**BEFORE THE PUBLIC UTILITIES COMMISSION
AND THE ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT 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 Emission Standards into Procurement Policies.	Rulemaking 06-04-009 (Filed April 13, 2006)
Order Instituting Informational Proceeding – AB 32.	CEC Docket No. 07-OIIP-01

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY SUPPLEMENT TO OPENING COMMENT AND REPLY COMMENT ON ALLOWANCE ALLOCATION ISSUES

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In accordance with the Administrative Law Judge's Ruling Requesting Comments and Noticing Workshop on Greenhouse Gas Allowance Allocation Issues ("Ruling") issued on October 15, 2007 in the captioned proceedings, the Southern California Public Power Authority ("SCPPA") respectfully submits this Reply Comment. In accordance with the Ruling, this Reply comment is being submitted simultaneously to both the California Public Utilities Commission ("CPUC") and the California Energy Commission ("CEC") (jointly, "Commissions"). Additionally, in accordance with Administrative Law Judge ("ALJ") TerKeurst's e-mail Ruling issued on November 8, 2007, SCPPA supplements its October 31, 2007 Opening Comment.

I. SUPPLEMENT TO SCPPA'S OPENING COMMENT.

In accordance with the direction received from ALJ TerKeurst, SCPPA supplements its Opening Comment with the following information about the cost of auctioned greenhouse gas

("GHG") emission allowances and about the wealth transfer that would occur if allowances were administratively allocated among retail providers on the basis of retail sales.

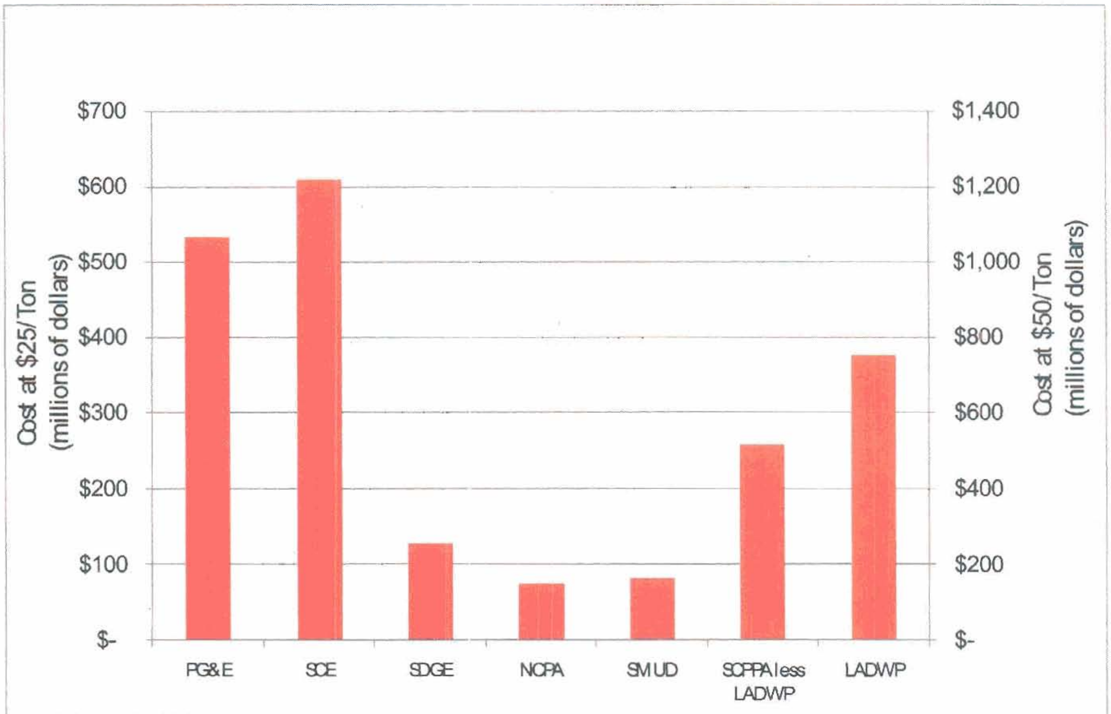
A. The Cost of Auctioning Allowances.

Auctioning allowances for greenhouse gas emissions would have a potentially massive impact on the retail price of electricity that is charged to consumers. If retail providers were the point of regulation and were required to acquire allowances to cover the emissions associated with serving their forecasted 2008 load, the retail providers would need to acquire 82.5 million tons worth of allowances. At $25 per ton, the cost of the allowances would be over $2 billion.[1] At $50 per ton, the cost would double to over $4 billion dollars. That would be for *one year alone*. The breakdown among California retail providers -- Pacific Gas & Electric Company ("PG&E"), Southern California Edison Company ("SCE"), San Diego Gas & Electric Company ("SDG&E"), Northern California Power Agency ("NCPA"), the Sacramento Municipal Utility District ("SMUD"), SCPPA members[2] other than the Los Angeles Department of Water and Power ("LADWP"), and LADWP -- would be as shown in the following Figure 1:

[1] Some estimates of the cost of allowances per ton are much higher. The Electric Power Research Institute, ("EPRI") estimates California CO_2 prices of about $110 per metric ton. EPRI Program on Technology Innovation: Economic Analysis of California Climate Initiatives: on Integrated Approach at 3-13 (May, 2007).

[2] SCPPA is a joint power authority. Twelve publicly owned utilities are members of SCPPA: Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. These members, in aggregate, serve over 2 million customer meters in a population of over 5 million people. SCPPA members own and control over 9,000 megawatts of electric generation capacity.

Figure 1. Annual Cost to Obtain Auctioned Allowances (2008 Base Case)[3]



For Southern California publicly owned utilities, the cost of auctioned allowances is estimated to be over $700 million per year, based on 2008 projected emissions at $25/ton. The cost is estimated to be over $1.4 billion per year if auctioned allowances cost $50/ton.

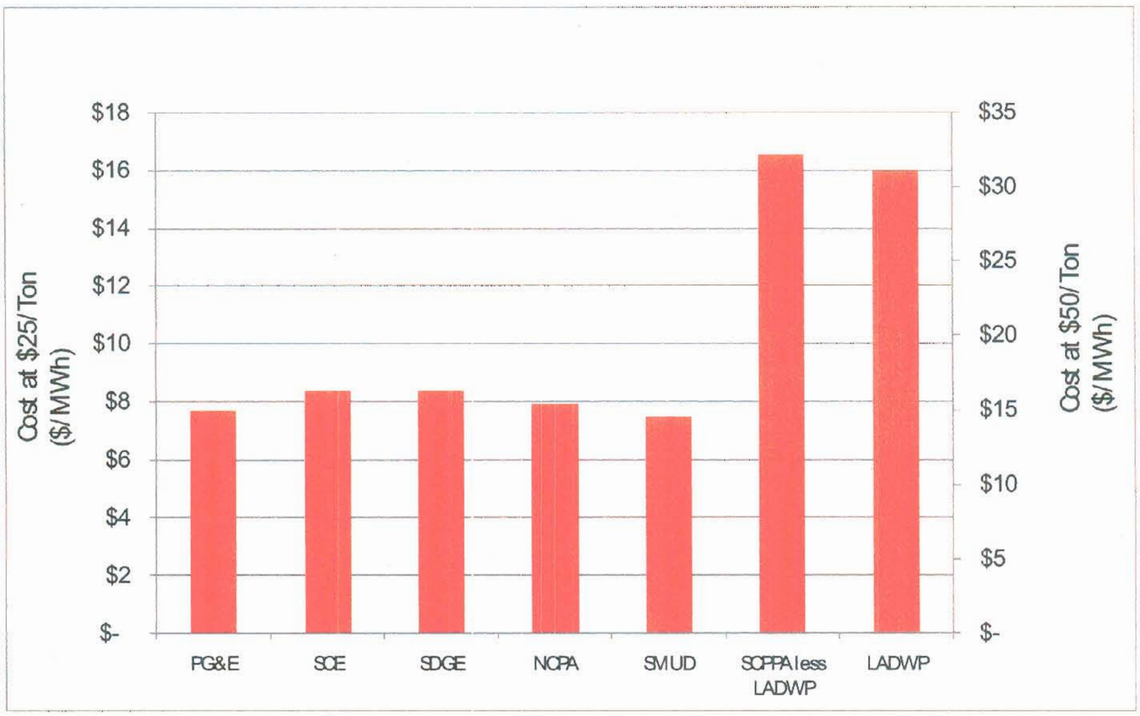
The cost of the auctioned allowances would ultimately be recovered from retail ratepayers. This cost would be *additional* to the cost of enhanced energy efficiency programs, the cost of adding renewable resources, the cost of new transmission systems, and the other costs of GHG reduction that are going to be imposed on retail ratepayers.

