

October 26, 2023

Ms. Rajinder Sahota
Deputy Executive Officer, Climate Change and Research
California Air Resources Board
1001 I Street
Sacramento CA 95814
[Submitted electronically](#)

Subject: Comments on the October 5, 2023 Cap-and-Trade Program Workshop

Dear Ms. Sahota:

The Los Angeles Department of Water (LADWP) appreciates the opportunity to provide comments in response to the October 5, 2023 workshop to discuss potential changes to the Cap-and-Trade Program.

LADWP urges the California Air Resources Board (CARB) to consider the following when deciding what potential changes to pursue for the electricity sector:

- Limit changes to the Electrical Distribution Utilities (EDU) allowance allocation to avoid disrupting publicly-owned utility long-term plans to reduce Greenhouse Gas (GHG) emissions from their electricity generation portfolio, as well as other programs that directly benefit customers while also reducing GHG emissions.
- Keeping electricity affordable is essential to support electrification and the state's overall GHG emission reduction goals. Several potential changes discussed at the workshop, specifically updating the EDU allowance allocation and phasing out the Renewable Portfolio Standard (RPS) Adjustment, would increase electricity costs. Increasing electricity costs while the state wants to encourage electrification to reduce GHG emissions would be counter-productive.
- Changes in the approach to GHG emission compliance for electricity imports from the Energy Imbalance Market (EIM) and the Extended Day Ahead Market (EDAM) are needed to reduce GHG costs to California consumers. As currently structured, California will pay two different GHG costs for electricity purchased from these wholesale electricity markets. The first GHG cost is embedded in the price of electricity purchased from the market to serve load in California -- that GHG revenue is distributed to generating resources in the name of GHG compliance, including zero-GHG emitting resources that do not have an actual GHG compliance obligation. The second GHG cost is the withholding of California Carbon Allowances (CCAs) by CARB from the EDUs' annual allocation to cover estimated Outstanding Emissions due to leakage. Retirement of allowances to cover Outstanding Emissions provides no GHG emission reductions or benefit to the electricity ratepayers. To address these concerns, LADWP encourages

CARB to have a forward-looking discussion with the market operator, the California Independent System Operator (CAISO), focused on potential changes to resolve the root cause of this extra GHG cost burden on California consumers.

I. EDU allowance allocation: Limit changes to continue benefits of the GHG emission reduce-and-invest cycle and minimize the cost burden to ratepayers of decarbonizing the electricity supply and upgrading the electric grid to support renewable energy and electrification.

In 2017, CARB provided EDUs a fixed 10-year allocation to incentivize early divestiture of high-emitting resources to reduce GHG emissions from electricity generation without reducing their allocation¹. The value of the fixed 2021-2030 EDU allowance allocation has helped tremendously in decarbonizing LADWP's electricity supply as well as funding emission reduction programs that benefit our community.

This fixed 10-year EDU allowance allocation provides an incentive and the financial justification for making investments to reduce GHG emissions, then invest the savings to further reduce GHG emissions. Publicly owned electric utilities (POUs) are vertically integrated, meaning they both generate and deliver electricity to their customers. LADWP has been proactive in reducing its GHG emissions from electricity generation by investing in renewable generating resources and divesting or replacing coal-fired generating resources within its generating resource portfolio. This has freed up allocated allowances that can be sold, with the proceeds from the sale of these allowances reinvested in additional renewable energy, electric vehicle chargers, energy efficiency and LADWP's Community Emission Reduction Grants program, which funds emission reduction projects in disadvantaged communities. This reduce-and-invest cycle is how cap-and-trade was intended to work, and the program has been successful so far. Reducing the EDU allowance allocation midstream would disrupt this reduce-and-invest cycle and eliminate the funding source for future emission reductions.

The EDU allowance allocation is very valuable to LADWP and provides multiple benefits to LADWP's customers. LADWP relies on the allowance allocation not only to protect its retail customers from the compliance cost of the Cap-and-Trade program and keep electricity affordable, but also as a source of funding to reduce GHG emissions.

