accurate and complete data is key, we think it would be well worth it.

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.

In order to create confidence in the system, it is important that it track emissions from “source to sink” to the greatest extent possible. As previously noted, we believe the first-seller approach is advantageous in this respect since it would require emissions reporting/tracking closer to the source of generation for in-state power and provides greater incentives for accurate reporting of imported power than would a load-based approach. In addition to enhancing the environmental integrity of the program, this is also likely to minimize the potential for market manipulation, thus increasing investor confidence.

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?

We do not believe that a first-seller approach would necessitate auctioning of allowances. There are a number of ways that allocation schemes can be designed and we agree with the *MAC report* that the method of initial allocation can affect prices and cost

distributions associated with meeting the state's emission reduction targets. We further agree with the *MAC* that "cost-effectiveness, fairness, and simplicity" are factors that should guide determinations about allowance distribution.

At this point we believe that the Commission should seriously consider (regardless of whether a load-based or first-seller approach is ultimately adopted) the use of a hybrid approach for the initial allocation of allowances. This will maximize the likelihood that the various stakeholders in the program will not be unduly harmed by the initial implementation of the system and that certain stakeholders do not receive undeserved profits.

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?

Yes. In order to be compatible the allowances created under the first-seller approach would need to be valued (i.e., represent equal emission amounts) the same across sectors.

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.

Assuming that both California and the other states in the region have the same type of system, there are some important distinctions between first-seller and load-based systems. If both/all states have load-based systems, then it will be crucial that both/all make similar assumptions regarding the make-up of energy that is being transmitted out of one region and into another region. Also, the various states would have to reach agreement regarding the emissions intensity of unspecified power that is used for import/export. There will also need to be significant cooperation and similar assumptions for the allocation of emissions from power marketers to LSEs. Otherwise, there will be inconsistencies between the emissions intensity for unspecified power purchased by LSEs

in one state and the emissions intensity associated with unspecified power that is being imported by the adjacent state.

Some amount of cooperation, while important under either system, is somewhat less critical (and more easily facilitated) for first-seller systems, since the owner of generation outside of California will either be a first-seller in their own state, first-sellers into California, or sellers of unspecified generation to the liquid trading markets either in- or out-of-state. Since all generators will be accounted for, it will be much easier to ensure that the total emissions across states are in fact what the sum of emissions within each state is.

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

Under the first-seller approach, it is likely that all generators in-state will be first-sellers of a portion of the generation from their facilities. Thus, the emissions of each generator will be known under a first-seller system. Each generator will have to allocate its generation to one of several tranches (e.g., sales to in-state LSEs, sales to out-of-state LSEs, sales to in-state power marketers, sales to out-of-state power marketers).

Contractual language and clear, convincing evidence will be needed to support these allocations. However, accounting for emissions associated with power that is exported should not be dependent upon whether the importing states have cap-and-trade systems.

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?

Double-counting (or failure to count) will always be a concern whenever there are incompatible systems in areas that are interconnected electrically. That being said, the risks for mis-counting emissions associated with imports (or exports) should not be appreciably larger if California adopts a first-seller system and other states develop load-based systems. This is because in-state generators in the states around California are the

sources for California's imports and the counting of emissions from in-state generators (in states other than California) would be fairly straightforward.

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?

The ease of linkage would ultimately depend upon the design of these programs. However, in terms of linkage with any eventual national program, we agree with the *MAC* that such a program is likely to be closer to a generator based approach than a load-based approach. We believe a first-seller approach would facilitate easier linkage with this type of program due to the fact that reporting, tracking, monitoring and other administrative and data requirements would be much more similar between a generator-based approach and a first-seller approach than between a generator-based approach and a load-based approach.

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.

See response to *Question 40*.

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

For the reasons variously stated in response to the preceding questions, we believe there are considerable merits of a first-seller approach as a model for other governments' efforts.

Respectfully submitted,



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Certificate of Service

I hereby certify that I have served this day a copy of "Comments of Environmental Defense in accordance with the 'Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report and Notice of En Banc Hearing" in the matter of R 06-04-009 to all known parties of record in this proceeding, to Assigned Commissioner Peevey, and to Assigned ALJ's Terkeurst and Lakritz by delivering a copy via email and by mailing and hand-delivering copies to the Public Utilities Commission's Docket Office and to the California Energy Commission's Docket Office.

Executed on August 6, 2007



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