**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

REPLY COMMENTS AND REPLY BRIEF OF THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) AND UNION OF CONCERNED SCIENTISTS (UCS) ON THE "FIRST SELLER" APPROACH

August 15, 2007

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I. Introduction and Summary

The Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) respectfully submit these joint reply comments and NRDC submits this reply legal brief 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 19, 2007, and in accordance with Rules 1.9 and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure. NRDC/UCS also concurrently submit these comments to the California Energy Commission (CEC) in Docket #07-OIIP-01, the CEC's sister proceeding to this CPUC proceeding.

NRDC is a non-profit membership organization with a long-standing interest in minimizing the societal costs of the reliable energy services that a healthy California economy needs. In this proceeding, NRDC represents its more than 124,000 California members' interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. UCS is a leading science-based non-profit working for a healthy environment and a safer world. Its Clean Energy Program examines the benefits and costs of the country's energy use and promotes energy solutions that are sustainable both environmentally and economically.

NRDC and UCS jointly submit these reply comments on the policy-related issues surrounding the deliverer/first-seller (hereinafter "first-seller") approach, and NRDC submits the enclosed reply brief on legal issues surrounding the "first-seller" approach. In these comments, NRDC and UCS reply to select comments and briefs filed by other parties in their opening comments on August 6, 2007. In addition, in the reply brief section of this filing, NRDC also responds to the additional legal issue as requested by the "Administrative Law Judges' Ruling Requesting that Parties Address an Additional Legal Issue in their Reply Briefs, due August 15, 2007," dated August 8, 2007.

NRDC and UCS continue to encourage the Commissions to clearly define and prioritize the various criteria to assess the significant policy tradeoffs between the load-based and first-seller approaches to regulating greenhouse gas (GHG) emissions from the electricity sector. After review of other parties' opening comments, NRDC/UCS continue to believe, as noted in their opening comments, that a load-based approach appears to more effectively provide lower cost to consumers, promote long-term emission reduction strategies, and avoid legal complications, whereas a first-seller approach appears to more effectively provide precise information about certain emissions attributable to the regulated entity and better serve as a model for and transition into a regional or federal program.

In summary:

Policy issues:

- Several parties indicate that E-Tags are collected by WECC and that WECC also maintains a listing of market participants, but it remains unclear whether CARB can obtain access to this information in order to identify first-sellers.
- Changes in long-term investments, not short-term dispatch, are the key to sustained GHG emissions reductions.
- NRDC/UCS are not persuaded by SCE and PG&E's claims that consumer cost impacts are independent of the point of regulation.
- NRDC/UCS support LADWP and SCPPA's comments that a load-based cap will produce stronger incentives for retail providers to invest in low-GHG emitting technologies.

- Some of the drawbacks of a load-based approach would be alleviated by development of a regional tracking system.
- The Commissions should focus first on the key principles for how allowances should be distributed before considering parties' recommendations for specific distribution methods.

Legal issues:

- The Natural Gas Act cases do not change NRDC's conclusion that the first-seller approach is not necessarily preempted by the Federal Power Act.
- Most parties agree that the first-seller approach creates more risk of preemption than the load-based approach, but that the program can be designed to avoid preemption either way.
- Most parties agree that CARB may derive the authority to auction allowances from the text of AB 32.
- GHG emission allowance value could be used to fund in-state projects, so long as they are not directly benefiting an in-state industry to the detriment of its out-of-state competitors.
- California's potential regulation of GHG emissions is not preempted by the Clean Air Act.

II. NRDC/UCS Reply Comments on Policy Issues

A. Several parties indicate that E-Tags are collected by WECC and that WECC also maintains a listing of market participants, but it remains unclear whether CARB can obtain access to this information in order to identify first-sellers.