As LADWP pursues a higher renewable energy goal of 80% by 2030, the value of the EDU allowance allocation has become essential in maintaining the affordability of investments in renewable energy. LADWP is concerned that CARB is considering a full update to the EDU allowance allocation for the remainder of the 2021-2030 period. A full update based on the most recent energy demand and supply forecast would punish EDUs such as LADWP that have made changes within their generation resource portfolio to reduce GHG emissions. A full update would cut LADWP's 2025-2030 allocation approximately 31% with an estimated

¹August 2017 CARB Final Statement of Reasons for the amendments to the Cap-and-Trade Regulation, page 39: "Staff supports utilities' taking voluntary action to reduce GHG emissions from electricity generation. Given that EDU allowance allocation is based on cost burden, this is one of the reasons that ARB has opted to set fixed EDU allowance allocations for 2021-2030. Any changes that utilities make to reduce GHG emissions will reduce their GHG costs while not changing their allocations, thus resulting in a net benefit. This incentive is inherent to the Cap-and-Trade Program and applies in all sectors that see costs from the Program."

loss of \$660 million in allowance value². Losing that significant allowance value would prompt LADWP to reevaluate the feasibility of and potentially roll back its pursuit of a higher renewable energy goal if those investments are no longer cost-neutral. For comparison, an RPS-only³ adjustment to the EDU allocation would cut LADWP's allowance allocation 10% with an estimated loss of \$250 million in allowance value. In either case, that allowance value would no longer be available for LADWP to invest in further GHG emission reductions. Furthermore, revising the EDU allowance allocation could also affect the feasibility of LADWP's Integrated Resources Plan. The portfolios LADWP built for its 2022 Strategic Long-Term Resources Plan were based on the most recent GHG price forecasts at the time. If changes to the Cap-and-Trade program affect the EDU allowance allocations and allowance price forecast, the portfolios LADWP developed for the SLTRP would need to be re-optimized to reflect those changes.

While LADWP recognizes that CARB needs to reduce the overall program allowance budget, LADWP encourages CARB to seek those reductions from other pools of allowances within the program. LADWP requests that CARB minimize any changes to the EDU allowance allocation. To address the change in the RPS target from 50% to 60% by 2030, LADWP agrees with the Joint Utilities Group's proposal to direct the value of that delta in allowances to support programs that benefit low-income customers, rather than taking those allowances away from the EDUs. For example, that value could be used to support community solar, energy efficiency, or weatherization upgrades to the homes of low-income customers. These improvements would have lasting effects by reducing electricity bills for low-income customers.

During the workshop, it was suggested that reducing the EDU allocation was necessary to reflect CARB's latest modeling and the 2030 GHG reduction targets. On the contrary, LADWP believes that reducing the EDU allocation would hinder efforts to achieve the 2030 GHG reduction targets by eliminating the source of funding needed to reduce GHG emissions.

In addition, CARB requested feedback on how to update the EDU allocation to reflect state climate policy. In the 2022 Scoping Plan, decarbonizing the electricity supply and electrification are key strategies to achieve the state's GHG emission reduction and carbon neutrality goals. CARB needs to recognize that decarbonizing the electricity supply and upgrading infrastructure to support more renewable energy and electrification come at a cost. LADWP recommends that CARB consider the benefits of the EDU allocation holistically, above and beyond the cap-and-trade program compliance cost burden, and broaden the purpose of the allocation to include protecting electricity ratepayers from the transition costs associated with the Scoping Plan goals. The electric sector is the backbone for supporting the State's transition to a clean energy economy; the EDU allowance allocation is a convenient and effective way for CARB to support electric utilities that are making investments to decarbonize the electricity supply, support electrification, and upgrade infrastructure to help achieve the state's GHG emission reduction goals.

State programs such as Cap-and-Trade need to support an electricity system that offers reliable power in a cost-effective manner to incentivize customers to electrify transportation, industrial operations, and commercial and residential buildings. Electrification has significant

² Based on the 2022 IEPR (CED 2022 Update) GHG Allowance Price Projections, Mid Price Scenario.

³ Limited to change in the RPS target from 50% to 60% by 2030 per Senate Bill 100.

potential to reduce emissions and improve air quality in disadvantaged communities. The Cap-and-Trade program can provide that support by ensuring EDUs continue to receive generous allowance allocations, to help pay for investments in clean electricity generating resources and infrastructure upgrades necessary to accommodate widespread electrification. The more assistance the Cap-and-Trade program can provide to the electric sector, the more support the electric sector can provide to the rest of the state.