[3] At $25 per ton, the cost of auctioned allowances is estimated to be $2.06 billion, based on projected sample year 2008 emissions. The breakdown is estimated to be (in millions of dollars): PG&E: $533; SCE: $610; SDG&E: $128; NCPA: $76; SMUD: $81; SCPPA less LADWP: $257; LADWP: $374

At $50 per ton, the breakdown is estimated to be (in millions of dollars): PG&E: $1065; SCE: $1219; SDG&E: $255; NCPA: $151; SMUD: $162; SCPPA less LADWP: $514; LADWP: $749.

The customers of the southern California publicly owned utilities would be disproportionately burdened by the cost of auctioned allowances in comparison to the customers of other California utilities. Not only would the cost of auctioned allowances be huge in absolute terms, as shown by Figure 1 above. The cost for the Southern California publicly owned utilities would be approximately *double* the cost for the other California utilities on a unit (per MWh) basis, as shown by Figure 2 below:

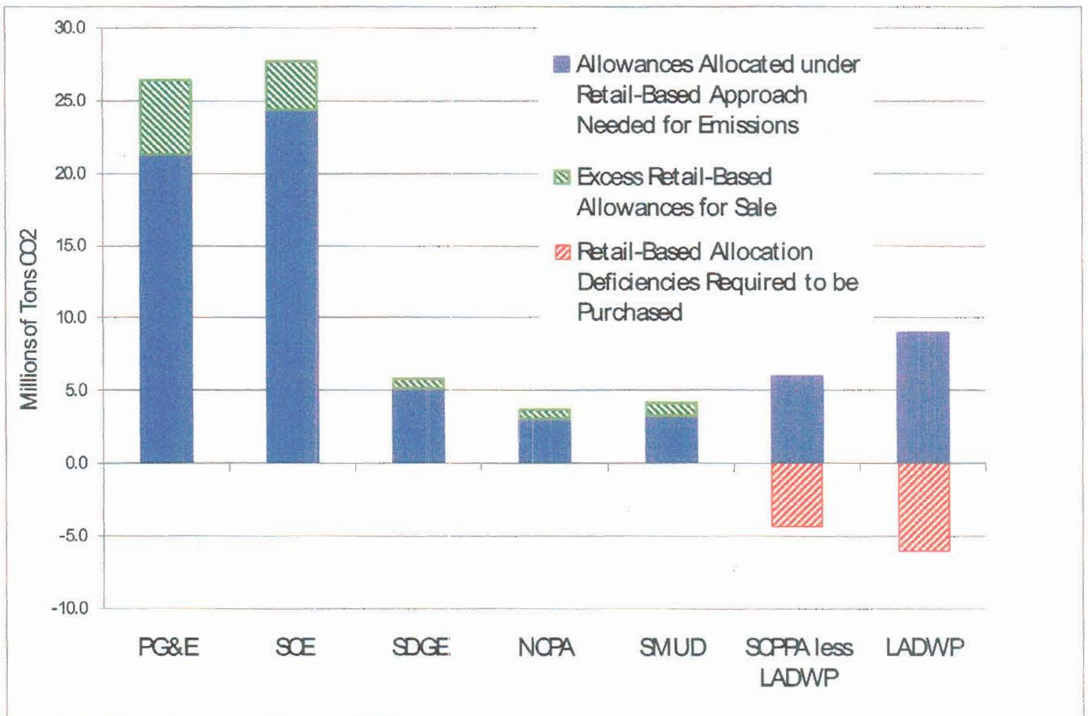
Figure 2. Per MWh Cost of Auctioned Allowances (2008 Base Case)



B. The Wealth Transfer Effect of Administratively Allocating Allowances on the Basis of Each Retail Provider's Retail Sales.

PG&E, SDG&E, and NCPA advocate allocating allowances among retail providers on the basis of each retail provider's retail sales. This would result in a wealth transfer from the retail providers that currently have a more carbon intensive resource mix to those that do not. Figure 3 below shows the amount of allowances that California retail providers would receive if allowances were allocated among retail providers on the basis of retail sales. Figure 3 shows the estimated amount of allowances that PG&E, SCE, SDG&E, NCPA, and SMUD would receive in *excess* of their actual need, and it shows the estimated *shortfall* in allowances that would be received by the southern California publicly owned utilities:

Figure 3. Allowances Allocated by Retail Sales -- Excess and Deficiency



The following Figure 4 shows the estimated quantity of excess allowances that PG&E, SCE, SDG&E, NCPA, and SMUD would receive and also shows the shortfall in allowances for southern California publicly owned utilities:

Figure 4. Quantity of Excess or Deficiency of Allowances Allocated Under Retail-Based Allocation Approach (2008 Base Case)