Several parties such as Southern California Edison (SCE) (p. 5) and Pacific Gas and Electric Company (PG&E) (p. 11) indicate that the Western Electricity Coordination Council (WECC) maintains a database of all E-Tags and market participants in the WECC. However, it remains unclear whether the California Air Resources Board (CARB), as the California agency with regulatory authority to implement AB 32, would be able to obtain access from WECC to this information, or any other information used to identify "first-sellers." As the Los Angeles Department of Water and Power (LADWP) points out, "Federal Energy Regulatory Commission governs access to the purchasing/selling entity data on the NERC e-tags" (p. 31). The Southern California Public Power Authority (SCPPA) also notes that "the information on E-tags is confidential except for the parties specifically identified on the E-tags" (p.10) and states that "it is unclear that state agencies would be able to gain access to E-tags." (p. 34) In order for the first-seller approach to be a workable regulatory system, CARB must be able to identify and verify the identities of the regulated first sellers, and the identity of these regulated entities must be transparent to the public. NRDC/UCS recommend that the Commissions investigate whether CARB will be able to obtain access to E-tag information, as the viability of pursuing a first-seller approach seems to rest on the information contained in E-tags to identify the regulated entities.

B. Changes in long-term investments, not short-term dispatch, are the key to sustained GHG emissions reductions.

Although several parties, such as the Division of Ratepayer Advocates (p. 10, 12), the Western Power Trading Forum (WPTF) and the Alliance for Retail Energy Markets (AReM) (p. 8), and Morgan Stanley Capital Group (MSCG) Inc. (p. 9, 12), note that an advantage of the first-seller approach is the direct internalization of GHG emissions costs into the price of in-state generation so that the price is reflected in dispatch, other parties observe that the dispatch order is unlikely to significantly change from current patterns. SCE notes:

> "It is likely that until the allowance price makes coal generation more costly than natural gas generation, the changes in dispatch will not be substantial, since the relative ranking in operating costs of natural gas generation units correlates reasonably well with the GHG emissions rates of those units. The added GHG emissions costs incorporated into a bid do little to reorder gas generation units that predominantly make up the marginal dispatch choices within the CAISO's market….dispatch should not be different under either the load-based or the First Seller approach." (p. 26)

PG&E states that under a load-based cap, "it is very likely that the coal facility will continue to dispatch as before" (p. 20) and "a load based cap is not likely to change near-term dispatch to reflect GHG emissions costs" (p. 27). WPTF/AReM state, "neither a first-seller nor the CPUC's proposed load-based approach can reasonably be expected to alter dispatch of or investment in out-of-state low-emission generation" (p. 1).

The observation that dispatch is not expected to change significantly under either a load-based or first-seller approach further emphasizes the importance of promoting long-term investments as the primary means of achieving GHG emissions reductions. Changing short-term dispatch alone will prove insufficient to accomplish the long-term GHG emissions reduction goals of the state, both to meet the 2020 emissions limit established by AB 32, as well as the Governor's 2050 target. As NRDC/UCS explained in opening comments, a load-based approach, which makes retail providers in California *directly* responsible for holding allowances and managing compliance costs, will provide stronger incentives for these entities to aggressively pursue long-term investments and innovation in low-carbon resources to achieve the deeper emissions reductions that are needed in later years. Long-term reductions demand significant changes to the existing generation infrastructure in the West; changing the way in which the existing infrastructure is operated is a secondary concern.

C. NRDC/UCS are not persuaded by SCE and PG&E's claims that consumer cost impacts are independent of the point of regulation.

Both SCE and PG&E argue that costs to consumers (specifically related to the costs of supply-side resource procurement) will be the same under either regulatory approach. SCE presents a pair of graphs and claims that "the total cost the LSE would incur and pass on to retail customers in either a load-based or First Seller approach is the same" (p. 14). However, SCE's own graphs fail to persuade NRDC/UCS that consumer costs will be independent of the point of regulation.

