California ISO | WESTERN ENERGY IMBALANCE MARKET

Memorandum

To: ISO Board of Governors and Western Energy Imbalance Market Governing Body

From: Anna McKenna, Vice President of Market Policy and Performance

Date: October 19, 2022

Re: **Decision on Washington WEIM Greenhouse Gas Enhancements**

This memorandum requires ISO Board of Governors and WEIM Governing Body action.

EXECUTIVE SUMMARY

Pursuant to Washington state's recently revised Clean Air Act and beginning in 2023, Washington will require reporting of greenhouse gas (GHG) emissions associated with WEIM transactions in emissions year 2022 and each subsequent year. Under Washington's Climate Commitment Act, Washington will also begin its cap-and-invest program in 2023, with a statutory requirement to address energy imports associated with a centralized energy market by October of 2026. Management proposes enhancements to recognize Washington-specific reference levels as well as an approach for supporting covered entity reporting obligations to the Washington Department of Ecology.

Through this stakeholder policy initiative, the ISO developed enhancements to the Western Energy Imbalance Market (WEIM) to update GHG reference levels as well as develop reports to support the WEIM Entities with their reporting obligations. GHG reference levels represent GHG compliance costs and are used in the market as part of commitment cost bid caps and default energy bids used in market power mitigation.

> ***Moved, that the ISO Board of Governors and WEIM Governing Body approve the inclusion of greenhouse gas reference levels in bids for entities subject to the Washington state greenhouse gas regulations, and approve the development of reports to support those entities' reporting obligations as described herein; and***
>
> ***Moved, that the ISO Board of Governors and WEIM Governing Body authorize Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the change proposed in this memorandum, including any filings that***

implement the overarching initiative policy but contain discrete revisions to incorporate Commission guidance in any initial ruling on the proposed tariff amendment.

DISCUSSION AND ANALYSIS

Management proposes (1) enhancements to recognize Washington-specific GHG reference levels, as well as (2) an approach for reporting GHG emissions to the Washington Department of Ecology.

GHG Reference Levels

With the launch of Washington's GHG cap-and-invest program, the ISO and stakeholders have worked to develop a proposal for the inclusion of associated compliance costs – that is, GHG reference levels – in the calculations of market inputs. Specifically, for those resources within Washington that will have a compliance obligation under the regulation, Management recommends the inclusion of GHG compliance costs in default energy bids used in the local market power mitigation process, and also in default commitment costs used to cap bids for start-up and minimum-load.

Management recommends a phased approach to implementing the GHG cap-and-investment program within the ISO markets. This phased approach is proposed because an allowance auction is not expected until February 2023, after the start of the cap-and-invest program. In the interim, the CAISO seeks to use best available data to approximate the wider market's expectations regarding the cost of compliance. As a first phase, the Washington Department of Ecology, through a consultant, has conducted economic and market modeling which indicates that a reasonable starting point for this value is $41 per MT CO_2e. In the first phase, Management recommends the ISO use a static, assumed value of $41 per MT CO_2e for the cost of GHG compliance within the Washington GHG regulation area. As a second phase, once an allowance auction is held in Washington, Management recommends that the ISO then use the auction clearing price. The proposed approach of using the auction price once available will allow the ISO's calculation of reference levels to respond to actual allowance trading market information once it is available. In the third phase, when index prices are available and implementable by the ISO, the ISO will use index prices for Washington analogously to how it does for California.

The ISO has determined not to propose additional modifications related to Washington's cap-and-invest program at this time. Under Washington statute, the Washington Department of Ecology, in consultation with other Washington State agencies, must adopt by regulation a methodology in the cap-and-invest context for addressing imported electricity associated with a centralized energy market by October 1, 2026. In the interim, the Department of Ecology issued regulations on September 29, 2022 outlining other specifics of the cap-and-invest program, and providing limited guidance on the application to WEIM. More specifically, the rules identify the recipient of WEIM electricity as the entity with a compliance obligation for the first compliance period (2023-2026). The timing of the September 29, 2022 identification of the point of regulation did not allow the ISO enough time for normal processes in order to implement the changes (i.e., stakeholder the enhancements, develop technology solutions, and seek board approval prior to filing at FERC). However, with the updated regulations and the statutory deadline for addressing a centralized market in 2026, the ISO intends to work with Washington's Department of Ecology and stakeholders to ensure the WEIM aligns with both the cap-and-invest program and associated reporting rules as these rules evolve.