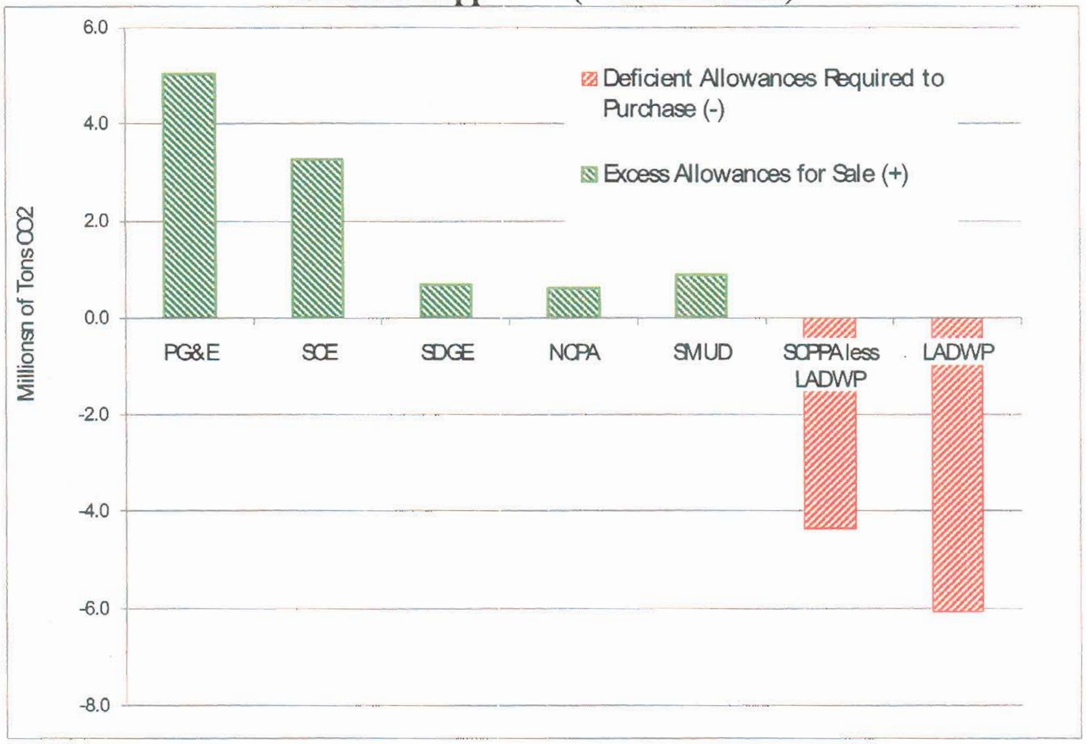
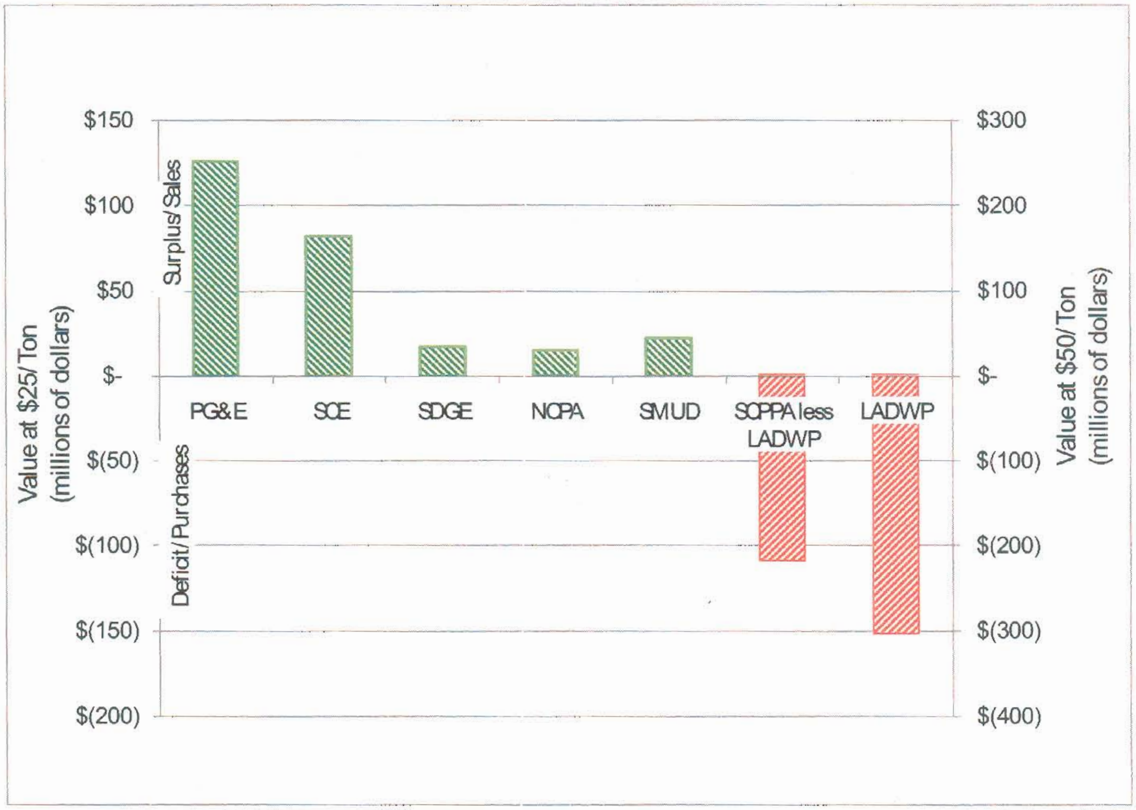


Figure 5 below shows the estimated value of the excess allowances that would be received by PG&E, SCE, SDG&E, NCPA, and SMUD if allowances were administratively allocated on the basis of retail sales, assuming allowances are valued at $25 and $50 a ton. Correspondingly, Figure 5 shows the estimated *cost* that LADWP and the SCPPA members other than LADWP would incur to make up the shortfall in allowances that they would receive if allowances were administratively allocated on the basis of retail sales, assuming allowances are valued at $25 and $50 a ton:

Figure 5. Value of Excess or Deficit of Allowances Allocated Under Retail-Based Allocation Approach (2008 Base Case)



As shown by Figure 5, if allowances were valued at $25/ton, an allocation of allowances based upon 2008 sample year emissions would result in a wealth transfer of over **$250 million** for just one year from southern California publicly owned utilities to other California utilities. The wealth transfer would swell to over **$500 million** for just one year if allowances were valued at $50/ton. This wealth transfer would be a cost for the southern California publicly owned utility ratepayers that would be *additional* to the enormous cost that those ratepayers are going to have to incur to wean themselves from the carboniferous resources that were added decades ago in compliance with state and national policies that existed at the time.

II. OVERVIEW: SCPPA'S RECOMMENDATION IN RESPONSE TO OPENING COMMENTS.

SCPPA has reviewed the 31 opening comments filed by other parties in this proceeding on October 31, 2007. After carefully considering the points raised by the parties, SCPPA remains convinced that the CPUC and CEC should stay on course and recommend to the California Air Resources Board ("CARB") a greenhouse gas ("GHG") emission reduction program for the electric sector that builds upon the framework as proposed by the CPUC in Decision ("D") 06-02-032 (February 16, 2006), as modified to accommodate Assembly Bill ("AB") 32 in CPUC President Peevey's Assigned Commissioner's Ruling and Phase 2 Scoping Memo ("Scoping Memo") (Feb. 2, 2007).

A. The Key Features of the CPUC's Program.

The CPUC's program provides for direct regulation of retail providers' GHG emissions with an element of flexibility being provided by allocating allowances to the retail providers and allowing allowance trading. The key features of the CPUC's program are as follows:

- Retail providers would the point of regulation in the electric sector. D.06-02-032 at 1, 18; Scoping Memo at 9.

- Current emission levels would be determined for each retail provider on the basis of each retail provider's "recent historical emission" profile. Scoping Memo at 16.

- Allowances would be administratively allocated to the retail providers. D.06-02-032 at 2-3, 42-43. The amount of allowances that are allocated to retail providers would be reduced progressively over time as retail providers move toward their GHG reduction goals. D.06-02-032 at 2-3, 39; Scoping Memo at 4.

- Retail providers would be required to hold an adequate number of allowances to cover the emissions associated with their service to load during any given compliance period. Failure to hold the requisite allowances would result in the assessment of a penalty. D.06-02-032 at 2, 47.

- The allowances would be stated in "tons of carbon-dioxide equivalent" so as to be tradable. A retail provider that achieved greater GHG reductions than required would be permitted to sell excess allowances. D.06-02-032 at 3, 19.

The CPUC's program is consistent with traditional air quality regulation in California under the Clean Air Act. *See* SCPPA Opening Comment at 3-6. Wisely, the CPUC's program would take full advantage of California's extensive experience with Clean Air Act regulation.

B. SCPPA Recommends that the Commissions Continue to Develop the CPUC Program.

In its Opening Comment, SCPPA recommended that the Commissions adopt a GHG emission allowance allocation methodology which would simultaneously accomplish the twin objectives of *achieving the GHG reduction goal of AB 32* while *minimizing GHG reduction costs for California electricity consumers*. SCPPA Opening Comment at 2. To that end, SCPPA recommended that the Commissions build upon the foundation laid by the CPUC in D.06-02-032 and the Scoping Memo. SCPPA continues to support that recommendation.

GHG emission allowances should be administratively allocated to regulated retail providers as the points of regulation in the electric sector for the benefit of the retail providers' customers. The allocation should be based upon recent pre-AB 32 actually experienced emissions, with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionally over time as necessary to achieve the AB 32 GHG reduction goals for the electric sector and for each retail provider by 2020. SCPPA Opening Comment at 51.

