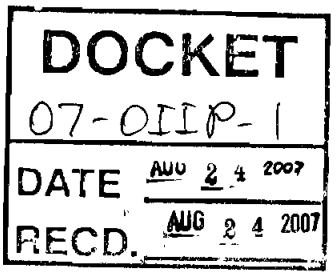
BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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)

ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA

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



COMMENTS OF THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION ON THE INTERIM DECISION ON REPORTING AND TRACKING

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COMMENTS OF THE CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION ON THE INTERIM DECISION ON REPORTING AND TRACKING

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 Opening Comments ("Comments") on the *Interim Opinion on Reporting and Tracking of Greenhouse Gas Emissions in the Electricity Sector* ("Interim Opinion") issued August 15, 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."

I. STATEMENT OF POSITION

CMUA members reaffirm their commitment to achieving the "statewide greenhouse gas emissions limit" as it will be set by the California Air Resources Board ("CARB").[1] The Joint Agencies should interpret CMUA's Comments in a productive light. CMUA offers comments related to the following points.

- The definition for "real reductions" exceeds the scope of AB 32. CARB's statutory authority is limited to regulating "statewide greenhouse gas emissions" as that term is defined in AB 32 and does not include emissions from electricity generated out-of-state that is not delivered to and consumed within California.[2]
- In order to be approved by the Office of Administrative Law, CARB's regulations must meet certain standards including necessity,[3] authority,[4] and consistency.[5] Therefore, in order to be considered by CARB, recommendations from the Joint Agencies must not violate these principles.

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[1] Health & Safety Code § 38505(n).

[2] Health & Safety Code § 38505(m).

[3] Gov't Code §§ 11349(a), 11349.1(a); 1 Cal. Code Regs. §§ 10, 11.

[4] Gov't Code § 11349(b); 1 Cal. Code Regs. § 14.

[5] Gov't Code § 11349(d).

- The Protocols must only attribute emissions to reporting entities according to the amount of electricity actually delivered to and consumed in California and not according to their proportional ownership share.
- Reporting entities should be attributed with the actual emissions of purchases, sales, and exchanges for all specified new and existing sources.

II. RULES OF THE ADMINISTRATIVE PROCEDURE ACT

CMUA makes note that the Administrative Procedure Act ("APA") sets standards for regulations adopted by CARB.[6] In order to be approved by the Office of Administrative Law, CARB regulations must meet certain standards including necessity, authority, and consistency. As proposed by the Interim Decision, certain aspects of the Proposed Electricity Sector Greenhouse Gas Reporting and Tracking Protocol[7] ("Protocol") may not meet these standards.

Pursuant to the APA, "necessity" means that "the record of the rulemaking proceeding demonstrates by substantial evidence the *need for a regulation to effectuate the purpose of the statute* . . . ."[8] The court's inquiry is generally confined to the question of whether or not the regulation is "arbitrary, capricious or [without] reasonable or rational basis,"[9] however, "[a]dministrative regulations that alter or amend the statute or enlarge or impair its scope are void . . . ."[10]

The APA requirement for "authority" shall be presumed to exist only if CARB cites a California constitutional or statutory provision which: (1) expressly permits or obligates the agency to adopt the regulation; or (2) grants a power to the agency which impliedly permits or obligates the agency to adopt the regulation in order to achieve the purpose for which the power was granted.[11]

The APA requirement for "consistency" means that the regulation is "in harmony with,

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[6] Gov't Code § 11340, *et seq.*

[7] Interim Opinion, Attachment A.

[8] Gov't Code § 11349(a) (emphasis added). A court may invalidate a regulation if it finds "[t]he agency's determination that the regulation is reasonably necessary to effectuate the purpose of the statute . . . that is being implemented, interpreted, or made specific by the regulation is not supported by substantial evidence." Gov't Code § 11350(b)(1).

[9] *Yamaha Corp. of America v. State Bd. of Equalization*, 19 Cal. 4th 1, 11 (1998).

