CALIFORNIA ENERGY COMMISSION

In the Matter of: Order Instituting Informational Proceeding – AB 32	**Docket No. 07-OIIP-01**

COMMENTS OF SEMPRA GLOBAL ON DRAFT INTERIM OPINION

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CALIFORNIA ENERGY COMMISSION

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, 2007)

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I. INTRODUCTION

In accordance with Rules 14.3 and 14.6 of the Commission's Rules of Practice and Procedure, Sempra Global herewith files its comments on the Proposed Interim Opinion of Reporting and Tracking of Greenhouse Gas Emissions in the Electricity Sector (the "PD") that was publicly released on August 15, 2007. Sempra Global is commenting on only a single issue, namely, the discussion in Section V.B.2.(a), which states that:

> [I]n our opinion it is unlikely that new contracts with existing generation sources would produce real reductions in GHG emissions, since most, if not all, of existing power plants would run the same regardless of any new contract. Therefore, we recommend that ARB attribute emissions for purchases from specified sources based on emissions of the specified resource only if (a) the purchase is made through a PPA that was in effect prior to January 1, 2008 and either is still in effect or has been renewed without interruption, or (b) the purchase is made through a PPA from a power plant that became operational on or after January 1, 2008. PD, at p. 21.

Global submits that this language is not supported by record evidence, is speculative, contrary to the goals of AB 32, and arguably unlawful with respect to existing generating units. For those reasons, the Commission should reject this language and require that load-serving entities report and track the greenhouse gas ("GHG") emissions of existing units subject to source-specific contracts according to their actual emissions rates, and not simply assign the default emissions factors applied to power delivered from unspecified resources.

Sempra Global stands to suffer substantial prejudice under this rule, and anticipates that this prejudice would be exacerbated and continued if the Air Resources Board ("ARB") were to continue the rule beyond the 2008 reporting year. This prejudice would be counterproductive to the goals of the recommendations and the overall California program to curb greenhouse-gas emissions. While the issue of contract shuffling with which the Commission is concerned and the Proposed Decision is attempting to address may be a legitimate concern, the remedy is misdirected, poorly crafted and could, if continued beyond 2008, result in the execution of new contracts with coal-fired generating units since those units would only benefit from the rule.

Further, to the extent that load-serving entities report 2008 emissions under the proposed rule and that this level of emissions is used to determine the emission- abatement or -mitigation requirements for those entities beginning in 2012, the power industry's reported emissions, and long-term program emission-reduction burdens, could be higher than they should be, with a concomitant increase in the industry's compliance costs to the detriment of all California retail customers.

II. COMMENTS

A. The record in this proceeding does not support adoption of the proposed rule.

The PD appears to have drawn its conclusion that new contracts with existing units will not achieve real GHG emissions reductions from language on page 15 concerning the issue of contract shuffling. The concern has to do with the *possibility* that some load-serving entities *might* sign power purchase agreements with low-emitting resources to achieve faux reductions in GHG emissions while continuing to operate their higher-emitting plants, thus achieving no real GHG emissions reduction. While this is a legitimate concern, the proposed solution is overly broad and creates additional problems. The record is lacking with respect to the number and size of contracts set to expire prior to 2012, their terms, the operating history of the units, and so forth. Sempra Global believes it is unduly speculative, and therefore arbitrary and capricious, for the Commission to adopt a rule based on such speculation.

The dispatch of generation is a function of numerous variables in the market, among which are electricity demand (which is itself driven by uncertainties of weather and economic conditions), hydroelectric availability, fuel prices and transmission availability, all of which are dynamic and interrelated. Added to this mix is, of course, the terms of the contract(s) between the unit(s) and the load-serving entity(ies). Thus, the PD's conclusion that existing units will continue to be operated identically to past operations is misplaced. Such conclusion is overly simplistic and necessarily makes a number of unfounded assumptions regarding each of the variables mentioned, along with the contract terms.

A unit under contract today to provide summer peaking or ancillary services might sign a new contract where it would serve as a dispatchable intermediate baseload unit in the future, or vice versa. At the same time, generation retirements, load growth, changes in system topography and transmission upgrades or derates all would impact unit dispatch. With so many variables operative, the assumption that a unit will operate next year (and beyond) in the same manner as it is today is unsupported, even in the absence of the new GHG emissions reduction program. The numerous assumptions and issues of fact required to reach this conclusion are not in the record, which consists of two days of workshops followed by a Joint Staff Report and comments on the staff report. There has been no factual development in the record that would provide the needed evidentiary basis for the PD's conclusions. Most importantly, logic would compel a finding that, pursuant to A 32, using source-specific emissions factors for as many units as possible provides greater clarity and transparency, along with the meritorious effect of assuring that low-emitting resources operate to the maximum extent possible, displacing higher emitting resources in the dispatch order. The proposed rule undermines these effects and benefits, and should be rejected.

Sempra Global recognizes that the Commission's recommendations to the ARB, if adopted, are only intended to affect reporting and tracking of greenhouse-gas emissions by load-serving entities for the 2008 operating year and that the Commission intends to undertake a comprehensive review of the reporting and tracking rules for the power sector in 2010. Nevertheless, because any 2008 recommendations (and, if adopted by ARB, the 2008 rules) would carry the weight of precedent and may receive some beneficial presumptions in the future, Sempra Global must protest the PD's recommendation.