SCPPA's recommended approach to allocating allowances would be fair. Insofar as each retail provider would be required to reduce emissions associated with its service to load by the same percentage amount, each retail producer would be required to contribute to meeting the statewide goal of reducing California greenhouse emissions to the 1990 level by 2020. On the other hand, utilities such as the southern California publicly owned utilities that are more carbon-intensive than others would have to do more on a per MWh basis than others to accomplish the same percentage reduction.[4] Retail providers that undertake GHG reduction programs prior to implementation of AB 32 regulations in 2012 would benefit insofar as the base period for calculating allowances would be set prior to enactment of AB 32.

III. THE COMMISSIONS SHOULD REJECT ARGUMENTS FOR ALLOCATING ALLOWANCES THROUGH AN AUCTION.

The Natural Resources Defense Counsel ("NRDC") and the Union of Concerned Scientists ("UCS") advocate 100 percent auctioning of allowances. NRDC/UCS Opening Comment at 5. Auctioning allowances would have a potentially massive impact on the price of electricity. As an illustration, as shown in Figure 1 above, if retail providers were the point of regulation and were required to acquire auctioned allowances to cover their 2008 emissions at $25 per ton, the cost would be over $2 billion for the year. At $50 per ton, the cost would double to over $4 billion. The Commission should reject the arguments for allocating allowances through auction.

A. Auctioning Allowances Would Be Unlawful.

This cost of auctioned allowances would have to be recovered from consumers through increases in electricity rates. The Legislature insisted in AB 32 that the mandated GHG reductions be achieved in an "efficient and cost-effective manner" Cal. H & S Code at §38561 (a). The Legislature required the California Air Resources Board ("CARB") to design its regulations under AB 32, including specifically the regulations governing the "distribution of

[4] For example, LADWP has a carbon intensity of approximately 1300 lbs.CO_2/MWh. LADWP Opening Comment at 3. Some other major California utilities have a carbon intensity that is less than half LADWP's. *Id.* If LADWP is required to make a 25 percent reduction in GHG emissions, it will have to achieve a reduction of 325 lbs.CO_2/MWh. A utility that has a carbon intensity that is half of LADWP's will have to achieve a reduction of only 162.5 lbs.CO_2/MWh. *See* SCPPA Opening Comment at 18.

emission allowances," so as to "*minimize* costs…." Cal. H & S Code at §38561 (b)(1) (emphasis added). *see* SCPPA Opening Comment a 11.

Electricity is a necessity. Not only would auctioning raise electricity prices. The cost of the auctioned allowances would be just as regressive as a food tax. "For example, the Congressional Budget Office ("CBO") estimated that the price rises resulting from a 15 percent cut in CO_2 emissions would cost the average household in the lowest one-fifth (quintile) of the income distribution about 3.3 percent of its average income. By comparison, a household in the top quintile would pay about 1.7 percent of its average income…." Tradeoffs in allocating allowances for CO_2 emissions, economic and budget brief at 3, Congressional Budget Office (April 25, 2007).

Auctioning would be completely contrary to the Legislature's directive in AB 32 that the GHG reduction program should be undertaken in such a way as to minimize costs. Cal. H & S Code §38562 (b)(1). As such, it would be unlawful. *See* SCPPA Opening Comment at 22; *see also* LADWP Opening Comment at 21; Energy Producers and Users Coalition ("EPUC") and Cogeneration Association of California ("CAC") Opening Comment at 4-5.

B. Allocating Allowances Through an Auction Gives Rise to Market Power and Manipulation Concerns.

Numerous parties express concerns about how an improperly designed auction could result in an exercise in a market power or manipulation. *See e.g.*, LADWP Opening Comment at 9. Even though it is an advocate for 100 percent auctioning of allowances, NRDC and UCS admit "that auctions must be designed to avoid market manipulation…." NRDC/UCS Opening Comment at 8.

EPUC/CAC caution that there would, particularly, be "a potential exercise of market power if non-generator interests are permitted to participate in the initial auction." EPUC/CAC

Opening Comment at 29. Accordingly, various parties argued that any auction "should be limited to those entities that need the allowances." SMUD Opening Comment at 7. *See also* NCPA Opening Comment at 6; PacifiCorp Opening Comment at 10. However, limiting participation in the auction would not, in itself, be sufficient to alleviate concerns about the exercise of market power. As The CPUC itself has observed, "an auction with so few buyers (as would be the case with the load-based cap for LSEs under CPUC jurisdiction) would be economically inefficient and prone to market power abuses." D.06-02-032 at 42.

There is a simple solution to the Gordian Knot of quandries about how design a GHG allowance auction to avoid market power and market manipulation issues: reject auctioning of allowances and adopt a program under which allowances would be administratively allocated, as recommended by SCPPA.

1. Partial Auctioning Is Not a Palliative to Market Power and Manipulation Concerns.

Given California's relatively recent experience with the 2000-2001 electricity market meltdown, various parties propose that if the Commissions are determined to proceed with auctioning, then the number of allowances that are made available through the auction should be sharply limited at the outset until California can gain hands-on experience with the auctioning mechanism. EPUC/CAC advises: "California needs to learn by doing, as the European Union has done. Auctions should be phased in a cautious, measured manner, after valuations are completed...." EPUC/CAC Opening Comment at 28. EPUC/CAC recommends that auctioning "should be limited to a nominal percentage" of auctionable allowances, pointing out that the EU-ETS sets the auction percentage at 5 percent. *Id.* SMUD recommends limiting the auction to two to three percent of available allowances. SMUD Opening Comment at 6. The Division of Ratepayer Advocates ("DRA") notes: "In the acid rain program, the Virginia NOX program, and the EU carbon market only 2.8-5 percent of allowances were auctioned, and the vast majority of allowances were given away for free." DRA Opening Comment at 9. FPL Energy Project Management, Inc. ("FPL") advocates an eventual transition to 100 percent auctioning but cautioned: "Economic modeling is necessary to determine the percentage of allowances to be auctioned in the first compliance period and determine which auctions should reach 100 %." FPL Opening Comment at 7. FPL notes that the National Energy Commission on Energy Policy recommended that no more than 50 percent of allowances should be allocated through an auction.

If the Commissions are inclined, contrary to SCPPA's recommendation, to allow auctioning of some portion of allowances, the Commissions should heed the call of numerous parties for restraint. There is overwhelming support for only a small percentage of allowances to be auctioned at the outset of the program.

However, the better course would be to avoid any auctioning whatsoever. Limiting the auction of allowances to a small percentage of available allowances would not solve the problem of market power and manipulation. It would only limit the size of the potential adverse consequences. Furthermore, limiting the percentage of allowances that would be auctioned to a small percentage would result in a smaller and less liquid market. That would increase the potential for the exercise of market power and manipulation. Auctioning should be avoided altogether.

2. PG&E's Proposal for Auctioning Allowances to First Sellers as a Point of Regulation After an Administrative Allocation of Allowances to Retail Providers Should Be Rejected.