GHG Emissions Reporting

Washington's cap-and-invest program sets forth requirements for compliance reporting starting with emissions year 2022, for reporting in 2023. The regulations specify that energy from the WEIM is considered imported electricity. Specifically, the code defines "imported electricity" to include "electricity from an organized market, such as the energy imbalance market." Thus, all transactions within the ISO's WEIM, including real-time market imbalance energy from resources located within the state of Washington, will constitute imported energy for purposes of Washington's reporting regulations.

To support WEIM entities' reporting requirements to the Washington Department of Ecology, Management recommends the ISO calculate the market dispatches, based on instructed imbalance energy, on an annual basis. Real-time instructed imbalance energy reflects WEIM transactions used to serve electricity demand. WEIM entities operating in Washington with balancing authority areas that extend to other states will need to calculate a load ratio to estimate the volumes that served their Washington demand. This approach will only provide a rough approximation of WEIM transfers used to serve load with the state of Washington.

POSITIONS OF THE PARTIES

GHG Reference Levels

In stakeholder comments, almost all stakeholders supported the ISO's proposal to revise the cost-based reference levels for resources with a reporting obligation inside of Washington to include Washington-specific GHG allowance prices. The exception to this support was one party who commented that CAISO should allow market participants to submit offers for reference levels that are consistent with their own estimates. The ISO notes there is a separate process for negotiating default energy bids that will accommodate this request.

Management received feedback from the Washington Utilities and Transportation Commission indicating concern that the inclusion of GHG reference level costs in default energy bids and commitment cost bid caps for Washington generating units with a compliance obligation could lead to a market disadvantage for those resources. Management assumes resources in Washington will include their cost of compliance in their energy bid—which would give rise to the asymmetry as described earlier. Management notes efforts to separately reflect reference costs are included as caps and as such resources can adjust their bids to levels below the starting value proposed. To not include these costs would prevent the resource from reflecting its full costs. Further, without the value of GHG compliance included automatically in these calculated bids, each generator with a compliance obligation would have to individually negotiate a default energy bid, creating significant workload for both those entities and the ISO.

GHG Emissions Reporting

Stakeholders mostly supported the proposed approach for GHG emissions reporting for 2022 and beyond and thought this approach would assist them in meeting their reporting obligations during the initial compliance period of Washington's program. The approach was supported on the basis that it was sufficient.

Some entities sought clarity on the treatment of in state generation and wheel-throughs in the reports. Management recognizes that as of September 29, 2022, the Washington Department of Ecology issued a final rule implementing the Climate Commitment Act Cap-and-Invest Program and addressing compliance related to in-state generation. In section WAC 173-446-040, the rules clarify that for electricity transferred through the energy imbalance market that is generated by a first jurisdictional deliverer with a compliance obligation, there is no compliance obligation for that same electricity if it is delivered to an energy imbalance market purchasing entity in Washington. These regulations, however, are related to Washington's cap-and-invest compliance construct and do not impact reporting, which was addressed in a separate, earlier rulemaking and requires reporting of all WEIM transactions. Instead, management understands that Ecology may work with entities to address section WAC 173-446-040 in their GHG reporting tool worksheet. Second, Management clarifies that wheel-throughs are not included in the calculation of total instructed imbalance energy and are therefore not included in the Washington WEIM GHG reports.

In addition, one stakeholder raised concerns that power would be double counted for reporting to Washington and reporting to California. Management recognizes both may account for the same power but defers to the states in their data collection requirements. While the California Air Resources Board collects of data on resources attributed to California, the Washington Department of Ecology is seeking data on all WEIM transactions. Management does not propose to change the reporting method in light of honoring both state's reporting requirements.

Lastly, four entities urged further coordination with the Washington Department of Ecology regarding reporting for multi-jurisdictional entities. Management supports this recommendation and staff will continue working with the Washington Department of Ecology on coordination for this unique case.

CONCLUSION

To support Washington WEIM Entities subject to the State's cap-and-invest program, Management recommends inclusion of GHG reference levels in Default Energy Bids and commitment costs. Further, to support Washington WEIM Entities subject to the State's reporting rules, Management recommends the ISO annually provide those entities with data, as described herein, to support their compliance reporting obligations. As rules related to Washington reporting and cap-and-invest program design continue to develop, we will collaborate with the Washington Department of Ecology and stakeholders to ensure alignment between our market design and Washington's program.