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1001 I Street
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Re: **Comments of the Northern California Power Agency on**
Staff Proposed Changes to AB 32 Cost of Implementation Fee Regulation

Dear Jon and Jeannie:

The Northern California Power Agency[1] (NCPA) appreciates the opportunity to provide these comments in response to the proposed and potential changes to the *Proposed AB 32 Cost of Implementation Fee Regulation* (Fee or Proposed Regulation) discussed during the August 25, 2009 California Air Resources Board (CARB) Workshop. In these comments, NCPA also addresses issues that CARB Staff and stakeholders have been discussing in the months since the Board directed Staff to consider revisions to the Proposed Regulation.

Introduction

As requested by CARB Staff during the August 25 Workshop, NCPA is submitting these comments on concepts and issues that have been raised by Staff for possible inclusion in the revised Regulation. While Staff has stated its intent to release for public review a revised version of the Proposed Regulation prior to the September 25 Board meeting, NCPA's comments are necessarily limited to responses to Staff's oral representations. NCPA looks forward to providing more substantive comments once actual revised language is officially released for public review.

1 NCPA members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

The Fee Should be Limited to the Net of Imported Electricity

During the June 25, 2009 Board Meeting and in written comments submitted the previous day, NCPA expressed concern about how the Fee would be applied to imported electricity and the potential to adversely impact the safe and reliable operation of the State's electric transmission system. At the Board Meeting, Staff was directed to further review aspects of the Proposed Regulation – particularly portions pertaining to the treatment of imported electricity – and work with stakeholders to resolve outstanding issues.[2] Since that time, Staff and stakeholders, including NCPA and its members, have diligently pursued resolution to some of these complex issues.

One such concern involves application of the Fee to all electricity produced in California, as well as electricity imported into the State without recognition of electricity exported. Imposing the Fee on both types of transactions, not just the net imports (which focus on the actual electricity consumed in California), adversely burdens the electricity sector by resulting in payment of the Fee on electricity <u>not</u> consumed in California. This outcome is clearly inconsistent with the stated purpose of the Fee in the Initial Statement of Reasons (ISOR)[3] and the treatment of other sources of emissions.[4]

One potential resolution to this concern is to net electricity imports and exports to ensure that the Fee is only applied to electricity consumed in California. Specifically, NCPA and other stakeholders have proposed the netting of electricity imports and exports that are associated with "energy exchange agreements" or seasonal transactions with a particular region. As more fully explained below, this change is necessary to avoid duplicative and burdensome imposition of the Fee on a single sector.

If the Fee is imposed on all electricity imports without recognition of the electricity actually consumed in California, CARB risks jeopardizing the efficient and reliable provision of electricity throughout the State. The purpose of multiple transactions that allow for the purchase and sale of electricity between states and regions is to allow entities to leverage the most effective operation of the entire western electric transmission system, based on transmission constraints, differing peaks, and facility operations. These transactions promote efficiency not only in California, but throughout the entire western region. If entities know that they are going to be assessed an additional Fee on certain electricity transactions, they may adjust their transactions to avoid the unwarranted imposition of the Fee. Such an outcome should be avoided, and *can* be

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2 The Board was concerned in part with the precedential impact of the Fee regulation on the Scoping Plan measures in general and the proposed cap-and-trade program in particular. Board members noted that ambiguities and concerns regarding the treatment of imported electricity must be addressed prior to the approval of a Fee Regulation.

3 The *Staff Report: Initial Statement of Reasons for Rulemaking* (ISOR) for the *Proposed AB 32 Cost of Implementation Fee Regulation* was issued by CARB on May 8, 2009.

4 NCPA also notes that the current calculations for imported electricity from unspecified resources could penalize certain entities, and encourages CARB to remain active in discussions before the Western Climate Initiative where the use of regional emissions factors is being contemplated.

avoided by adjusting the proposed Fee to reflect that the charge will only be assessed against the net imports of electricity *consumed in California*. For example, one NCPA member has significant energy sales and purchases with the Pacific Northwest (PNW), as well as some imports from the Southwest. Under the proposal to net exports against imports pursuant to exchange agreements or between specific regions, the utility would only be able to net sales with the PNW (since it has both sales and purchases from that region) and not other regions where there are not corresponding sales and purchases.[5]

Staff has correctly noted that in order to include a mechanism to net imports in the Proposed Regulation, the provisions must be based on sound public policy and be administratively feasible. NCPA maintains that the netting of imports and exports associated with energy exchange agreements and seasonal/regional transactions is both.

Netting imports and exports is based on sound public policy. As a practical matter, it is sound public policy to ensure that the electricity sector and California's electricity customers are not called upon to bear a disproportionate amount of the Fee burden. Staff has acknowledged that the Fee is intended to be applied to fuels and electricity consumed in California – netting imports and exports would only apply the Fee to electricity consumed by California consumers. Some opponents of this concept have opined that allowing such netting ignores the language in AB 32 that calls for reporting of electricity produced in-state and electricity imports.[6] However, this is simply not true.