PG&E supports making "first-sellers" rather than retail providers the point of regulation in the electric sector under AB 32, but PG&E recommends that all emission allowances be allocated to retail providers on the basis of each retail provider's retail sales. PG&E Opening

Comment at 2. In order to get the allowances out of the hands of the retail providers and into the hands of the first-sellers who would be the points of regulation, PG&E proposes that the allowances that would be administratively allocated to the retail providers should be auctioned "under the supervision of an independent entity" to the first-sellers, with the proceeds of the auction being returned to the retail providers "for the benefit of their customers." *Ibid.*

Numerous parties opposed PG&E's proposed auction. The Independent Energy Producers Association ("IEP") response to the PG&E proposal was: "Emphatically, NO." IEP Opening Comment at 11. In IEP's view, allowing retail providers that own their own generation to have any involvement in either the administration of an auction or the allocation of auctioned revenues would "fundamentally undermine the commission's goal of fostering a 'competitive level playing field' within the generation sector." *Ibid* at 12. "Importantly, if retail service providers were allowed to control the administration of the auction and/or revenues from the sale of allowances, California would further exacerbate the barriers to generation investment in CA and, as a result, valuable IPP investment dollars, innovation, and experience would move to locations [and] more favorable investment environments out-of-state." *Ibid.*

Other parties were equally emphatic. Calpine Corporation ("Calpine") commented: "Retail providers should not, *under any circumstances*, be allocated allowances for subsequent auctioning to deliverers/first sellers." Calpine Opening Comment at 23 (emphasis in original). Constellation NewEnergy, Inc., ("Constellation") observed that "allocating allowances to a jurisdictional retail provider – when the jurisdictional retail provider also owns emitting resources – would create a significant conflict of interest for the retail provider:

> Specifically, there would be a conflict between the retail provider's objective of selling the allowances at the highest price so as to maximize the revenues from the auction, and the objective of

> purchasing allowances for its owned and/or controlled generation at the lowest possible price to minimize its expenses.

Constellation Opening Comment at 23.

PG&E's proposal for an administrative allocation of allowances to retail providers on the basis of retail sales with a subsequent auction to first sellers as the points of regulation is a gerry-built scheme designed to accomplish two self-serving PG&E objectives simultaneously: (1) it allows PG&E to avoid being the GHG point of regulation (which appears to be an objective that is shared by all of the CPUC –jurisdictional retail providers, including SCE and SDG&E as well as PG&E), and (2) it permits PG&E to obtain the windfall profit shown in Figure 5 above in virtue of being allocated administrative allowances in excess of its actual need. Beyond allowing PG&E to escape being a GHG point of regulation while gaining the benefits of a wealth transfer, PG&E's scheme would accomplish nothing but harm to the purchasers of PG&E's excess allowances and, potentially, the generators that compete with PG&E. SCPPA joins the other parties that have urged the Commission to say "emphatically, NO" to PG&E's self-serving proposal.

C. Obstacles to Using Auction Proceeds to Remedy the Harm Caused by Auctions Make Auctioning a Poor Choice for Allocating Allowances.

Auctioning allowances would be likely to lead to adverse consequences. As shown on Figure 1 above, assuming that allowances are auctioned at $25 per ton, the estimated cost of auctioned allowances would be over $2 billion, assuming 2008 emission levels. At $50 per ton, the cost would be over $4 billion. If the allowances are auctioned to "first-sellers", the first-sellers will pass the cost of allowances through in the form of increased wholesale prices for electricity. The increased wholesale prices will then passed on to end-use consumers. Likewise, if the auction is to retail providers as the point of regulation, the retail providers will seek to pass through the cost to their ratepayers. The impact of high electricity prices would be regressive, insofar as a larger percentage burden would be placed on lower income households than higher income households. *See* SCPPA Opening Comment at 12-13.

Another adverse consequence of auctioning is that the more carbon-intensive retail providers such as SCPPA members will be required to bear both the enormous capital cost of reconfiguring their resource mix to reduce GHG emissions *and* the cost of auction allowances. As discussed in SCPPA's Opening Comment (at 14-15), SCPPA members are going to be required to aggressively fund energy efficiency, new renewable resources, new transmission projects and other initiatives to reduce their current level of GHG emissions. Additionally, if auctioning were imposed as the allowance allocation methodology, SCPPA members would, as shown above, need to expend over **$700 million** annually to buy emission allowances at $25 per ton, assuming 2008 emissions. This would result in allowance-driven rate increases that would be *additional* to the rate increases that SCPPA would need to impose on their customers to pay for new energy efficiency programs, new resources, new transmission, and other initiatives.

Recognizing the rate burdens of auctioning allowances as well as the potential burdens on the southern California publicly owned utilities, advocates of auctioning have proposed several ameliorative measures. However, there are obstacles to those measures. The better course would be to avoid auctioning altogether so as to avoid both the adverse rate consequences and the unfair imposition of a double burden on particularly challenged carbon-intensive retail providers.

1. There are Legal Obstacles to Using Auction Revenues for Rate Relief.

Various parties that support auctioning are, nevertheless, concerned about the potential impact of auctioning on rates. For example, if first sellers are the point of regulation under the ultimately adopted California GHG regulatory scheme, The Utility Reform Network ("TURN"), supports 100 percent auctioning of allowances, provided there is "distribution of the revenues to mitigate adverse impacts on consumers, including lower-income people in particular." TURN Opening Comment at 10. (If retail providers are the point of regulation rather than first sellers, TURN advocates an administrative allocation of allowances. *Ibid* at 11.) TURN urges the Commissions to "insure that auction proceeds are either returned to ratepayers, used to subsidize rates for vulnerable low-income customers, and/or used to offset the costs of existing programs designed to lower GHG emissions...." *Ibid* at 6.

SCPPA shares TURN's concern about the rate impact of auctioning, absent ameliorative measures. However, SCPPA is concerned that rate relief would not be an available option for the use of auction proceeds.

First, auction proceeds cannot be used for any purpose without restriction as though the auction proceeds were tax revenues. A valid tax can be imposed on California citizens only when the authorizing legislation is passed by a two-thirds majority of the Legislature or a vote of the people. Cal. Const. Art. XIII. AB 32 was passed by majority vote. Thus, AB 32 does not provide authority to impose a tax. Accordingly, revenues recovered under authority of AB 32 must be construed to be regulatory fees rather than taxes.

California law imposes restrictions on the use of revenues derived through regulatory fees. The fees must be used "to mitigate the actual or anticipated adverse effects of the fee payers' operations...." *Sinclair Paint Company v. State Board of Equalization*, 15 Cal. 4th 866, 869; 937 P. 2nd 1350, 1351 (1997) (*Sinclair Paint*). Under *Sinclair Paint*, "the State must use the funds it collects [through the regulatory fee] *exclusively* for mitigating the adverse effects [of the fee payers' activities], and not for general revenue purposes." *Ibid* at 881; 456 (emphasis in original.) *See also San Diego Gas and Electric Co., v. San Diego county Air Pollution Control District*, 203 Cal.App.3d 1132 (1988); *Beaumont Investors v. Beaumont-Cherry Valley Water*

District, 165 Cal.App.3d 227 (1985). The purpose of AB 32 is to reduce GHG emissions, not to provide rate relief. Thus, while auctioning revenues may be used for various GHG emission reduction activities, the revenues may not be used for rate relief under *Sinclair Paint.*

Second as pointed out in various responses to Ruling Question 22, there is a potential for Commerce Clause violations if auction proceeds are obtained from all deliverers/first sellers and spent solely for the benefit of California ratepayers. Where a state government regulates local aspects of interstate commerce, the regulation is generally valid if it (1) does not facially, or in its practical effect or purpose, discriminate against out-of-state competition to benefit local economic interests *and* (2) is not unduly burdensome, *i.e.*, the incidental burden on interstate commerce does not outweigh the legitimate local benefits produced by the legislation. *See, e.g., Pike v. Bruce Church, Inc.*, 397 U.S. 137, at 142 (1970).

If the revenues derived from auctioning allowances to first-sellers are dedicated to providing rate relief to California retail ratepayers, there could be clear discrimination against out-of-state ratepayers and a benefit to in-state ratepayers. Under the first-seller approach, all first sellers including importers of electricity would be required to buy allowances. As a result, the marginal price charged for electricity in the wholesale market would be increased. Infra-marginal generators may shift from selling to wholesale buyers in other states in order to sell to California to take advantage of the higher California market clearing price. That shift by infra-marginal wholesale sellers of electricity could, in turn, cause an increase in wholesale prices paid for electricity in other states. That would tend to result in higher retail prices being charged to consumers in other states. The rate relief that would be provided through use of auctioned revenues would go to California consumers, but not to adversely affected consumers in other states. Accordingly, as SCPPA explained in its Opening Comment (at 41), dedicating auction revenues to providing rate relief for California consumers could result in a challenge under the Commerce Clause.

