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

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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. | Rulemaking 06-04-009 (Filed April 13, 2006) |

**ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION**
**OF THE STATE OF CALIFORNIA**

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| In the Matter of:<br><br>Order Instituting Informational Proceeding on a Greenhouse Gas Emissions Cap | Docket 07-OIIP-01 |

# REPLY COMMENTS OF THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION ON THE MARKET ADVISORY COMMITTEE REPORT

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**REPLY COMMENTS OF THE**
**CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION**
**ON THE MARKET ADVISORY COMMITTEE REPORT**

In accordance with Rules of Practice and Procedure of the Public Utilities Commission ("CPUC") of the State of California, the California Municipal Utilities Association ("CMUA") hereby files these Reply Comments on the *Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report* and new Comments on the *Administrative Law Judges' Ruling Requesting That Parties Address an Additional Legal Issue* issued August 8, 2007, in Rulemaking 06-04-009. CMUA also files these Comments with the California Energy Commission ("CEC") in Docket 07-OIIP-01. In these Comments, the CPUC and CEC will collectively be called the "Joint Agencies."

## GENERAL COMMENTS

- An improperly structured regulatory scheme will unjustly harm certain retail providers and inhibit the achievement of AB 32.[1] The time frame for this proceeding is aggressive and, in many respects, proposes to accomplish in months what the Legislature has afforded years to the California Air Resources Board ("CARB"). CARB must eventually develop regulations that will eventually be reviewed by the Office of Administrative Law to ensure they meet the panoply of standards including authority, clarity, and necessity.[2] The point being that the Joint Agencies should not rush to judgment in crafting recommendations. CMUA encourages the Joint Agencies to ensure that this proceeding includes a reasonable schedule for public involvement and stakeholder comment.
- The GHG limit and emission reduction goals are statewide and the Joint Agencies should reject any proposals advancing parochial interests (utility-specific, geography-specific, jurisdiction-specific, etc.).[3]
- AB 32 provides that any *optional* market-based system must achieve additional GHG reductions at a lower cost than achievable under the direct regulatory approach that will form the basis for achieving emission reductions.[4] The First-Seller approach is merely one idea and no record has been developed nor has any determination been made that the

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[1] *Accord* SDG&E Comments at 3.

[2] Gov't Code § 11349.1.

[3] *See* Health & Safety Code § 38505(m), (n).

[4] Health & Safety Code § 38570(b), (c).

First-Seller approach will achieve the additionality and cost-effectiveness requirements of AB 32. Therefore, the Joint Agencies should not infer from CMUA's legitimate questioning of the First-Seller approach, any intent to inhibit the success of this proceeding.

- At this very early stage, and in relation to any market-based system being discussed, CMUA has initial preferences toward having the retail provider as the point of regulation.

## REPLY COMMENTS TO SPECIFIC QUESTIONS

**Q.1 Is the MAC report's description of this First-Seller approach accurate?**

- The First-Seller concept is untested, exploratory, and replete with federal preemption concerns. While some parties weighed in heavily in support of First-Seller, others expressed their concern.[5] CMUA encourages the Joint Agencies to carefully consider the practical and legal questions of all approach proposals.

**Q.8 Provide a 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 First-Seller approach.**

- CMUA points out that the entire set of fifty-four questions concern only the First-Seller approach, which is just one proposal for implementing an optional market-based compliance mechanism. The parties' answers were constrained by the call of the question and should not be taken as a sector-wide approbation of First-Seller or the primacy of any market-based mechanism.[6] CMUA requests that the Joint Agencies remain open to considering additional approaches that might be presented by *any* party during the course of this proceeding.[7]

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[5] *See e.g.*, support by SCE Comments at 2-3, PG&E Comments at 5, and WPTF Comments at 2; concern by Calpine Comments at 2-3, SDG&E Comments at 4, and IEPA Comments.

[6] *See e.g.*, LADWP Comments at 18, SCPPA Comments at 14-15, WPTF Comments at 4, and SCE Comments at Appendix A.

[7] *See e.g.*, NRDC Comments at 3-4, EPUC Comments at 4-5.

**NEW QUESTION PRESENTED BY ALJ RULING ON AUGUST 8, 2007**

**Q.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.**

As requested by the Ruling, *California ex rel. Lockyer v. Dynegy, Inc.* states that the "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."[8] The Ruling requests parties to consider a line of three cases dealing with pre-emption under the NGA and Natural Gas Policy Act of 1978 ("NGPA"). In accordance with CMUA's Opening Comments and these cases, CMUA believes that a First-Seller approach is more likely subject to pre-emption under the Federal Power Act ("FPA") than a load-based approach.

All three cases involve state laws covering natural gas produced from a common gas pool. For reasons compelled by the laws of *physics*, the unilateral action of one producer in a common gas pool may adversely affect the gas allocation of other parties as gas in all areas of the pool flow toward the low pressure created by extraction. Therefore, it is left to the laws of *governments*[9] to conserve natural resources and protect the producers' correlative property rights in the common pool.

The cases deal with regulatory actions in the States of Kansas and Mississippi.[10] The first two regulatory actions, intended to achieve the same conservation goal under the NGA and NGPA, were held invalid by the U.S. Supreme Court as pre-empted by federal law. Both of the invalidated regulations attempted to resolve the common pool problem by governing the actions of gas purchasers and thereby "impinged on the comprehensive federal scheme regulating interstate transportation and rates" of gas.[11] In contrast, the third regulation was upheld since it regulated only the in-state actions of gas producers, an area having been *expressly* reserved for the states by the NGA.