Furthermore, drafting the Fee Regulation in a manner that does not impose a double burden on the electricity sector does not change entities' reporting obligations under AB 32, or the compliance obligation for emissions reductions as outlined in the statute and the Scoping Plan. Indeed, the Fee is intended to be applied in a manner that is administratively feasible, and the ISOR expressly states that the result is a Fee on approximately 85% of the state's emissions – there is no actual link between a compliance obligation and assessment of the Fee. Additionally, ensuring that the Fee is assessed on the net of imported and exported electricity is also crucial in the development of a multi-jurisdictional cap-and-trade program; if not applied in this manner, electricity consumed in a partner jurisdiction will be assessed a different set of fees and subject to corollary requirements in that jurisdiction; simply put, the same electricity should not be subject to two sets of fees, especially when the power at issue is not consumed in California.

Netting imports and exports is also administratively feasible. The mechanism for

5 In the example note above, the member has a total of 656,172 MWh of electricity imported from the PNW and 27,620 MWh imported from the SW pursuant to various power purchase agreements. During the same time period, the utility exported 4,862 MWh to the PNW. Under the netting scenario proposed, the 4,862 MWh exported to the PNW would be deducted from the total imports from the PNW and the utility would pay the Fee on the net imports from the PNW and on all imports from the SW. Nothing in this scenario impacts the utility's reporting or compliance obligation under AB 32 and the utility still pays the Fee on all electricity consumed in California.

6 Health & Safety Code § 38530(b)(2).

calculating net energy imports is straightforward and would not entail additional administrative complexities. The reporting of imports and exports under the Mandatory Reporting Tool could be easily tracked with minor modifications to the Tool itself, making verification of the total imported electricity consumed in California easy to determine. NCPA members intend to work closely with CARB Staff to outline this process for purposes of future reporting periods.

Finally, imposition of the Fee must not adversely impact the overall efficiency of the state and regional electricity grid operations. To that end, it would be helpful for the Board to give its Staff an opportunity to either provide empirical data that substantiate findings claimed in the original ISOR that "the imposition of the Fee is too small to affect wholesale market dispatch" (ISOR, p. 46) or remove the language entirely.

Modification to Billing Cycle Should Include Additional Time to Remit the Fee and Should Utilize the Most Current Reporting Data Available.

CARB Staff has proposed that the billing cycle for collection of the Fee be adjusted from February to October to "provide better alignment" with the state fiscal year. NCPA does not object to changing the actual billing date. NCPA recommends that Fee Determination Notices be due for collection ninety (90) days after receipt of the Notice, rather than sixty (60) days in order to ensure that affected entities have sufficient time to meet the revenue requirement.

In its June 25 Comments, NCPA noted a concern about the relatively short turn-around time between receipt of the Fee Determination Notice and the payment due date. This limited payment period is compounded in the first few years of the program implementation when pass-through of the costs is not an option for raising the necessary funds in advance of paying the Fee. In response to this concern Staff noted that the total revenue requirement will be known well in advance of issuance of the Fee Determination Notice, so affected entities will have all of the information necessary to estimate the total amount due in advance of receiving the Notice. The amount due, revised annually and based on an unspecified and uncapped amount, has the potential to vary greatly from year to year making estimating and planning for the total annual obligation problematic, and under the proposal to change the billing to the first half of the fiscal year, entities will be completely unaware of the total revenue requirement until a State budget is passed. This process significantly shortens the time during which an entity can estimate their Fee obligation. Accordingly, as part of the proposal to modify the billing cycle, CARB should also increase the amount of time an affected entity has to remit the Fee to the State.

In concert with a modified billing cycle, CARB should also further investigate the efficacy of using more updated data for purposes of making the Fee Determination. The ISOR maintains that the costs will be passed along to end users, and CARB "*expects that most businesses paying the Fee*" will be able to pass the costs through to consumers. (ISOR, p. 46) However, as several stakeholders have noted, there is no data to support such a position. Under the current proposal, the first Fee remittance will be in November 2010 (assuming a an approved State budget between July and September) and will be based on annual usage information from 2008. Looking at the actual dates, it is clear that any notion that the costs can be passed-through to the entities that actually consumed the fuel or electricity would be impossible. Rather, those paying the Fee will be forced to adjust their current rates – if possible – to address past consumption; such a scenario is extremely problematic in instances where those currently undertaking extreme measures to conserve will be called upon to bear the burden for a Fee associated with past customer usage. As it pertains to repayment of the loans for past amounts due, there is little likelihood that the costs themselves can be attributed to the entities who consumed the electricity upon which the Fee Determination is based.[7]

While the problem does not disappear in the event that 2009 data is used rather than 2008 data, using more recent data does allow for a calculation that is closer in time to the actual consumption. Furthermore, the problems are exacerbated when viewed in light of the fact that the 2008 reporting period was essentially a test year, with no requirement for validation of the results. If possible, Staff should explore means by which to implement the Fee using more recent data, and data that is based on more experience with the Mandatory Reporting Regulations and use of the Reporting Tool.

