INDEPENDENT
ENERGY
PRODUCERS

September 8, 2009

Chairman Larry Goulder and Committee Members
Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Dear Chair Goulder and Committee Members,

The Independent Energy Producers Association ("IEP") appreciates the opportunity to provide comments to the Economic and Allocation Advisory Committee ("EAAC"). At the July 1, 2009 Committee meeting, I briefed the committee on an important issue for the independent power producers ("IPP") related to allowance allocation and use of allowance revenues. As the Committee continues to develop its recommendations to CARB, it is important to restate concerns of the IPP industry related to the potential negative impact that allowance allocation policy could have on the competitive market in electricity.

At the outset, we recognize that AB 32 will undoubtedly have an impact on the types of electric generation developed and operated to serve California load. Competition among technologies is not unexpected or concerning. On the other hand, we have strong concerns that allocation policy may have an effect on the competitive market based not on technology but, rather, on ownership type (e.g. utility vs. IPP). Specifically, an unintended consequence of an allowance allocation policy could be the undermining of the competitiveness of the "hybrid market structure" implemented by the California Public Utilities Commission (CPUC). This market structure serves approximately 75% of total statewide demand.

As early as 2004, the Commission articulated a plan to implement a hybrid market structure in which utility-owned generation and independent power generation would compete on a level playing field [Decision 04-12-048]:

> "While the Commission has stated a preference for a hybrid wholesale electric market consisting of PPAs [power purchase agreements] and IOU [investor-owned utility] owned resources, this should not undermine the Commission's goal of having the IOUs acquire supply-side resources based on LCBF [least-cost/best-fit] principles, regardless of ownership form. We agree . . . that PPAs and utility-owned resources need to participate in the same all-source open

solicitations to ensure LCBF, not in separate PPA and utility-owned specific solicitations . . . ."[1]

In Decision 07-12-052, at page 209, the Commission reiterated its preference for a competitive level playing field when it established an important principle regarding the utilities' procurement of generating resources:

> "We want to make it clear that we continue to believe in a 'competitive market first' approach. As such we believe that all long-term procurement should occur via competitive procurements, rather than through preemptive actions by the IOU, except in truly extraordinary circumstances."

As the EAAC forms its recommendations to the CARB regarding the allocation of allowances, including the potential allocation of allowance revenues, it is critical that the recommendations not undermine the competitive market structure currently implemented by the CPUC in which utility-owned generation ("UOG) and IPPs compete against each other to develop new, preferred resources to serve load. Allowance allocation policy has a high risk of undermining the attainment of a fully competitive level playing field between UOG and IPP development due to the following:

1. **Allocating Allowances to Utilities For Resale/Auction to Electric Generators Raises Competitive Concerns**. Allowances will be necessary for all fossil-based electric generators to operate. Both the utilities and the IPPs operate fossil-based electric generators. Any approach to the allocation of allowances that employs the utilities in the distribution of allowances raises serious competitive concerns. For example, if the utilities were placed in control (or even had advance knowledge) of the timing and/or implementation of any allowance allocation protocol, then they could potentially use this control and knowledge to create a significant competitive advantage. The allowance allocation protocol should not result in this negative outcome for competitive markets.

2. **Allocating Auction Revenues To Utilities Risks Creating a Capital Pool for Utilities That Is Unavailable to IPPs**. In the interest of ensuring consumer benefits from the GHG program, some parties have argued that auction revenues should be allocated directly to the utilities to lower rates for consumers. While IEP supports lower rates for consumers, hence the need for a truly competitive market, we have concerns that auction revenues have the potential for creating a huge capital pool on utility balance sheets. Were this to occur, then the utilities could obtain innumerable competitive advantages. For example, by effectively placing a sizable amount of allowance revenues on the utilities' balance sheets, the allocation could create a favorable competitive advantage for the utilities through enhanced access to credit markets, beneficial capital structures, etc. Accordingly, to the extent that allowance revenues are directed back to the benefit of consumers, then the flow of funds should be structured to prevent competitive advantage accruing to the utilities in the generation sector due to their unique role as load-serving entities.

[1] D.04-12-048, p. 139 (footnote omitted.).

Clearly, programs affecting the allocation of allowances and/or the revenues derived from any allocation program can have tremendous impacts on the competitive market. Thus, these issues have important implications to California consumers served by the utilities. We urge the EAAC, as it formulates its recommendations to the CARB, to design its recommendations such that they do not undermine the goal of obtaining fully competitive markets.

Respectfully,

Steven Kelly
Policy Director