[10] *Henning v. Division of Occupational Saf. & Health*, 219 Cal. App. 3d 747, 758 (1990).

[11] Gov't Code § 11349(b); 1 Cal. Code Regs. § 14.

and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law."[12] Under the proper legal standard of review, a court will determine whether the agency reasonably interpreted its legislative mandate when deciding that the challenged regulation was necessary to accomplish the purpose of the statute. In other words, "the court will determine whether the regulation is reasonably designed to aid a statutory objective."[13]

III. SEVERAL PROTOCOL SECTIONS VIOLATE THE PRINCIPLES OF AB 32

A. Definition of real reductions

Importantly, the term "statewide greenhouse gas emissions" ("Statewide GHG Emissions") means the "total annual emissions of greenhouse gases *in the state*, including all emissions of greenhouse gases from the generation of electricity *delivered to and consumed in California*, accounting for transmission and distribution line losses, whether the electricity is generated in state or imported."[14] The "statewide greenhouse gas emissions limit" ("Statewide GHG Limit") is the maximum allowable level of Statewide GHG Emissions in 2020[15] which will be set equivalent to the historical Statewide GHG Emissions level in 1990.[16] In order to monitor and enforce compliance with AB 32 requirements, CARB shall adopt regulations to require the reporting of GHG emissions[17] from sources that affect the Statewide GHG Limit.[18] This includes the GHG emissions "from all *electricity consumed in the state*, including transmission and distribution line losses from electricity generated within the state or imported from outside the state."[19] AB 32 could not, and did not, authorize CARB to monitor or limit any GHG emissions from electricity except for those actually *emitted in the state* or resulting from electricity *consumed in the state.*

CMUA believes that the Interim Opinion errs in its interpretation of real reductions by

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[12] Gov't Code § 11349(d).

[13] *Benton v. Board of Supervisors*, 226 Cal.App.3d 1467, 1479 (1991).

[14] Health & Safety Code § 38505(m) (emphasis added).

[15] Health & Safety Code § 38505(n).

[16] Health & Safety Code § 38550.

[17] Health & Safety Code § 38530(b)(1).

[18] Health & Safety Code § 38505(i).

[19] Health & Safety Code § 38530(b)(2) (emphasis added).

expanding the geographic scope of AB 32 to include emissions that have *no* connection with the State of California.[20] Pursuant to the Statewide GHG Limit and emission reduction measures that will be established by CARB,[21] POUs recognize the need to begin reducing their Statewide GHG Emissions. These emission reductions achieved by the POUs, i.e., *the reductions in their Statewide GHG Emissions*, must be "real, permanent, quantifiable, verifiable, and enforceable" by CARB.[22] A "real" reduction of Statewide GHG Emissions will actually occur if the POU reduces its "total annual emissions of greenhouse gases *in the state*, including all emissions of greenhouse gases from the generation of electricity *delivered to and consumed in California*, accounting for transmission and distribution line losses, whether the electricity is generated in state or imported."[23] The definition of "real" is necessarily limited to the jurisdictional scope of AB 32.

B. Protocol sections 3.7/3.9/3.11 – total emissions attributed to reporting entities

The Joint Agencies intend these Protocols to be used by CARB for determining a reporting entity's compliance with the Statewide GHG Limit.[24] Accordingly, it appears that a reporting entity's compliance will be gauged by its total CO_2e emissions from owned facilities and purchases[25] minus adjustments for certain sales from specified[26] and unspecified resources[27] to counterparties within California. CMUA is unclear concerning the Protocol's proposed treatment of sales and exchanges to counterparties outside California. Furthermore, the Protocol adds reporting restrictions on plant operations, purchases, and sales that are contrary to the statutory reach of AB 32.

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[20] Interim Opinion at 15.

[21] Health & Safety Code §§ 38550, 38560, 38562.

[22] Health & Safety Code § 38562(d)(1). This requirement pertains to the regulations adopted by CARB which deal only with Statewide GHG Emissions. Health & Safety Code § 38562(d). See also Health & Safety Code § 38565 (recognizing a jurisdictional limit on CARB's authority over GHG emission rules.)

