**BEFORE THE PUBLIC UTILITIES COMMISSION**
**OF THE STATE OF CALIFORNIA AND THE CALIFORNIA ENERGY COMMISSION**

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| Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies | R.06-04-009 |
| AB 32 Implementation | 07-OIIP-01 |



# REPLY COMMENTS ON THE MARKET ADVISORY COMMITTEE REPORT OF THE ENERGY PRODUCERS AND USERS COALITION AND THE COGENERATION ASSOCIATION OF CALIFORNIA

Michael Alcantar
Donald Brookhyser
Alcantar & Kahl LLP
1300 SW Fifth Avenue
Suite 1750
Portland, OR 97201
503.402.9900 office
503.402.8882 fax
mpa@a-klaw.com
deb@a-klaw.com

Counsel to the
Cogeneration Association of California

Evelyn Kahl
Seema Srinivasan
Alcantar & Kahl LLP
120 Montgomery Street
Suite 2200
San Francisco, CA 94104
415.421.4143 office
415.989.1263 fax
sls@a-klaw.com
ek@a-klaw.com

Counsel to the
Energy Producers and Users Coalition

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# REPLY COMMENTS ON THE MARKET ADVISORY COMMITTEE REPORT OF THE ENERGY PRODUCERS AND USERS COALITION AND THE COGENERATION ASSOCIATION OF CALIFORNIA

The Energy Producers and Users Coalition[1] and the Cogeneration Association of California[2] (jointly, EPUC/CAC) submit the following reply comments on the Market Advisory Committee Report. These comments are submitted pursuant to the July 19, 2007 and August 8, 2007 Administrative Law Judge's Rulings.

## I. OVERVIEW

Through these comments, the Commission seeks feedback on the First-Seller approach for greenhouse gas (GHG) regulations, advocated by the Market Advisory Committee (MAC). Opening comments not only explored practical

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1 EPUC is an ad hoc group representing the electric end use and customer generation interests of the following companies: Aera Energy LLC, BP West Coast Products LLC, Chevron U.S.A. Inc., ConocoPhillips Company, ExxonMobil Power and Gas Services Inc., Shell Oil Products US, THUMS Long Beach Company, Occidental Elk Hills, Inc., and Valero Refining Company – California

2 CAC represents the power generation, power marketing and cogeneration operation interests of the following entities: Coalinga Cogeneration Company, Mid-Set Cogeneration Company, Kern River Cogeneration Company, Sycamore Cogeneration Company, Sargent Canyon Cogeneration Company, Salinas River Cogeneration Company, Midway Sunset Cogeneration Company and Watson Cogeneration Company.

limitations of the First Seller, Load-Based and Hybrid approaches, they also examined the potential for legal challenge under these three approaches. Despite the detailed briefs filed, two legal issues require additional clarification:

- The *Healy* case, relied upon by some parties, does not invalidate state regulations that have *some* extraterritorial impact. Instead, it applies only to those statutes that have a wholly extraterritorial effect and therefore is not applicable to the GHG regulations contemplated in this proceeding.

- In determining whether a state GHG regulatory scheme will be preempted by the Federal Power Act (FPA), a state's authority to exercise its police power must be balanced against FERC's authority to regulate wholesale transactions. Given that regulation of environmental attributes has been categorized as a matter of state law outside the scope of the FPA, preemption under any of the three regulatory approaches is unlikely.

These issues are discussed in detail below.

## II. *HEALY* CASE DOES NOT PRECLUDE STATE REGULATIONS WITH EXTRATERRITORIAL IMPACT

Some parties cite *Healy v. Beer Institute, Inc.* for the proposition that state regulation must not regulate extraterritorially.[3] The *Healy* case, however, only addresses statutes with impacts that are wholly outside the state and therefore are not relevant to the analysis of contemplated GHG programs in California. In *Healy*, the Supreme Court found that the "*Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside the State's border, whether or not the commerce has effects within the State.*"[4] In applying this standard, *Healy* invalidated a Connecticut statute that required out-of-state beer importers to certify that the price of their products in Connecticut

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3 *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 336 (1989). Parties which describe *Healy* in this way include the Los Angeles Department of Water and Power (LADWP), PacifiCorp, and the Southern California Edison Company (SCE). See Comments of LADWP, at 45; Comments of PacifiCorp, at 15-16; Comments of SCE, at 47.

4 *Id.* (emphasis added)

was no higher than surrounding states.[5] The *Healy* court found that the effect of the statute was to restrict the price of beer sold in other states. Since it regulated sales made by out-of-state beer importers to other states, it constituted an impermissible extraterritorial regulation of transactions wholly outside the state.