Any reduction in allocated allowances will result in additional costs being passed through to electricity ratepayers (including low-income customers) that otherwise could have been mitigated by selling allowances. Higher electricity costs will compound into increased costs for other goods and services, because as providers of other goods and services experience higher electricity costs, they will pass that cost through to their customers. These cumulative cost impacts will hurt low-income customers the most. In addition, higher electricity costs will make electrification less desirable and discourage the adoption of electric vehicles within the transportation sector, the largest source of GHG emissions according to the California GHG emissions inventory. These adverse cost impacts can be avoided by minimizing any reduction to the EDU allowance allocation.

In summary, the firm 10-year allowance allocation to EDUs is supporting the transition to a low-carbon electricity supply, as well as electrification to help California achieve its GHG emission reduction goals, while protecting ratepayers and low-income customers from the costs associated with these efforts. The existing regulatory structure effectively provides certainty so that utilities can make long-term planning decisions and investments to accelerate changes in their electricity supply portfolio to reduce GHG emissions. POU's rely on having a firm allowance allocation to plan and budget for investments in GHG emission reduction projects, and budget their allowances for compliance which will become more important as the overall supply of allowances decreases. A firm 10-year allocation also provides stability and mitigates the risk of unexpected cost increases to customers. LADWP recommends that CARB continue providing a firm allowance allocation to EDUs to support all the benefits mentioned above, for the duration of the transition to a 100% zero-carbon electricity supply.

II. Imported Electricity Reporting and Compliance Requirements

LADWP encourages CARB to work with the market operator (CAISO) to evaluate the benefits of changing the First Jurisdictional Deliverer (FJD) for EIM and EDAM wholesale market imports from the out-of-state "deemed delivered" electricity generating resources to the in-state electricity purchaser. During the workshop, CARB stated an FJD is the entity responsible for first placing power onto the California grid at the state border and has GHG emission reporting and Cap-and-Trade compliance requirements. While LADWP agrees with this approach for e-tagged bilateral imports, untagged imports via the EIM and EDAM markets are different.

As stated in LADWP's comments dated July 7, 2023, the Western Climate Initiative (WCI) Program Design document defines FJD as "*The owner or operator of an electricity source in a Partner jurisdiction, or an electricity importer that is jurisdictional to the program authority or the immediate downstream purchaser or recipient of electricity from a non-jurisdictional electricity importer*" [emphasis added].

Electricity generating resources located outside of California are not subject to California's GHG emissions reporting and Cap-and-Trade regulations, unless they deliver electricity into California. Currently, the EIM optimization model attributes electricity "deemed delivered" into California to specific out-of-state generators selected by the model based on lowest cost. However, attribution to the lowest cost generating resources is a paper accounting exercise that may not reflect the actual generating resource(s) that increase production to support the electricity transfer to California. In other words, the generating resource(s) assigned deemed delivered imports to California may not actually produce the electricity that is delivered to California, yet they are assigned reporting and compliance responsibility for the imported electricity under the current design.

Since the EIM does not utilize e-tags for the deemed delivered electricity imports, there is no documentation to track the physical delivery/import to the California grid or who owns the electricity when it crosses the California border. In the absence of physical delivery documentation, LADWP believes the load-serving entity (LSE) within the GHG regulation area who is "the immediate downstream purchaser or recipient of electricity from a non-jurisdictional electricity importer" should be responsible for GHG emission reporting and compliance in California, since the out-of-state generating resource is beyond the jurisdiction of the regulatory program authority.

During the workshop, CARB stated that any changes to GHG accounting for electricity imports must meet state and federal statutory requirements. LADWP requests that CARB clarify what specific statutory requirements this statement is referring to.

For EDAM, LADWP believes that e-tags will be used to show delivery for self-scheduled **specified** imports, similar to today's practice in the bilateral market; therefore the purchasing-selling entity (PSE) on the physical path of the e-tag when the path crosses into California is responsible for GHG emissions reporting and compliance. For the remaining **unspecified** imports without e-tags, LADWP encourages CARB to consider the benefits of shifting FJD reporting and compliance responsibility to the downstream electricity purchaser.