[23] Health & Safety Code § 38530(b)(2) (emphasis added). The concept of "leakage" as defined in AB 32 is not implicated by reducing the amount of out-of-state electricity delivered to and consumed in California, so, leakage will not be discussed here. Health & Safety Code § 38505(j).

[24] Interim Opinion at 11.

[25] Protocol section 3.7.

[26] Protocol section 3.9.

[27] Protocol section 3.11.

C. Protocol section 3.2 – emissions for owned plants

Protocol section 3.2 states that emissions from an owned powerplant should be attributed "to the reporting entity based on its proportional ownership share (not the amount of electricity received)." CMUA recognizes that reporting entities must provide sufficient information so that CARB may monitor and verify compliance. Therefore, Protocol 3.2 understandably would comprise an initial "gross" value of emissions from a particular power plant. In particular to plants located outside California, the reasonableness of section 3.2 is entirely dependent upon making the proper adjustments for electricity that was *not delivered and consumed* in California by the reporting entity/power plant owner.

D. Protocol sections 3.3/3.4/3.6 – emissions for purchases and exchanges from specified sources

Protocols 3.3/3.4/3.6 *effectively* place limitations on the types of specified resources that reporting entities may purchase or exchange by attributing emission levels to "certain power" that is "different than the level of GHG emissions that [actually] *occurs* from the source specified in the contract."[28] For power plants that became operational before January 1, 2008 and that have actual emission factors lower than the applicable default emission factor,[29] Protocols 3.3/3.4/3.6 *effectively* limit purchases and exchanges with these power plants by attributing the applicable default emission factor to them. Under Protocols 3.3/3.4/3.6, a zero-emission eligible renewable resource could be attributed an emission level as high as 1075 pounds CO2e per MWh.[30]

E. Protocol sections 3.8/3.9 – emission adjustments for sales and exchanges from specified sources

The Interim Opinion states that the Protocols, "taken as a whole, would not automatically result in a retail provider being responsible for all of the GHG emissions associated with its ownership share of the plant."[31] Yet, Protocols 3.8/3.9 *effectively* place limitations on sales and exchanges *from* specified resources by setting unreasonable, arbitrary, and capricious restrictions

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[28] Interim Opinion at 16 (emphasis added).

[29] *See* Protocol section 3.6.

[30] Protocol sections 3.4, 3.6; Interim Opinion at 26-31.

[31] Interim Opinion at 20.

on calculating the emissions attributed to the reporting entity[32] for sales or exchanges greater than 10 percent of the reporting entity's ownership share. Protocols 3.8/3.9 attribute to the reporting entity, emissions for the sold or exchanged "power using the average emission factor of power available for sales from unspecified sources"[33] unless the reporting entity can prove that: (1) the power could not be delivered to itself; or (2) the reporting entity did not need the power because it had surplus power from its owned power plants and the specified plant was the marginal plant.[34]

CMUA believes that these Protocols have several problems. One problem is that the Protocols summarily impute malfeasance to reporting entities for engaging in a proper sale or exchange. In addition, Protocols 3.8/3.9 do not appear to expressly mention the situation when electricity generated by a specified source outside California is then sold or exchanged by the power plant owner whereby the electricity is delivered and eventually consumed outside California. CMUA seeks clarification that emissions from the electricity included in these sales and exchanges are not attributable to that power plant owner.

IV. CONSTITUTIONAL ISSUES IMPLICATED BY THE PROTOCOLS

If the Protocols discussed above were adopted by CARB as proposed, CMUA believes that several constitutional issues may arise. They are briefly mentioned below.

A. Substantive due process

The Due Process Clause of the Fifth and Fourteenth Amendments require that laws passed by the federal and state government must not be "unreasonable, arbitrary or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained."[35] In particular, the criteria for Protocol sections 3.3 and 3.8 discussed above are not reasonably necessary to effectuate the purpose of the statute and may violate substantive due process by depriving plant-owning retail sellers of property without due process of law.