Third, if the Commission decides to pursue the "first-seller" approach to establishing the GHG regulatory point of regulation, it is likely that there will be a legal challenge on the basis that the direct impact of regulation under the "first-seller" approach affects the electricity wholesale market which is subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") and is, accordingly, preempted. As observed by EPUC/CAC, "where a regulation could be perceived to be directed to rate reduction, the likelihood of preemption is higher." EPUC/CAC Opening Comment at 37 *citing Northern Natural Gas Co. v. State Corp. Comm'n of Kansas*, 372 U.S. 84, 92 (1963).

Fourth, it is not up to the Commissions or CARB to decide how auction revenues shall be spent. The only provision in AB 32 about the disposition of revenues is contained in the new Cal. H & S Code §38597. That section provides: "The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division." Cal. H & S Code §38597. If the Commissions or CARB were to attempt to use auction revenues for rate relief without depositing the funds in the Air Pollution Control Fund for appropriation by the Legislature, the use of the funds for rate relief would be unlawful.

Thus, there are multiple legal issues that will arise if the Commissions or CARB attempt to use revenues derived through auctioning of allowances for rate relief. There would be more legal issues if there were auctioning of allowances under the "first seller" approach than if there were auctioning to retail providers as the point of regulation. However, legal issues arise if auction revenues are used for rate relief regardless of the point of regulation.

The Morgan Stanley Capital Group, Inc. ("Morgan Stanley") advocates assigning auction revenues through an assignment of "Auction Revenue Rights" ("ARRs"). Morgan Stanley Opening Comment at 2, 14. However, the legal issues that would arise are the same.

Instead of having an auctioning of allowances that results in a dramatic increase in electricity prices and a responsive attempt to provide rate relief by channeling auction revenues back to rate payers, the better course would be to avoid the problem altogether by rejecting auctioning. The problems caused by auctioning would be fully avoided by adopting the program envisioned by the CPUC in D.06-02-032 and as supported by SCPPA.

2. There Is a Practical Obstacle to Using Auction Revenues to Assist Overburdened Carbon-Intensive Communities.

Southern California publicly owned utilities that have carbon-intensive resource mix are going to be particularly challenged if they are going to be required both to fund GHG reduction efforts and to buy auctioned allowances. *See* Figures 1 and 2 above. As a palliative, NRDC/UCS propose "to allow utilities to keep a portion of the amount they spend in the auction to invest in specified ways, subject to oversight and verification that the investments meet appropriate criteria." NRDC/UCS Opening Comment at 10.

A return of 100 percent of the revenues spent for auctioned allowances would eliminate the problem of requiring retail providers such as the southern California publicly owned utilities from being required both to fund GHG reduction efforts and to purchase of allowances. In the case of the southern California publicly owned utilities, the return of auction revenues would meet the *Sinclair Paint* criteria insofar as the revenues would be directed to GHG reduction efforts, consistent with the purpose of AB 32.

However, under Cal. H & S Code §38597 as promulgated in AB 32, the revenues received through an auction are to be deposited in an Air Pollution Control Fund to be appropriated by the Legislature for the purposes of carrying out AB 32. Given the many potential uses for auction revenues, all of which may be consistent with *Sinclair Paint*, it is highly unlikely that 100 percent of the revenues or even some lesser but nevertheless substantial percentage of the revenues that are derived from retail providers such as the southern California publicly owned utilities would actually be returned to those utilities for GHG reduction efforts. Thus, the adverse consequences of adopting the auction approach cannot be dismissed by suggesting that the double burden that would be experienced by the southern California publicly owned utilities would be mitigated by a return of auction revenues to the utilities.

EPUC/CAC make a suggestion that is similar to NRDC's proposal to return auctioned revenues to retail providers such as the southern California publicly owned utilities. EPUC/CAC suggest "auction revenue retention." EPUC/CAC Opening Comments at 30. However, Cal. H & S Code §38597 requires that revenues "shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division." Insofar as auction revenues must be deposited in the Air Pollution Control Fund, the suggested "revenue retention" would be contrary to AB 32.

IV. AN ADMINISTRATIVE ALLOCATION OF ALLOWANCES ON THE BASIS OF "OUT PUT" OR ANY OTHER MEASURE THAT IGNORES ACTUAL EMISSIONS WOULD RESULT IN A WEALTH TRANSFER AND WINDFALL PROFITS FOR THOSE THAT RECEIVE ALLOWANCES IN EXCESS OF THEIR NEED.

PG&E and NCPA propose that allowances should be administratively allocated to retail providers and that the allocation should be based on retail sales. As shown by Figures 3, 4, and 5 above, an allocation of allowances on the basis of retail sales would result in an enormous wealth transfer from the southern California publicly owned utilities and their customers to other California utilities.

Emission allowances should not be allocated on the basis of retail sales, "benchmarked" lbs. CO_2 /kWh of output, population, or any other factor that does not bear a direct one-to-one correlation to a retail provider's actual historical emissions. Any allocation on a basis that is not correlated to emissions and the actual need of regulated entities for allowances would result in cross-subsidies and wealth transfers among retail providers. The allocation would be inequitable and would degrade the integrity of the GHG regulatory program.

A. Allowances are a Regulatory Tool, Not Rewards for Past Behavior.

A variety of parties contend that allowances should be allocated on the basis of "output" measured as retail sales or on the basis of retail sales multiplied by a statewide benchmark stated in lbs. CO_2/kWh. Either way, allowances would be allocated among the regulated entities without regard to the actual emissions associated with the regulated entities' output.

The common refrain of the parties that seek to have an output-based allocation of allowances among regulated entities is that it "rewards" the regulated entities that have a "cleaner" resource mix: "This approach rewards the retail providers that already have a clean resource mix, and recognizes early action they have already taken." NRDC/UCS Opening Comment at 12. Conversely, they argue against allocating allowances on the basis of actual experienced emissions or "grandfathering" because that would "reward" regulated entities that have higher emissions such as the southern California publicly owned utilities: "[G]randfathering fails to recognize and reward those entities that have taken early action to reduce GHG emissions, and at the same time, grandfathering rewards entities with high historic emissions." *Ibid* at 11-12.

It would be bad public policy to allocate allowances to some regulated entities as a reward for past actions while denying an allocation of allowances to other entities as a penalty for past actions. Allocating allowances to reward some regulated entities and to penalize others would require the regulatory agency to investigate the appropriateness of the reward or penalty. For example, in deciding whether to reward or penalize the SCPPA members, the regulatory agency would need to investigate the circumstances that led to the reliance by SCPPA members on coal resources, primarily the Intermountain Power Project in Utah and the San Juan Project in New Mexico.

The SCPPA members' reliance on coal is a legacy of the 1970s. In 1978, Congress adopted the Powerplant and Industrial Fuel Use Act ("PIFUA"). This Act prohibited development of new gas-fired baseload resources. The national policy was to encourage the use of coal, a domestic resource. When confronted by the need to add capacity, state and public resistance to developing nuclear facilities, and the unavailability of hydroelectric options in the region, SCPPA and its members resorted to coal-fired facilities located in nearby western states, consistent with PIFUA and national policy. The addition of the coal-based resources was driven by a combination of legal, geographical, and economic circumstances. The global warming consequences of such resources were not understood at the time. It would be unjust to either reward or penalize the southern California publicly owned utilities for actions they took in the past on bases that were entirely valid at the time and were unrelated to concerns about carbon emissions.