A market GHG accounting approach where the downstream electricity purchaser is the FJD for untagged imported electricity would:

- Provide more accurate GHG emission accounting for unspecified market imports.
- Eliminate leakage and the need for the Outstanding Emissions compliance obligation.
- Reduce GHG emissions compliance costs borne by electricity ratepayers.
- Be compatible with different state climate policies (e.g. different carbon costs, clean energy standard).
- Relieve out-of-state generating resources of the burden of GHG emission reporting and compliance with different state GHG regulatory programs, and potential unintended consequences associated with that responsibility.

- Provide hourly electricity purchases and GHG emission data to California utilities for reporting to the California Energy Commission to comply with Senate Bill 1158 requirements.

Please see LADWP's July 7, 2023 comment letter⁴ for a more detailed discussion of the potential benefits.

For background, CAISO's EIM and upcoming EDAM are wholesale spot markets that operate simultaneously with the bilateral energy market (i.e. OATT trades). In the bilateral electricity market, GHG emitting resources delivering to California are paid the "as bid GHG cost" to cover their GHG compliance obligation based on their resource specific emission rate. In the bilateral market, non-emitting generators who do not have a GHG compliance obligation do not receive a GHG payment. However, the GHG accounting design for the EIM and EDAM markets collects GHG revenue from electricity buyers at the marginal GHG emission rate based on the generator at the top of the resource stack selected by the optimization model. Collecting GHG revenue at the marginal emission rate may result in over-charging compared to the actual GHG compliance obligation, thus increasing the cost burden on the electric utility and its ratepayers. The current EIM and EDAM market design includes the GHG bid adder in the energy bid for all participating resources within California, and the market distributes the GHG revenue to all participating resources including zero-emitting generating resources within California. This different treatment of equally situated generating resources between the CAISO markets and OATT trades is a design issue.

With the expected higher transaction volumes in EDAM and more non-emitting resources integrated into the market, charging for GHG emissions at the marginal emission rate will adversely impact the electricity customer's bottom line. Solving the root cause of the excess GHG costs will require fundamental changes to the market GHG accounting design. Changing the FJD for unspecified EIM and EDAM market imports from the out-of-state generator to the in-state electricity purchaser would allow CAISO to move away from the current practice of attributing deemed delivered imports to specific generating resources, and instead calculate after-the-fact an aggregate GHG emissions rate for all generating resources that supported the electricity transfer into California. An aggregated GHG emissions rate could capture all dispatch that supported the electricity transfer into California, thereby eliminating emissions leakage and the need for the Outstanding Emissions calculation. Looking forward, if the electricity purchaser becomes the FJD and is responsible for GHG emission reporting and compliance, they would apply the aggregated GHG emissions rate calculated by CAISO to the amount of unspecified electricity purchased from the market to serve their load.

LADWP recognizes that CAISO's GHG accounting design is based on previous conversations with CARB regarding the FJD, and CARB is basing its regulations on CAISO's market tariff as currently constituted. However, things have changed, and there is a much better understanding now of how the market is working. If CAISO is willing to change their EDAM and EIM GHG accounting design to capture the benefits discussed above, is CARB willing to adapt their regulations and FJD interpretation to accommodate the changes? In addition, if CAISO can accurately calculate an after-the-fact GHG emissions intensity rate for the unspecified imported electricity, would CARB be open to using the more

⁴ <https://ww2.arb.ca.gov/form/public-comments/submissions/4451>

accurate GHG intensity factor instead of CARB's default GHG emission factor (0.428 MT CO₂e/MWh) for the unspecified market imports?

With regards to the Outstanding Emissions calculation, LADWP appreciates that CARB recognizes the need to "right-size" this calculation and the associated GHG compliance obligation. The value of CCAs retired to satisfy the compliance obligation for EIM Outstanding Emissions over the past five years was approximately \$103.5 million. That allowance value could have been invested to reduce GHG emissions, but instead was retired to cover the compliance obligation for estimated GHG emissions leakage associated with EIM electricity imports to California, which does not yield any emission reduction benefits.

LADWP requests that CARB address the following questions:

- If a California entity participates in both EDAM and EIM, how would Outstanding Emissions for that entity be calculated? Would the Outstanding Emissions include the sum of attribution below the base schedule (or counterfactual) for both EIM and EDAM transactions?
- If electricity transacted in EDAM will be settled in the EIM, why are Outstanding Emissions not limited to just the EIM transactions?
- If EDAM transactions are added to Outstanding Emissions, how much will the compliance obligation increase? Will the EDU allowance allocation be sufficient to cover the Outstanding Emissions compliance obligation, as well as, the EDU's own Cap-and-Trade compliance obligation?