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[32] Interim Opinion at 19-20.

[33] Protocol 3.9.

[34] Protocol 3.8.

[35] *Nebbia v. New York*, 291 U.S. 502, 525 (1934).

B. Regulatory taking

The Takings Clause of the Fifth Amendment of the U.S. Constitution provides that no "private property be taken for public use, without just compensation."[36] Although, public property may be taken through eminent domain by a superior sovereign without compensation,[37] there are two primary exceptions to the general rule: federal takings of state property and takings of public property held in a proprietary capacity.

In regard to POU, California courts have upheld an exception to the general rule where the public property is being held in a proprietary capacity and the analysis for determining a Fifth Amendment violation is identical to the analysis involving private property.[38] The landmark case was an 1861 California Supreme Court case which held that when municipal corporations hold private property for municipal uses, that property acquires the protections of private property.[39] The State cannot take away the "private property of the [municipal] corporation or change the uses of its private funds acquired under the public faith."[40] Owning infrastructure for generating electricity is undoubtedly a proprietary act of a local government.[41] Modern cases continue to support this position. In 1963, the Second Appellate District of the California Court of Appeal held that "lands held by a municipal corporation in its proprietary capacity may not be taken from it by the State without the payment of just compensation."[42]

There are four different tests in which a taking may be analyzed.[43] At least two tests are

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[36] U.S. CONST. amend. V.

[37] EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 32.81 (3d ed. 2007).

[38] *Id.*

[39] *Grogan v. San Francisco*, 18 Cal. 590, 613 (1861). "So far as municipal corporations are invested with subordinate legislative powers for local purposes, they are mere instrumentalities of the State for the convenient administration of the Government, and their powers are under the entire control of the Legislature; they may be qualified, enlarged, restricted, or withdrawn at its discretion. But these bodies . . . "may also be empowered to take and hold private property for municipal uses, and such property is invested with the security of other private rights." *Id.*

[40] *Id.* (quoting 4 Wheat 694).

[41] The Federal Court for the Southern District of California held that when a city contracts "for water works to supply itself and its inhabitants with water, the city is not exercising its governmental or legislative powers, but its business or proprietary powers. The purpose of such a contract is not to govern its inhabitants, but to obtain a private benefit for the city itself and its denizens." Los Angeles City Water Co. v. Los Angeles, 88 F. 720, 732 (1898) (citing 1 DILLION MUN. CORP. § 27).

[42] *People v. Los Angeles*, 220 Cal. App. 2d 345, 351 (1963).

[43] *Lingle v. Chevron*, 544 U.S. 528, 548 (2005).

relevant to the proposed Protocols.

1. Lucas Per Se Taking

In *Lucas v. S.C. Coastal Council*,[44] the U.S. Supreme Court stated that a *per se* taking exists if the regulation "completely deprive[s] an owner of 'all economically beneficial use' of her property."[45] A *per se* taking by the proposed Protocols is plausible in light of the Statewide GHG Limit that will be mandated on all reporting entities. It will be necessary for virtually all California reporting entities to reduce the Statewide GHG Emissions in their portfolio. Undoubtedly, those reporting entities with ownership interests in high emission power plants will need to replace the high emission resources currently used to *actually* serve their load and procure lower emission resources to *actually* serve their load. The Protocol, however, will penalize this action unless the low emission resource was already under contract with the reporting entity prior to January 1, 2008, or the low emission resource was not operational before January 1, 2008.

By attributing the default emission factors to an existing resource that actually emits low or zero-emissions, the Protocol has effectively restricted the ability of a power plant owner to sell or exchange power to achieve actual reductions in its Statewide GHG Emissions. Therefore, the Protocol leaves the power plant owner with only two options to reduce its Statewide GHG Emissions: (1) selling the owner's share in the plant; or (2) laying-off the owner's proportional share by actually changing the power plant's operation.[46] In both of these cases, the Interim Opinion states that the reporting entity would no longer be responsible for emissions from the powerplant but also in both cases, the power plant owner will be deprived of all beneficial use of the property. The complete and absolute economic deprivation is abundantly clear if the owner cannot sell the plant and must lay-off its proportional share.