Similarly, it would be unjust to either reward or penalize low-carbon retail providers for actions they took in the past. For example, just as the southern California publicly owned utilities acquired resources such as the Intermountain Power Project for reasons that were valid at the time and were unrelated to concerns about carbon emissions, PG&E constructed the Diablo Canyon nuclear facility and the Helms pumped storage project for reasons other than concerns about carbon emissions. Just as the southern California publicly owned utilities do not deserve to be either rewarded or penalized for their decision to participate in the Intermountain Power Project in the 1970s, PG&E should not be either rewarded or penalized for its decision to construct the Diablo Canyon nuclear facility or the Helms pumped storage project.

The allocation of allowances should not be regarded as being an opportunity to grant rewards or levy penalties. Instead, as correctly conceived by the CPUC in D.06-02-032 and in traditional air quality regulation under the Clean Air Act, allowances are a feature of a regulatory structure that can add flexibility to the structure. Under the program as conceived by the CPUC as well as under Clean Air Act regulations, entities are required to reduce their emissions from a base level to lower levels at a prescribed rate over time. Progressively fewer allowances are made available during each successive compliance period as the regulated entities progress toward their ultimate emission reduction goals. If trading of allowances is permitted as it is under the SCAQMD's RECLAIM Program or under the GHG regulatory program envisioned by the CPUC in D.06-02-032, an element of flexibility is introduced. Entities that have surplus allowances can trade the allowances to others that have a deficit in exchange for monetary consideration.

It would be a major policy mistake to transmute allowances from being a feature in a regulatory program that adds an element of flexibility to being a mechanism for rewarding or punishing past behavior. If the Commission were to adopt the view of NRDC/UCS and others that allowances should be used to reward or punish past actions, the Commissions or CARB would be obligated by fundamental precepts of justice to inquire on a case-by-case basis whether a reward or a punishment was warranted. A case-specific analysis would have to be performed for each and every regulated entity to determine whether it merited a reward or a punishment for its past actions. Clearly, intent associated with past actions would need to be ascertained.

The Commissions and CARB should avoid getting into the business of rewarding or punishing regulated entities for past actions that bear, one way or another, on their current carbon footprint. The Commissions and CARB should categorically reject the notion proffered by NRDC/UCS and others that allowances should be allocated as rewards or punishments for past actions.

B. Retail Providers That Currently Have a Less Carbon Intensive Resource Mix Should Not Be Permitted to Escape Making a Contribution to the Attainment of AB 32 GHG Reduction Goals.

Retail providers that currently have a resource mix with a lower carbon intensity should not be permitted to escape making some contribution, albeit smaller in absolute terms than the contribution of others, to achieving AB 32 GHG reduction goals.

As NRDC/UCS correctly observed, allocating allowances on the basis of emissions "essentially obligates each regulated entity to reduce its emissions by the same percentage." NRDC/UCS Opening Comment at 11. That is what happens under Clear Air Act regulation, that is what would happen under the program envisioned by the CPUC in D.06-02-032, and that is what SCPPA recommends. It would be fair. The more carbon-intensive regulated entity would be required to do more than a less carbon intensive regulated entity insofar as a percentage of a larger number results in a larger number while the same percentage multiplied by a smaller number results in a smaller number. Yet, each regulated entity would have to make some contribution.

PG&E argues, however, that it should *not* be required to make a contribution to attaining GHG reduction goals. It claims that "low emitting utilities will have fewer low cost GHG reduction opportunities because they already have taken advantage of those opportunities." PG&E Opening Comment at 17-18. PG&E is effectively claiming that it has done all it can do and should not be called upon to do more.

PG&E's attempt to avoid making a contribution to attaining AB 32 GHG reduction goals should be rejected. PG&E *can* do more. That has been demonstrated by the modeling that has been done by the CPUC's modeling consultant, Energy and Environmental Economics, Inc. ("E3"). Under both E3's business-as-usual model and E3's aggressive policy model, PG&E, like all other California retail providers, is shown as achieving substantial reductions in CO_2 intensity between 2008 and 2020. Under the business-as-usual model, PG&E's CO_2 intensity is shown by E3 as declining by roughly *half* between 2008 and 2020. Modeling Ruling, Attachment B at 172.

More generally, E3's modeling shows that *all* California retail providers can make a contribution by 2020 to reducing electric sector GHG emissions under both the business-as-usual model and the aggressive policy model. E3's modeling shows that there is no basis for PG&E's claim that it "cannot do more" that it has already done to reduce GHG emissions. Thus, E3's modeling shows that there is no factual basis for requiring that the full burden for meeting AB 32 electric sector GHG reduction goals for 2020 should fall entirely on the retail providers that have a more carbon-intensive resource mix currently.

C. Allocating Emission Allowances on the Basis of Output Would Result in Unjust and Unacceptable Wealth Transfers Among Retail Providers.

Allocating GHG emission allowances on the basis of output without regard to each regulated entities' actual emission levels would "simply create wealth transfers related to the overall goal of achieving new, additional GHG emission reductions." PacifiCorp Opening Comment at 19. As shown by Figure 5 above, if allowances were valued at $25/ton, an allocation of allowances based upon 2008 sample year emissions would result in a wealth transfer of over **$250 million** for just one year from southern California publicly owned utilities to other California utilities. The wealth transfer would swell to over **$500 million** for just one year if allowances were valued at $50/ton. This wealth transfer would be a cost for the southern California publicly owned utility ratepayers that would be *additional* to the enormous cost that those ratepayers are going to have to incur to wean themselves from the carboniferous resources that were added decades ago in compliance with state and national policies that existed at the time.

TURN says it agrees with PG&E's proposal to allocate allowances on an output basis. TURN Opening Comment at 21. However, TURN appears to be unaware of the wealth transfer consequences of the PG&E proposal. An output-based allocation of allowances would be unjust, unfair, and unreasonable. Proposals for allocation based on output should be rejected.

D. An Allocation of Allowances on the Basis of Output to Generators Would Result in Windfall Profits.

In addition to proposals for an allocation of allowances to retail providers on the basis of output, there have been proposals for an allocation of allowances to generators on the basis of output. Constellation says: "The point of regulation should be the emitting resources – a source-based approach." Constellation Opening Comment at 3. To the extent to which allowances are administratively allocated, Constellation says "allowances should be allocated using an 'output' based methodology." *Ibid.* Similarly, Calpine recommends "administratively allocating allowances rather than auctioning them, regardless of whether a load-based or deliverer/first seller approach is adopted." Calpine Opening Comment at 6. Calpine advocates that the administrative allocation should be based on a "output-based allocation methodology…." *Ibid.*

EPUC/CAC go even further. Not only do they propose that there should be an administrative allocation of allowances to co-generators on the basis of output. EPUC/CAC propose that there be "double benchmarking" calculated "on the basis of the emissions of a typical, and often 'best available technology' ("BAT"), plant for a given energy output."

EPUC/CAC Opening Comment at 19. Under the "double benchmarking" approach, a co-generator would receive an administrative allocation of allowances on the basis of both its electrical output and its heat output. *Ibid* at 20.

These pleas by generators and co-generators for an administrative allocation of allowances on the basis of output should be categorically rejected. First, generators and co-generators should not be a point of regulation at all. Retail providers should be the point of regulation and should be the ones to receive administratively allocated allowances.

Second, to the extent to which the generators and co-generators are designated as being points of regulation and are able to pass most of their cost on to consumers, they should not receive a free allocation of allowances. As the MAC correctly observed: "The free distribution of allowances can result in a substantial transfer of wealth from consumers to those entities that receive allowances." MAC Recommendations at 56. Accordingly, the MAC appropriately recommended that "California avoid windfall profits, where they would occur, by limiting the free allocation of allowances." *Ibid.* Specifically: "There should be no free allocation to firms under the cap that are able to pass most of their costs on to consumers."