B. The proposed rule would unlawfully interfere with wholesale energy transactions.

Under the proposed rule for existing units, if a load-serving entity were to execute a new long-term, source-specific contract with an existing combined cycle natural gas-fired unit, that load-serving entity would be forced to impute the applicable default emission factor to the contract rather than the source-specific emission factors achieved by the actual unit. In the case of generation owned by Sempra Global's subsidiary, the source-specific emission factor would in most instances be *lower* than the default emissions factor that would be applied. In fact, even compared to the nominally lower default emission factor proposed for Pacific Northwest imports, the source-specific emissions factor would be only marginally, and from a commercial perspective negligibly, higher. The proposed rule would thus eliminate the incentive for load-serving entities to contract with existing low-emitting units, and leave those units vulnerable to competition from higher-emitting, but cheaper, fuels and technologies. In this regard, an existing coal-fired unit would be benefited under the proposed rule since its higher source-specific emissions rate would also be disregarded from the load-serving entity's perspective – the load-serving entity signing a new contract with an existing coal-fired generating plant would report emissions using the appropriate default emissions factor, which in the case of every existing coal plant of which Sempra Global is aware, would be lower than the source-specific rate.

By eliminating any source-specific differentiation between low- and high-emitting resources solely on the basis that the plant was operational prior to January 1, 2008, the PD harms low-emitting units and benefits high-emitting units. This result cannot be the intent of either the Legislature or the Commission.

The practical effect of the proposed rule strips away any emissions-related incentive a load-serving entity would otherwise have to enter into a new contract with the low-emissions units, essentially stranding those units in a competition against identical, but newer, units and, even more irrationally, against existing coal-fired units with higher emissions but lower variable costs of operation. This outcome is wholly inconsistent with the very purpose of the greenhouse-gas emissions program, namely, providing incentives to load-serving entities to procure power from generating facilities with the lowest available emissions profiles. There is simply no reason to replace these incentives to "go low" with irrelevant criteria related to start-up dates or pre-existing contracts.

Throughout this proceeding, the Commission has expressed concerns about implementing a program that would survive constitutional scrutiny. A chief concern has been that the program could suffer fatal defects under the Commerce Clause of the Constitution of the United States. Because the proposed rule would have the effect of directing that wholesale sellers of electricity from existing units could only contract with their current counterparties, the rule could easily be found to unlawfully interfere with interstate commerce. Also, limiting the seller's pool of potential buyers to a single party could be viewed as creating an unlawful restraint on trade.

Viewed differently, leaving only a single load-serving entity as the sole potential buyer could be viewed as conferring monopsony power on that buyer, which in turn raises anti-trust concerns if that leverage is perceived as harmful to the market. At the very least, the seller would have little to no bargaining power under such circumstances. It would be ill-advised and unfortunate if the Commission were to make a recommendation that created or exacerbated its legal concerns, and it would do so here, since Commission's rationale for the proposed rule is highly speculative, and finds little to no support in the record. The Commission should eliminate this recommendation from the PD, rather than put the GHG reduction program at risk by this proposed rule.

C. The proposed rule undermines the goals of AB 32.

The long-run effects of the proposed rule would undermine what most parties presume should be the effect of Assembly Bill 32 on the power industry, *viz.,* a migration away from higher-emitting units and toward lower-emitting ones. The proposed rule will prevent this migration by placing all existing generating units, including ostensibly renewable resources, on an equal footing with respect to emissions – all existing units subject to the rule would compete with one another, whether for long-term contracts or through the short-term markets operated by the California Independent System Operator, using the applicable default emissions rate. This eliminates the incentives load-serving entities would otherwise have to discriminate among resource options based on the emissions profiles of differing units. Only by reflecting source-based emissions rates in the fixed and/or variable costs associated with every resource option will the incentives to load-serving entities be clear.

In the absence of the proposed rule as more and more low-emitting units, whether existing or new, are added to the resource portfolios of load-serving entities pursuant to source-specific contracts, the default emission factors would be expected to rise as the mix of units available to serve contracts without specified sources changes, with lower-emitting units leaving the pool and only higher-emitting units remaining. Removing the incentives for this attrition to occur is patently counterproductive to achieving reductions in emissions since it reduces, and may eliminate, any probability that higher-emitting units will be unable to compete and would be forced to exit the market or reduce their production.

Finally, Sempra Global strenuously objects to the contribution the proposed rule will make to the prejudice that existing units owned by independent power producers face in the California market. Sempra Global has frequently objected to the structural bias existing units face in the market for new long-term contracts. In several instances, existing units have been precluded from even bidding for certain contracts. This prejudice is reflected in the proposed rule related to emission factors. Where a load-serving entity owns an existing unit, it is permitted to use the actual emissions rate of the source. But where the load-serving entity contracts for capacity and/or energy from *that same or an identical unit* where owned by a third party, that load-serving entity is required to report the emissions from the using the applicable, and in Sempra Global's case, higher default emission factors. This results in the load-serving entity reporting greater than actual emissions for power generated by independent producers, while for its own units the load-serving entity would report lower emissions pursuant to the rules for self-owned units. This outcome is plainly irrational and discriminatory in its effect and fails to serve the GHG emissions reduction goals of AB 32 and the Commission.

The Commission's purported concern with contract shuffling cannot be used to justify such blatant favoritism that serves no purpose in the overall scheme of the emissions program and may in fact serve to undermine the program. The proposed rule should be rejected, and further consideration given to more narrowly tailored measures that address the contract shuffling issue without the discriminatory effects of the rule as proposed in the PD.

III. CONCLUSION

The Commission's attempt to address contract shuffling by assigning a default emissions factor to contracts between load-serving entities and existing units unless (a) the purchase is made through a PPA that was in effect prior to January 1, 2008 and either is still in effect or has been renewed without interruption, or (b) the purchase is made through a PPA from a power plant that became operational on or after January 1, 2008 is an unsatisfactory solution to this problem. The proposed rule is speculative, unsupported by record evidence, raises numerous legal problems, is contrary to the objectives of AB 32, and blatantly discriminates against existing units owned by independent power producers. For all of these reasons, the Commission should reject this provision in the PD.

Respectfully submitted,

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