SCE states that the "total costs an LSE incurs in either case is represented by the shaded sections in the figure above, with the gray areas illustrating the operating costs, and hatched areas representing the emission costs" (p. 14). While the costs under either approach may be the same for the LSE in question illustrated by SCE's graphs, other retail providers may experience substantial differences in cost. Imagine a hypothetical LSE that is purely dependent on market purchases. This LSE would experience a lower market-clearing price under a load-based cap, per SCE's example. The sum of the emissions costs associated with its market purchases, represented by the hatched areas in SCE's figures, could be less than the increased expenditures from the higher market clearing price under a source-based cap, depending on the resource composition of the bid supply curve and the increase in market clearing prices. Rather than demonstrate that consumer costs will be the same in either instance, SCE's illustration indicates that further analysis is required to better understand cost impacts on all California consumers.

PG&E also argues that "costs should be about the same under either a load-based cap or a first seller approach" (p. 20) and presents two illustrative tables on page 21 of their comments to illustrate its argument that there are minimal differences in costs to consumers under the two approaches. However, the first of these tables, which shows the costs to consumers if load-serving entities (or any retail providers) are the point of regulation, appears to incorrectly represent the illustrative costs of hydroelectric power. While the table shows the wholesale market price of hydro to be $49, PG&E shows that the "ultimate cost to ratepayer" is $57. In a load-based system, as PG&E shows, the GHG emissions cost to the retail provider for hydro is $0, assuming a clear line of sight for emissions, so the ultimate cost to ratepayers should be equal to the wholesale market price of hydro, which is $47 in PG&E's example.

Thus, recreating PG&E's page 21 illustrative tables, and correcting for this error using "strikeout and underline" indicates that costs to ratepayers under a load-based approach could be lower if low-emitting resources like hydroelectric and nuclear facilities provide more power in the forward market than do coal plants.

GHG Point of Compliance: Load-Serving Entity

	Running Cost $/MWh	Wholesale Market Price $/MWh	CO2 Cost to LSE $/MWh at $20/ Metric Ton	Ultimate Cost to Ratepayer $/MWh	Generator's Profit Margin $/MWh
Gas-CC (price-setter)	$49	$49	$8	$57	$0
Hydro (price-taker)	$0	$49	$0	~~$57~~ <u>$49</u>	~~$57~~ <u>$49</u>
Coal Plant (price-taker)	$26	$49	$8-$20(i)	**$57-$69(i)**	**$23**

(i) This range is driven by a policy choice in setting a default emissions rate. PG&E believes that the default emissions rate should reflect actual market conditions, which it believes would be closer to $57 under this illustrative example.

GHG Point of Compliance: First Seller

	Running Cost $/MWh	CO2 Cost to LSE $/MWh at $20/ Metric Ton	Wholesale Market Price $/MWh	Ultimate Cost to Ratepayer $/MWh	Generator's Profit Margin $/MWh
Gas-CC (price-setter)	$49	$8	$57	$57	$0
Hydro (price-taker)	$0	$0	$57	$57	$57
Coal Plant (price-taker)	$26	$8-20	$57	$57	$11-23

Furthermore, the cost impacts might also be lower under a load-based approach if a natural gas peaker plant were to set the wholesale market price, as the higher GHG emissions costs of a peaker plant would result in a larger increase in wholesale market prices than is shown in PG&E's example. This would also increase the generator profit margins illustrated in PG&E's example.

These examples presented by SCE and PG&E fail to provide compelling evidence that consumer costs will be the same under either a load-based or first-seller approach, and reinforce the need for further analysis before drawing broad conclusions about the relative cost impacts of a first-seller approach. Even if a first-seller approach is shown not to increase consumer costs (specifically stemming from costs of supply-side resource procurement) relative to a load-based approach, NRDC/UCS continue to believe that a load-based approach will encourage greater investments in energy efficiency, which will provide significant ratepayer benefits by lowering customer bills and will serve as one of the most important determinants of the long-term GHG compliance costs experienced by the electric sector and the state as a whole.

D. NRDC/UCS support LADWP and SCPPA's comments that a load-based cap will produce stronger incentives for retail providers to invest in low-GHG emitting technologies.