In regard to a [forced-]sale of the ownership share, CMUA points out that if the plant remains in operation under the new ownership, then the original emissions will continue unabated. Therefore, even if an owner sells its interest in a power plant, no real reduction will be

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[44] 505 U.S. 1003 (1992).

[45] 505 U.S. at 1019.

[46] Interim Opinion at 20.

achieved *according to the Interim Opinion's definition.*[47] This provides an additional example of Protocol's arbitrary standard that has no substantial relation to achieving emission reductions.

2. Penn Central Factors

When a regulation does not result in a physical invasion and does not deprive the property owner of all economic use of the property, a reviewing court must evaluate the regulation in light of the factors the Court discussed in *Pennsylvania Central Transportation. Co. v. New York City.*[48] In determining whether or not a regulatory action constituted a taking that required just compensation, the *Penn Central* Court devised criteria to analyze: (1) the economic impact of the regulation on the reporting entity; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action.

At this point, CMUA will not engage in a complete *Penn Central* analysis of the Protocols using a specific POU example. It is enough to state that the economic impact of selling or laying off the proportional share of a large coal-fired plant could cost the plant owner many millions of dollars. A forced sale or lay-off of the plant would surely interfere with the owner's reasonable investment-backed expectations whereby the owner could not have contemplated that contingency years ago during the original investment. The last test of the takings analysis considers the nature rather than the merit of the governmental action, and particularly whether the regulation is closer to a governmental adjustment of economic benefits and burdens.[49] In terms of achieving reductions in Statewide GHG Emissions that will benefit all Californians, a Protocol section that effectively forces an owner to sell or lay-off its generating capacity implicates a public obligation and a compensatory payment to the affected plant owner.

C. Impairment of Contracts

The Contract Clause of the U.S. Constitution provides that "[n]o State shall... pass any...

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[47] Interim Opinion at 15.

[48] 438 U.S. 104, 124 (1978).

[49] 438 U.S. at p. 127; The California Supreme Court laid out ten factors for analyzing a takings issue. *Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal. 4th 761, 775-776 (1997). *Kavanau* utilized ten factors from *Penn Central* and subsequent cases to determine if a taking has occurred.

law impairing the obligation of contracts . . . ."[50] In *United States Trust Co. v. New Jersey*,[51] the Court stated that, "[i]t long has been established that the Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties. Yet, the Contract Clause does not prohibit the States from repealing or amending statutes generally, or from enacting legislation with retroactive effects."[52] However, the "adjusting [of] the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption."[53]

In *U.S. Trust Co.* the Court outlined a process to determine whether an impairment of contract had taken place. Essentially, the severity of the impairment acts as a measure for the state action. A minimal alteration of contractual obligations may end the inquiry at its first stage. A "[s]evere impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation."[54] Then the court must decide if the impairment served a significant and legitimate public purpose.[55] Lastly, the impairment must not be overly broad and unnecessary because "[a] State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well."[56] As mentioned above, the Protocol may trigger an unconstitutional impairment of contracts if it effectively forces a plant owner into an untenable choice between sale and lay-off or failing to comply with the Statewide GHG Limit.

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[50] U.S. CONST., Art. I, § 10, cl. 1.

[51] 431 U.S. 1 (1977).

[52] 431 U.S. at 14.

[53] *Allied Structural Steel v. Spannaus*, 438 U.S. 234, 244 (citing U.S. Trust Co.).

[54] 438 U.S. at 245.

[55] 431 U.S. at 22.

[56] 431 U.S. at 31.

V. CONCLUSION

CMUA requests that the Joint Agencies take these Comments under advisement in proposing changes to the Protocols that are consistent with AB 32, constitutional principles, and the APA.

Dated: August 24, 2007 Respectfully submitted,

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