Delay in Implementation Should Not Cause Excess Additional Costs

During the Workshop, Staff proposed delaying implementation of the Fee until the 2010-2011 fiscal year. Implementation of the Fee in 2010-2011 would be consistent with the proposed modification to the billing period, and would not unduly impact the original schedule proposed by the Agency. Staff has proposed the possible delay due to the fact that statutory timelines require mandatory review and comment periods on the revisions to the Proposed Regulation, and it would likely be physically impossible for the Fee to be implemented in time to issue Fee Determination Notices and collect the Fee before the end of the 2009-2010 fiscal year. Based on this reasoning, NCPA does not oppose the delay in implementation of the Proposed Regulation. It is absolutely imperative that the process for adoption of this precedent-setting Fee follow all of the legal requirements to ensure that Staff and stakeholders alike have ample opportunity to review the Proposed Regulation and all of the legal and practical issues associated with it.

With that said, however, NCPA is concerned that the delays in implementation – although necessary - will result in an even greater monetary burden on entities responsible for paying the Fee. As proposed, the first payment of the Fee will now include even greater past due amounts, as well as increased interest payments on the loans. Furthermore, the annual revenue requirement for 2010-2011 is unknown, and could be significantly higher than the 2009-2010 amount used to estimate the revenue requirement. This is of particular concern to NCPA due to the fact that the total revenue requirement is uncapped. Even in future years, it will not be possible for entities to

7 Additionally, in many cases, due to transmission ownership characteristics, some entities may import a large share of electricity; even if those same entities are only importing the electricity to immediately sell to another party, previously signed contracts may prohibit passing along the Fee, which would result in an even higher proportion of the Fee being paid by remaining customers.

plan ahead for subsequent Fee determinations, as there are no checks or limitations on the total revenues needed to implement (and enforce) the provisions of the Scoping Plan.

Current Revenue Requirements Should Not be Used to Justify the Fee Structure

During discussion between stakeholders and Staff regarding the proposed regulation, it was noted that the total fee at issue is de minimus in many instances, and that the total impact on end-users of electricity is expected to remain low. While Staff is confident that the total revenue requirement for implementation of AB 32 and the numerous measures set forth in the Scoping Plan are not likely to increase significantly from year to year, this optimism is not shared by many that will have to pay the Fee, nor is it borne out when looking at the increasing levels of activity that will be needed to implement the Scoping Plan measures. NCPA remains concerned with rationalizations of the Fee based on the <u>current</u> dollar impact. Hence, any justification of the structure of the Fee based on the overall impact to individual compliance entities is misplaced.

Electricity Sector Point of Regulation Must be Legally Sound

During the Workshop, Staff proposed that the point of regulation for the Fee be adjusted so that all electricity is assessed a fee on the first deliverer, on a megawatt hour basis. Under this scenario, the Fee would apply to all electricity generated in California and imported into the State. Without the benefit of actual language upon which to comment, NCPA's comments are necessarily broad. However, it is important that the Proposed Regulation include a legal analysis showing the grounds upon which application of the Fee to electricity based on megawatt hours of electricity generated does not treat the electricity sector "sources" of greenhouse gas emissions differently than those other sources in the state that are assessed the Fee based on their upstream fuel source.

Natural Gas Placed in Storage Should Not be Assessed the Fee

It is also important that the revised Proposed Regulation clarify that the purchase of natural gas placed in storage not be assessed the Fee. Sometimes natural gas is placed in storage and not immediately purchased by the electric generator; this intermediate transaction must not be not considered an "end-use" for purposes of assessing the Fee. This clarification is necessary in order to minimize the potential for double-counting and ensure that there is no assessment of the Fee on natural gas that is subsequently used for the generation of electricity since the Fee is assessed directly on the megawatt hours of electricity produced.

Conclusion

NCPA understands the Agency's need to implement the Proposed Regulation as soon as possible, but cautions that the urgency to effect a revenue stream not override the very real practical implications that the Fee will have on California businesses and residents. To that end, NCPA cautions Staff and the Agency not to give in to the temptation to adopt a regulation that is overly simplistic and legally tenuous in order to expedite the process. The Fee must be based on sound legal principles and good public policy. NCPA looks forward to reviewing the further modifications Staff makes to the Proposed Regulation prior to the September 25 Board Meeting and continuing to work with Staff and other stakeholders to develop the best possible Fee Regulation. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or scott.tomashefsky@ncpa.com.

Sincerely,
MCCARTHY & BERLIN, LLP

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