LADWP (p. 22-23) and SCPPA (p. 30) state that a load-based cap, under which retail providers are directly regulated and responsible for reducing their emissions, is preferable for encouraging energy efficiency and long-term investment in low GHG-emitting generation technologies as retail providers are in a better position to evaluate the most cost-effective means of reducing GHG emissions. LADWP also points out that a marketer in a first-seller system "will not have any incentive to invest in low-GHG emitting generation technologies as it does not own generation assets" (p. 23). NRDC/UCS agree.

E. Some of the drawbacks of a load-based approach would be alleviated by development of a regional tracking system.

In presenting arguments about accuracy or leakage or environmental integrity, various parties, such as SCE (p. 9, 12), PG&E, and MSCG, assume that the load-based approach would only use the draft reporting protocol that staff has proposed, which incorporates only currently available information. If the Commissions choose to recommend a load-based approach to CARB, the development of a regional tracking system, as supported by LADWP (p. 14) and various other parties in earlier comments on the draft reporting protocol, would greatly increase accuracy of emissions information.

F. The Commissions should focus first on the key principles for how allowances should be distributed before considering parties' recommendations for specific distribution methods.

Several publicly-owned utilities and their representatives, including LADWP (p. 33), argue for free allocation of allowances based on historical (or current) emissions under either the first-seller or load-based approach. We oppose this "grandfathering" of allowances because it would penalize early actors that have proactively reduced their greenhouse gas emissions prior to the onset of the AB 32 cap. However, we believe there may be ways to address the publicly owned utilities' concern (e.g., Southern California Public Power Authority, p. 40) that they not "pay twice" (for both allowances and to make the long-term investments needed to reduce emissions) while at the same time not penalizing early actors. For example, the allowances could be auctioned and retail sellers could be allowed to keep a portion of the amount they spend in the auction to make long-term investments in greenhouse gas reduction measures (subject to oversight and verification that the investments meet appropriate criteria). We urge the Commissions to focus first on the key principles for how allowances should be distributed, and then to encourage parties to think creatively about how those principles can be met.

III. NRDC Reply Brief on Legal Issues

A. Additional Question from ALJ Ruling Issued August 8, 2007

54. To what degree if any, does the following line of cases suggest that a deliverer/first-seller approach is more likely than a load-based approach to be subject to preemption under the Federal Power Act?* Northern Natural Gas Co. v. Kansas*, 372 U.S. 84 (1963);* Transcontinental Gas Pipe Line Corp. v. Mississippi*, 474 U.S. 409 (1986);* Northwest Central Pipeline Corp. v. Kansas*, 489 U.S. 493 (1989). Please consider these cases in light of* Calif. Ex. Rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 842 n8 (2004) (finding that the Federal Power Act and the Natural Gas Act are similar statutory schemes and therefore case law for the two Acts is often interchangeable). Please provide a detailed analysis.

This line of cases determining whether state regulations are preempted by the Natural Gas Act (NGA) does not change the preemption analysis of the first-seller approach under the Federal Power Act (FPA). The NGA cases define the line between federal and state authority in the regulation of natural gas. The analysis in each of these cases turns upon the text and history of the NGA, and the nature of the state regulation. As noted in NRDC's opening legal brief, the text and history of the Federal Power Act (FPA) indicate that regulation of the environmental impact of electricity within a state's borders is within the jurisdiction of the state.

In the most recent of these NGA cases, the court held that when "state law impacts on matters within FERC's control, the State's purpose must be to regulate production or other subjects of state jurisdiction, and the means chosen must at least plausibly be related to matters of legitimate state concern." *Northwest Central Pipeline Corp. v. Kansas,* 489 U.S. 493, 518 (1989). Here, California's purpose is to regulate GHG emissions in order to protect the health, safety, and environment of its citizens, which are subjects of traditional state jurisdiction. California's means of achieving its purpose – regulations including a cap and trade system for GHG emissions and performance standards – is directly related to the legitimate state concern.