The *Healy* standard applies to statutes which regulate transactions wholly outside the state, not to state statutes that merely have *some* extraterritorial effect. As the Massachusetts District Court found, if the Dormant Commerce Clause (DCC) invalidated all statutes with some extraterritorial effect, state tort law would be eviscerated because "*almost every activity a state regulates has some 'extraterritorial effects.*" [6] A New York state regulation with upstream pricing impacts, therefore, overcame the *Healy* extraterritorial dormant commerce clause analysis where out-of-state actors remained free to conduct commerce on their own terms in other states.[7] In that case, the New York regulation applied only to those transactions directed to the state of New York and did not apply to transactions wholly outside the state (sales to neighboring states).[8] Many courts do not, in fact, apply the *Healy* standard to evaluate statutes with only some extraterritorial effect.[9] Instead they evaluate such regulations using the traditional two prong test which focuses on whether a state regulation is facially

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5 *Id.*

6 *Stone v. Frontier Airlines, Inc.*, 256 F.Supp.2d 28, 46 (D.Mass. 2002)

7 *Freedom Holdings Inc. v. Spitzer*, 357 F.3d 205, 221 (2nd Cir. 2004)

8 *Id.*

9 *See Alliant Energy Corp.*, 336 F.3d at 547; *Star Scientific Inc. v. DKT Liberty Project*, 278 F.3d 339, 356 (4th Cir. 2002) (applying two-tiered dormant commerce clause standard where statute at issue did not regulate transactions wholly outside of state); *Star Scientific Inc.*, 278 F.3d at 356 (applying *Pike* balancing test after finding that *Healy per se* rule did not apply to the statute at issue); *Stone*, 256 F.Supp.2d 28 (applying *Pike* balancing test after rejecting invalidation under Healy extraterritorial dormant commerce clause analysis)

discriminatory or discriminatory in effect.[10]

The application of *Healy*'s extraterritorial analysis does not alter the potential for legal challenge under the DCC because the three GHG regulatory approaches do not regulate commerce taking place wholly outside of California. The first seller approach, the only approach which would have the potential to directly regulate out-of-state entities, limits its regulation to those entities seeking to sell into the California market. As such, even under the first seller regulatory approach, regulated transactions would be located within California. This also means that out-of-state entities would remain free to conduct commerce with other states on their own terms. Under the load-based and hybrid approach, regulations would be applied directly only to in-state entities and therefore could not be challenged as regulation of out-of-state transactions.[11] In short, the *Healy* standard does not apply to any of the three regulatory approaches and therefore does not provide a basis for invalidation under the Dormant Commerce Clause.

## III. Natural Gas Act Cases in August 8, 2007 Ruling Do Not Clarify Whether GHG Regulations Will Be Preempted by Federal Power Act (Question 54)

The August 8, 2007 ruling requests review and feedback on a line of cases which discusses preemption in the context of the Natural Gas Act (NGA Cases). As discussed below, these cases are inapplicable to the contemplated GHG regulations because they do not address preemption of a state regulation which exercises state police powers.

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10 *Id.*

11 *Freedom Holdings Inc.*, 357 F.3d at 221 (where statutes impose no out of state burden, they cannot be said to regulate prices or control terms of out-of-state transactions).

The cases in the Ruling examine federal preemption in the context of the NGA. The *Lockyer* case clarifies that, due to the similarity in the FPA and NGA statutory schemes, the preemption analysis in NGA Cases applies to FPA cases.[12] Together, the NGA Cases clarify when a state regulation, promulgated under power reserved to it under the FPA, would be preempted because it implicates FERC's exclusive jurisdiction under the FPA. The same analysis does not apply when balancing a state's police powers with FERC's authority to regulate wholesale transactions. As a result, the NGA Cases do not clarify whether GHG regulations under consideration in this proceeding will be preempted by the FPA.

To appreciate the distinction between the NGA Cases and the contemplated GHG regulations, some background on the NGA Cases is needed. Of the NGA Cases in the ruling, *Northwest Central Pipeline Corp.* is the most recent Supreme Court case. It provides that when a state regulation is promulgated under powers reserved to the states, it will not be preempted despite impacts on an issue that is within the exclusive jurisdiction of Congress.[13] In fact, collectively, the NGA Cases, indicate that preemption is likely only when (i) a state regulation is "unmistakably and unambiguously" directed to regulate transactions that are within Congress' jurisdiction or (ii) a state regulation stands

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12 The *Lockyer* case states that "*[t]he FPA and the Natural Gas Act ("NGA") are similar statutory schemes, and that the Supreme Court has held that the applicable case law for the two Acts is often interchangeable.*" *California ex rel. Lockyer v. Dynegry, Inc.*, 375 F.3d 831, 842 n.8 (2003).