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[8] *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 842 footnote 8 (9th Cir. 2004). "The relevant provisions of the two statutes are in all material respects substantially identical . . . . We therefore follow our established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes."); [citations omitted]. *Id.*

[9] And, the crux of the issue was whether it was the state or federal government.

[10] *Transcontinental Pipe Line Corp. v State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986).

[11] *Northwest Central Pipeline Corp. v. Kansas*, 489 U.S. 493, 513 (1989) (citing *Northern Natural*, 372 U.S. at 91-93 and *Transco*, 474 U.S. at 422-424).

Several lessons may be extracted from these cases that are applicable to the First-Seller versus load-based question.

- As described in CMUA's Opening Comments, the FPA delegates exclusive[12] authority to the Federal Energy Regulatory Commission ("FERC") to regulate the wholesale sales and rates of electric energy in interstate commerce.[13] The "sale of electric energy in interstate commerce" means a sale of electric energy to any person for resale.[14] In *Northern Natural Gas Co. v. Kansas* (*"Northern Natural"*), the interference with the federal regulatory scheme arose because the state's regulations were "unmistakably and unambiguously directed at wholesale purchasers involved in interstate commerce."[15] By virtue of being defined as the "importing contractual party," the First-Seller will in many cases be a wholesale purchaser or seller involved in interstate commerce. The proposed definition is "unmistakably and unambiguously directed" at entities involved in interstate commerce. At the very least, the First-Seller approach implicates federal issues while the load-based approach does not.
- Just as in *Northern Natural*, the state's order in *Transcontinental Gas Pipe Line Corp. v. Mississippi* ("*Transco*") also regulated the purchaser. Mississippi, however, believed that the NGPA had removed federal jurisdiction over wholesale rates by replacing the traditional cost-based ratemaking system with a "hands-off" market-based system. Mississippi argued that the State was free to regulate in the gap. The Court disagreed, and stated that the new market-based approach was actually a positive exercise of federal jurisdiction by instituting a scheme to let market forces set the rates and not the states.[16] Therefore, the NGPA had not "intended to give to the States the power it had denied to FERC" and the States were not free to directly impact rates.[17] The Court declared that the Mississippi order obstructed Congress' determination that the supply, demand, and price of gas be determined by market forces. The FPA is substantially similar in that it now incorporates a market-based regulatory structure for establishing wholesale rates. Similarly, California has no authority through the First-Seller approach to directly impact

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[12] *See, e.g., Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 304 (1988).

[13] 16 U.S.C. § 824(a); 16 U.S.C. § 824(b)(1).

[14] 16 U.S.C. § 824(d).

[15] *Northern Natural Gas Co. v. Kansas*, 372 U.S. 84, 92 (1963).

[16] *Transco*, 474 U.S. at 420, 422.

[17] *Transco*, 474 U.S. at 422.

the wholesale rates of electricity.

- Not only is the direct regulation of wholesale rates clearly proscribed, but so too a state's regulation that would achieve the same result.[18] The *Transco* Court stated that the Mississippi order ran "afoul" of the federal regulatory scheme because it "would have the effect of increasing the ultimate price to consumers."[19] This would "frustrate[e] the federal goal of ensuring low prices most effectively" by requiring consumers to bear the financial burden of contracts that purchasers were forced to enter by virtue of the state's regulatory mandate.[20] The FPA has an identical goal of driving down wholesale prices and concomitantly the price to consumers.[21] Arguably, this federal scheme may be disrupted if consumers are forced to pay higher prices as a result of implementing the First-Seller approach.
- The Court stated in *Northern Natural* that even if the state regulation involves a traditional state function such as conserving natural resources, the regulation may still be invalidated if the "means chosen [ ] to exercise the conceded power threaten effectuation of the federal regulatory scheme."[22] "[A] purpose, however legitimate, to conserve natural resources, does not warrant direct interference by the States" with wholesale prices in interstate commerce.[23] The Kansas regulation in *Northern Natural* was designed to conserve resources but was invalidated by the Court. The Kansas law in *Northwest Central Pipeline Corp. v. Kansas* was instituted for exactly the same purpose, however, it was upheld even though the Court stated that it might affect interstate rates. The difference between the two regulations was that while the former "invalidly invade[d] the federal agency's exclusive domain,"[24] the latter regulated "in a field that Congress expressly left to the States," i.e., the in-state production of gas.[25] Federal authority to regulate the sale of electricity in interstate commerce is exclusive.[26] The FPA offers no similar exclusion to importing First-Sellers as the NGA does to gas producers. The State

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[18] *Northern Natural*, 372 U.S. at 90-91.

[19] *Transco*, 474 U.S. at 423.

[20] *Transco*, 474 U.S. at 424.

[21] *PUD No.1 v. FERC*, 471 F.3d 1053, 1064, 1067 (9th Cir. 2006).

[22] *Northern Natural*, 372 U.S. at 93.

[23] *Northern Natural*, 372 U.S. at 93.

[24] *Northern Natural*, 372 U.S. at 92.

[25] *Northwest*, 489 U.S. at 509, 524.

[26] 16 U.S.C. § 824(a); 16 U.S.C. § 824(b)(1).

of California has no express grant of authority to regulate *importers* of electricity. The State of California may not regulate importers' "purchasing decisions in the mere guise of regulating [an environmental concern]."[27] CMUA agrees in part with NRDC that CARB must develop regulations that promote environmental concerns, but the First-Seller approach does not clearly evade the realm of FERC. The load-based approach appears to present no similar jurisdictional infirmity.

## CONCLUSION

CMUA looks forward to further discussions at the *en banc* hearing.

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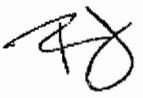
Respectfully submitted,



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[27] *Northwest*, 489 U.S. at 516- 518.