In both *Northern Natural Gas Co. v. Kansas*, 372 U.S. 84 (1963) and *Transcontinental Gas Pipe Line Corp. v. Mississippi*, 474 U.S. 409 (1986), the Court determined that the state was regulating the price of natural gas, and that this regulation was not within state jurisdiction and interfered with the federal scheme. In enacting a cap and trade program for the electricity sector, California would be regulating the environmental impact of electricity, not its price. Unlike the state regulations in *Northern* and *Transcontinental*, California would not be interfering with the federal scheme.

The Court in *Transcontinental* also emphasized that the state regulation was at odds with Congress's intent to let market forces guide wholesale prices of natural gas. It stated that Congress enacted the NGA to "give market forces a more significant role in determining the supply, the demand, and the price of natural gas" *Transcontinental* at 422. Congress did not intend to leave electricity prices to market forces; the FPA orders FERC to ensure that wholesale rates are "just and reasonable." California's cap and trade program would not be at odds with the FPA because any impact that California's environmental regulation has on electricity prices may be incorporated into FERC's rate approval process.

The Court in *Northwest Central Pipeline Corp. v. Kansas,* 489 U.S. 493 (1989) held that state regulation of production of natural gas was not preempted because the NGA excluded natural gas production from federal authority. *Id*. at 507, 521; *See* 15 U.S.C. § 717(b). The Court even acknowledged that the state regulation would "effect … interstate rates" but still held that it was not preempted because it was "exercising traditional state control over the conservation of natural resources". *Northwest Central*, at 512. The correlating section of the FPA echoes the Court's holding regarding natural gas when it states that federal jurisdiction "extend[s] only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a).

Calif. Ex. Rel. Lockyer v. Dynegy, Inc., 375 F.3d 831, 842 n8 (2004) indicates that case law from the Federal Power Act (FPA) and the Natural Gas Act (NGA) may be used interchangeably where the "relevant provisions of the two statutes are in all material respects substantially identical." *Id*. (quoting *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 578 n.8 (1981)). Here, the language is not identical, but it is clear that natural gas production is exempt from federal jurisdiction under the NGA and that the parallel FPA clause exempts areas of traditional state authority from federal jurisdiction. As Southern California Edison (Edison) noted in its comments, FERC has forsworn jurisdiction over environmental considerations, thus leaving regulation of environmental issues to the states. *Grand Council of Crees v. FERC*, 198 F.3d 950, 957 (2000) ("environmental … problems [are] beyond the Commission's authority"); *See also Small Power Production and Cogeneration Facilities – Environmental Findings,* 10 FERC ¶ 61,314 at 61,632 (1980); *See* Edison Comments at 45. In addition, as LADWP noted, FERC has also declared that emissions allowances are not within its jurisdiction. *Edison Electric Institute*, 69 FERC ¶ 61,344 (1994); See LADWP Comments at 41. A California GHG emissions allowance program aimed at environmental regulation should not be preempted by the FPA.

B. Most parties agree that the first-seller approach creates more risk of preemption than the load-based approach, but that the program can be designed to avoid preemption either way.

It is clear that there is some legal ambiguity as to whether the first-seller approach would be preempted by the FPA. However, most parties agree that the first-seller approach creates more risk of preemption than the load-based approach, but that the program can be designed to avoid preemption either way. *See* Edison Comments at 45 ("either approach may be found to be immune from preemption by the Federal Power Act"); SDG&E and SoCalGas Comments at 10 ("when characterized as a species of air pollution or electric power regulation, state GHG regulations fall within traditional state responsibilities."); Community Environmental Council Comments at 6 ("the FPA should not preempt adoption of the first-seller approach."); PG&E Comments at 1-5 (concluding that the first-seller approach is not preempted by the FPA); Energy Producers and Users Coalition and The Cogeneration Association of California Comments at 22 ("the First Seller approach on the surface appears to present some level of vulnerability to a … federal preemption challenge, although these challenges could be overcome."); DRA Comments at 22 ("Arguably, this would be an environmental regulation unrelated to FERC's authority over wholesale sales of power"); LADWP Comments at 39 ("the first seller approach raises the question of preemption under the Federal Power Act in a way that the load based approach does not."). Only one party reached the definitive conclusion that the first-seller approach would be preempted by the FPA. *See* Pacificorp Comments at 11-13.