13 *Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kansas*, 489 U.S. 493, 511-515 (1989).

as an obstacle to the execution of Congressional objectives.[14] Accordingly, a Kansas regulation which regulated a field expressly reserved to the states, impacted issues within the exclusive jurisdiction of Congress, and complemented FERC's regulation was not preempted.[15] In contrast, a Kansas regulation which regulated purchasers making interstate sales of natural gas directly conflicted with FERC's exclusive jurisdiction over these sales and therefore was preempted.[16] Similarly, a Mississippi regulation which regulated the very thing that FERC intended to deregulate was found to directly conflict with Congressional intent and therefore was preempted.[17] In short, all of the NGA Cases balance a state's authority under the NGA with federal exclusive jurisdiction under the NGA. If applied to the FPA, the cases reveal when an exercise of state authority reserved to it under the FPA would be preempted by FERC's exclusive jurisdiction under the FPA.

The balancing of interests done in the NGA Cases will not apply if a party seeks to preempt GHG regulations because GHG regulations are not an exercise of state authority reserved under the FPA. Instead, the state's ability to promote the health and safety of its citizens will be balanced against FERC's authority under the FPA. *American Ref-Fuel Co. et al.*, specifically addresses the balance between federal jurisdiction under the FPA and a state's authority to promote

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14 *Northwest Central Pipeline Corp.*, 489 U.S. at 511-515;*Transcontinental Gas Pipeline Corp. v. State Oil and Gas Bd. of Mississippi*, 474 U.S. 409, 422 (1985); *Northern Natural Gas Co. v. State Corp. Comm'n of Kansas*, 372 U.S. 84, 92 (1963).

15 *Northwest Central Pipeline Corp., 489 U.S. at 511-515.*

16 *Northern Natural Gas Co.*, 372 U.S. at 92.

17 *Transcontinental Gas Pipeline Corp.*, 474 U.S. at 422.

"*policy goals such as improved air and water quality.*"[18] In that case petitioners sought a declaratory order that avoided cost contracts entered into pursuant to the Public Utilities Regulatory Policies Act of 1978 (PURPA) did not inherently convey state renewable energy credits (RECs).[19] In evaluating this request, FERC had to determine whether the existence of contracts falling within FERC's jurisdiction would govern the ownership of RECs which were created by state law. Like the GHG regulations, the RECs were observed, among other things, to promote policy goals such as improved air and water quality and reduction of greenhouse gas emissions.[20] Despite potential impacts on issues within FERC jurisdiction, FERC determined that environmental attributes are not addressed by the Federal Power Act.[21] In fact, in this decision, FERC made clear that "*[w]hat is relevant here is that the RECs are created by the States.*"[22] In addition, FERC stated: "*States, in creating RECS, have the power to determine who owns the REC in the initial instance and how they may be sold or traded; this is not an issue controlled by PURPA.*"[23] Finally, FERC held: "*While a state may decide that a sale of power at wholesale automatically transfers ownership of the state-created RECS, that requirement must find its authority in state law, not PURPA.*"[24]

The facts and analysis in *American Ref-Fuel Co. et al.* are more appropriate to GHG regulation preemption analysis than the NGA Cases which

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18 *Federal Energy Regulatory Comm'n*, 105 FERC ¶ 61004, 2003 WL 22255784 *1 (F.E.R.C. 2003).
19 *Id.*
20 *Id.*
21 *Id.* at *5.
22 *Id.*
23 *Id.*
24 *Id.*

balance state and federal authority under the same statutory scheme. As noted in EPUC/CAC's opening comments, the analysis and determination provided in *American Ref-Fuel Co. et al.* strongly suggests that GHG regulations will be viewed, like RECs, as an issue that is outside the purview of the Federal Power Act. The opening comments of PG&E, SCE and DRA also explain that GHG regulations are likely to be outside the scope of the Federal Power Act.[25] For this reason, none of the regulatory approaches should be invalidated on the basis of preemption.

August 15, 2007

Respectfully submitted,

Seema Srinivasan

Evelyn Kahl
Michael Alcantar
Seema Srinivasan

Counsel to the Energy Producers and Users Coalition and the Cogeneration Association of California

[25] See Comments of PG&E, Attachment 1, at 2-3; Comments of SCE, at 44-45; Comments of DRA, at 21-22.

## CERTIFICATE OF SERVICE

I, Karen Terranova hereby certify that I have on this date caused the attached **Reply Comments on the Market Advisory Committee Report of the Energy Producers and Users Coalition and the Cogeneration Association of California** in R.06-04-009 to be served to all known parties by either United States mail or electronic mail, to each party named in the official attached service list obtained from the Commission's website, attached hereto, and pursuant to the Commission's Rules of Practice and Procedure.

Dated August 15, 2007 at San Francisco, California.

Karen Terranova