Given the significantly higher volume of imports expected in the EDAM market, LADWP recommends that self-scheduled specified imports to California be excluded from the Outstanding Emissions calculation.

Lastly, in consideration of the issues and potential benefits mentioned above, LADWP asks CARB to work with CAISO to evaluate changing the FJD for unspecified EIM and EDAM imports to the downstream electricity purchaser, as allowed under the WCI definition of First Jurisdictional Deliverer.

III. RPS Adjustment

LADWP recalls the RPS Adjustment being discussed at length in 2017 during a previous Cap-and-Trade rulemaking, and the consensus was to retain the RPS Adjustment as is. During the October 5 workshop, CARB staff discussed the idea of phasing out the RPS Adjustment, expressing concern about how to handle GHG emissions for the firmed/shaped replacement energy in light of California's emission reduction goals. LADWP does not support phasing out the RPS Adjustment for the following reasons:

- 1) LADWP customers should continue to receive the benefit of LADWP's early investments in renewable energy located outside of California. LADWP has long-term contracts with

four wind farms that are located in the Oregon and Washington state area, that are grandfathered resources (Bucket 0) under California's RPS regulation.

- 2) There is no direct transmission pathway from the wind farms to California, therefore it is necessary to deliver replacement energy as a firmed/shaped product. In addition, the existing transmission pathways into California are oversubscribed. Until such time as more transmission capacity can be built, the firmed/shaped product provides delivery flexibility.
- 3) Zero-emission energy produced by these wind farms goes into the local Balancing Authority Area. The RPS Adjustment appropriately recognizes the zero-carbon attributes of the wind energy which is produced and delivered to the electric grid and displaces generation from other resources.
- 4) CARB's GHG emission reporting regulation is designed to assign default GHG emissions for unspecified electricity to the firmed/shaped replacement electricity delivered to California, unless the contract identifies a specified generating resource for the replacement energy.
- 5) Phasing out the RPS Adjustment would require more allowances for Cap-and-Trade compliance at a time when fewer allowances will be available, thereby increasing Cap-and-Trade compliance costs borne by electricity ratepayers. The RPS Adjustment credit reduces the number of CCAs that must be retired to satisfy the Cap-and-Trade compliance obligation for imported electricity. If the RPS Adjustment is phased out, electric utilities would need more allowances for Cap-and-Trade compliance at a time when CARB wants to reduce the EDU allocation and the overall program allowance budget. Increasing demand for allowances when fewer allowances are available will increase Cap-and-Trade compliance costs.
- 6) Phasing out the RPS Adjustment would increase electric utilities' share of the AB 32 Cost of Implementation fees, which would be another cost increase borne by electricity ratepayers.
- 7) The GHG emissions for firmed/shaped renewable energy deliveries that CARB staff expressed concern over are based on the delivery method rather than the generating resource. Renewable energy generating resources do not produce GHG emissions.

At the workshop, CARB staff asked how CARB should align the RPS adjustment with state climate policy. LADWP believes CARB should continue recognizing the zero-emission environmental attributes of renewable energy produced and put onto the electric grid, regardless of the electricity delivery method. If CARB is concerned about the effect of the default GHG emissions on California's GHG emissions inventory, LADWP suggests that CARB consider treating RPS-eligible firmed/shaped renewable energy deliveries to California as zero GHG emission to align with California's RPS regulation and the SB 100 zero carbon electricity goals.

Ms. Rajinder Sahota

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In closing, LADWP appreciates the opportunity to provide comments and feedback on these important topics. LADWP urges CARB to carefully consider the cost impacts to electricity ratepayers before making any regulatory changes that will increase compliance costs. The EDU allowance allocation is very valuable to LADWP and benefits our customers in many ways, including investments to reduce GHG emissions and affordable electricity to support cost-effective electrification.

If you have any questions, please contact Ms. Andrea Villarin at (213) 367-0409 or Ms. Cindy Parsons at (213) 367-0636.

Sincerely,

Katherine Rubin

Director of Corporate Environmental Affairs Division

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