NRDC disagrees with SDG&E and SoCalGas's conclusion that the preemption analysis is the same under the first-seller and the load-based approaches. *See* SDG&E and SoCalGas Comments at 11. For the reasons noted in our opening legal brief, NRDC believes that the risk of preemption is greater under the first-seller approach, but that the program can be designed to avoid preemption under either approach.

C. There is broad agreement among the parties that CARB could derive the authority to auction from AB 32.

Of the parties that answered ALJ Ruling Question 52, most agree that CARB could derive the authority to auction from the text of AB 32. *See* Comments from Morgan Stanley, SCPPA, SDG&E and SoCalGas, and Edison.

LADWP acknowledges that CARB could have the authority, but points out that CARB might not have the authority to appropriate the funds created by the auction. LADWP Comments at 49. The issue of appropriation of the funds from an auction is separate from the issue of whether CARB has the authority to create an auction in the first place. As LADWP points out, *California Ass'n for Safety Education v. Brown*, 30 Cal.App.4th 1264, 1282 (1994) indicates that the legislature may need to act separately to determine to what use the auctions funds may be put. That question will need to be addressed, but it does not impact CARB's authority to create an auction in the first place.

PG&E questions CARB's authority to auction allowances, asserting that an auction could be interpreted as a "separate emissions limit" that would be more stringent than the emissions limit or emission reduction measures adopted by CARB, rather than being an "alternative means of compliance with an emissions limit." PG&E Comments at 17. In making this argument, PG&E appears to ascribe a narrower definition of "emissions limit," applying only to a single entity, than is contained in AB 32. As PG&E notes, AB 32 defines "greenhouse gas emissions limit" as "an authorization, during a specified year, to emit up to a level of greenhouse gases specified by the state board, expressed in tons of carbon dioxide equivalents." CAL. HEALTH & SAFETY CODE § 38505(h). The law further authorizes CARB to adopt "a regulation that establishes a system of market-based declining annual aggregate emission limits for sources *or categories of sources* that emit greenhouse gas emissions…" CAL. HEALTH & SAFETY

CODE § 38562(c) (emphasis added). CARB is clearly authorized to establish an emissions limit applicable to the electric sector, as a category of sources, and to auction allowances as a means of ensuring compliance with that limit.

D. GHG emission allowance value could be used to fund in-state projects, so long as they are not directly benefiting an in-state industry to the detriment of its out-of-state competitors.

Contrary to the contentions of Los Angeles Department of Water and Power (LADWP) and Southern California Power Producers Association (SCPPA), GHG emission allowances ***could*** be used to fund in-state initiatives without violating the dormant Commerce Clause (DCC). *See* LADWP Comments at 48 and SCPPA Comments at 56. In their response to ALJ Ruling Question 51, LADWP and SCPPA cite *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194-97 (1994) for the proposition that the Market Advisory Committee (MAC) Report's suggested use of allowances would amount to prohibited protection of in-state businesses. However, the MAC Report's proposed uses of GHG emissions allowances are very different from the use of funds that occurred in *West Lynn Creamery*.

The purpose of the program in *West Lynn Creamery* was explicitly to protect local industry form out-of-state competition. Immediately prior to issuing the offending order, the Commissioner of the challenged agency found that local production costs were higher than the prevailing market price and he declared that action was needed to "preserve our local industry." *West Lynn Creamery*, at 190. This blatant economic protectionist purpose is not present in the MAC Report, which seeks to design a cap and trade program that is simple, fair, and includes as many of California's GHG emission sources as possible. *See* MAC Report, at 11. The uses of auction funds described in the MAC report are not intended to prop up a failing domestic industry against out-of-state competition, as was the case in *West Lynn Creamery*.

In addition, the West *Lynn Creamery* program took money from out of state dairies and gave it to their direct competitors – the in-state dairies. This would not be the case in California. The MAC Report suggests using the allowance value for a variety of purposes, including to advance pollution reductions in "low-income and minority communities," to fund innovation emission reduction technologies, and to invest in end-use energy efficiency.   This is a far cry from taking money from out-of-state electricity generators and transferring it to in-state electricity generators to give them a competitive advantage.

In sum, CARB will only run afoul of the DCC if it uses allowances to benefit an in-state industry while simultaneously burdening its out-of-state competitors. CARB can comply with the DCC on this issue under both the first-seller and load-based approaches.

E. California's potential regulation of GHG emissions is not preempted by the Clean Air Act.

Contrary to LADWP's assertion, the Clean Air Act (CAA) would not preempt either the first-seller or the load-based approach. LADWP's reliance on *International Paper v. Ouellette*, 479 U.S. 481 (1987) to support its theory of preemption is misplaced. *Ouellette* addresses the question of whether the Clean Water Act (CWA) preempted a common law nuisance suit brought against an entity in one state using the common law of another state. These facts have no bearing on whether the CAA would preempt California's regulation of GHG emissions from electricity sold in California.

According to LADWP, *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 source in any other way." LADWP Comments at 50. This provision, 33 U.S.C. 1341(a)(2), requires states proposing to issue an NPDES permit to notify other states whose waters may be "affected" by this discharge and give them an opportunity to object at a public hearing. Because the CAA also has a provision wherein a state proposing to issue a Title V operating permit must notify all states whose air quality may be "affected" by the source, LADWP concludes that "[g]iven *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." *Id.*

The flaw with this reasoning is that the CWA notification provision that LADWP labels "preemptive" in *Ouellette*, and whose CAA analogue LADWP relies on here, was entirely irrelevant to the *Ouellette* decision. The Court noted this provision only at the very end of its "brief review of the regulatory framework" (*Ouellette* at 487, 490), and never cited or discussed it again. This is not surprising, as the question presented in *Ouelette* was "whether the Act pre-empts a common-law nuisance suit filed in a Vermont court under Vermont law, when the source of the alleged injury is located in New York." *Id*. at 483. In holding that the appropriate common law of nuisance to apply was that of New York, and not Vermont (*Id.* at 491-500) the Court extensively discussed the goals and structure of the Clean Water Act, but never once referred to or discussed the notification provision that LADWP describes as "preemptive."

Even if LADWP's reading of *Ouellette* were correct, the next step in its argument – that a notification provision under a single CAA permitting program (Title V) preempts state authority to regulate the sale of electricity within that state – is untenable. Title V, which was added in the 1990 Amendments to the CAA, was expressly designed as a purely procedural enactment that would help rationalize the Act's myriad substantive permitting requirements. It is difficult to see how Congress intended this Title V notice provision, which imposes no substantive requirements of its own, to suddenly, three decades after passage of the 1970 Clean Air Act, preempt state authority to regulate GHG emissions from electricity used within the state.

In short, LADWP's argument is completely incorrect, as applied to either a first seller or a load-based regulatory approach.

IV. Conclusion

NRDC and UCS thank the Commissions for considering these reply comments and appreciate the Commissions' efforts to better understand and evaluate the legal, regulatory, market and operational issues associated with the different regulatory approaches proposed for the electric sector. NRDC and UCS look forward to discussing these comments with other parties at the August 21, 2007 en banc hearing.

Dated: August 15, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Reply Comments and Reply Brief of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on the 'First Seller' Approach" in the matter of R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on August 15, 2007 at San Francisco, California.

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