However, there should be some degree of flexibility to accommodate situations in which the generators or co-generators operate under long term fixed price contracts so as to not be able to pass through costs of allowances until those contracts expire. *Ibid.* SCPPA agrees with the MAC that "whether these producers should receive a free allocation in the interim should be evaluated carefully" if a first-seller regulatory scheme were adopted. *Ibid.*

E. Administratively Allocating Allowances on the Basis of Output Cannot Be Justified as an Accommodation for Load Growth.

The advocates for an administrative allowance on the basis of output advocate using a recent base period to establish allowances, and they urge regular updating of base period data.

See e.g., FPL Opening Comment at 11. They claim that this feature is a strength of their proposal. They claim that, as a result of frequent updating, load growth can be accommodated.

Accommodating load growth is not a sufficient selling point for adopting the terribly unfair output-based methodology for administratively allocating allowances. There is a question about the degree to which load growth should be explicitly accommodated. Other measures such as revisions of land use practices or building codes may be a better way to accommodate load growth. Furthermore, under the regulatory approach proposed by the CPUC in D.06-02-032 and supported by SCPPA, there is provision for trading of allowances through a secondary market. That would be an avenue for obtaining allowances beyond those initially allocated on the basis of base year emissions.

F. LADWP's Proposal to Move from Allocating Allowances on the Basis of "Current Emissions" to Allocating Allowances on the Basis of "An Emission Level that Reflects Best Industry Practices" as a Transitional 2020 End-Point Is An Acceptable Alternative.

In its October 31, 2007 Opening Comment as well as at the November 5, 2007 workshop, LADWP appeared to take a position on the allocating allowances that differs from SCPPA's view that allowances should be allocated on the basis of emissions associated with a retail provider's service to load, with the amount of allocated allowances declining over time.

Like SCPPA, LADWP supports an administrative allocation of allowances to retail providers as a point of regulation in the electric sector. LADWP Opening Comment at 2, 6. Also like SCPPA, LADWP supports an initial allocation of allowances that would be based upon emissions rather than some other factor such as retail sales, population, or a statewide "benchmark" stated in lbs.CO_2/MWh. LADWP Opening Comment at 14-15.

However, in both its Opening Comment and in its oral presentation at the November 5, 2007 workshop, LADWP said that it would support an administrative allocation of allowances that would start with an initial allocation of allowances based upon emissions but move over time to a point at which "each regulated entity in the electric sector" reaches "an emission level that reflects best industry practices" by 2020. LADWP stated in its Opening Comment:

> LADWP supports an administrative allocation of allowances at the program inception date (2012) based on current and accurate emissions levels, with an annual declining cap that ultimately brings each regulated entity in the electric sector to an emission level that reflects best industry practices.

LADWP Opening Comment at 2. This was reiterated by LADWP spokesperson at the November 5, 2007 workshop: "LADWP's proposal is to support an administrative allocation of allowances at the program's inception in 2012, based on current and accurate emission levels, with an annual declining cap that ultimately brings each regulated entity in the electric sector to an emission level that reflects best industry practices in 2020." Transcript ("Tr.") at 13-14.

The key phase in LADWP's statement of its position is the one that describes the end points that "each regulated entity in the electric sector" would be required to achieve by 2020: "an emission level that reflects best industry practices." This would *not* be a statewide "benchmark" stated in lbs.CO_2/MWh that would be common to all retail providers. Instead, "each regulated entity in the electric sector" would be required to reach an emission level by 2020 that is consistent with "best industry practices."

LADWP did not proffer a definition of "best industry practices" in its Opening Comment. However, E3 has provided a workable definition. E3 provides a description of an "Aggressive Policy Reference Case" in its CPUC GHG Modeling Stage 1 Documentation that was Attachment B to the Administrative Law Judges' Ruling Requesting Comments on Modeling-Related Issues ("Modeling Ruling") issued on November 9, 2007, in this proceeding.

Under E3's Aggressive Policy Reference Case, each retail provider (which E3 assumes to be a point of regulation) is assumed to reach an energy efficiency level at 100 percent of "net economic potential" at described in a separate report by E3. Modeling Ruling, Att. B at 24. Additionally, each retail provider is assumed to achieve a Renewables Portfolio Standard ("RPS") of 33 percent. *Id.*

The E3 Aggressive Policy Reference Case also incorporates a number of assumptions that are included in the E3 Business-as-Usual Reference Case. As a result, the Aggressive Policy Reference Case assumes, among other things, that existing California Solar Initiative ("CSI") installation rates are maintained through 2020, existing Self Generation Incentive Program ("SGIP") installation rates continue through 2020, the default emissions standard of 1100 lbs. CO_2/MWh is assigned to unspecified resources of retail providers, and, importantly, "[a]ll existing coal plant ownership [is] maintained [and] long-term contracts end if known to expire before 2020 (Reid Gardner, Boardman, Bonanza-1, Hunter-2)." *Ibid.*

E3's Aggressive Policy Reference Case is, at this point, the best available description of "best industry practices" as used but as undefined by LADWP. With the understanding that E3's Aggressive Policy Reference Case is what LADWP means by the phase "best industry practices", SCPPA can support the proposal by LADWP as a workable alternative to SCPPA's primary proposal, namely, that allowances be administratively allocated to regulated retail providers as the electric sector points of regulation on the basis of recent pre-AB 32 experience emissions with the amount of allocated allowances decreasing over time proportionally for each retail provider as necessary for the retail providers to achieve their AB 32 GHG reduction goals by 2020.

Given SCPPA's understanding that "best industry practices" is equivalent to E3's Aggressive Policy Reference Case, adoption of LADWP's proposed benchmark for 2020 would mean that any retail provider that follows "best industry practices" as defined by E3's

Aggressive Policy Reference Case would not be a net buyer of allowances in 2020. Also, it would mean that no retail provider would be required to abrogate or cease performance under an existing contract until the contract expires in accordance with its current terms.[5]

G. Emission Allowances Should Not Be Allocated on the Basis of Population.

NRDC/UCS propose: "Another allocation approach that should be considered is per-capita or per-customer allocation." NRDC/UCS Opening Comment at 13. Their reasoning is as follows: "A per-customer allocation would implicitly allow each customer to emit an equal

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[5] LADWP also says in its Opening Comment:

> The LADWP can support a transition to an electric sector average benchmark as the 2020 emissions reduction goal. LADWP recognizes that this would result in an overall greater burden for those retail providers that have high carbon footprints in comparison to those that are relatively cleaner. They would be required to reduce a greater percentage in comparison to retail service providers with low carbon footprints.

LADWP Opening Comment at 13. If this statement is taken out of context and in isolation, it appears to commit LADWP to supporting a transition from allocating allowances among retail providers on the basis of emissions to allocating allowances on the basis of a statewide benchmark stated in lbs. CO_2/MWh by 2020. However, LADWP qualifies the statement by explaining that if there were to be an initial allocation of allowances on the basis of emissions with a transition to an allocation on the basis of a benchmark by 2020, there would need to "accommodations":

> [If] such approach is adopted, the LADWP believes that other accommodations are necessary, and must be included in order for such a methodology to be feasible. These include a reasonable glide path for high carbon retail service providers in the early years to provide an adequate planning horizon for new investments in renewable generation and related transmission. This would be followed by a steeper curve in later years until reaching the required reduction levels in 2020.

LADWP Opening Comment at 13-14. Another "accommodation" would be that the benchmark would be based on "best industry practices". LADWP Opening Comment at 2.

Statewide "benchmarking" is infeasible insofar as California retail providers are so diverse in the structure of their existing and potential resource portfolios. Northern California retail providers are geographically situated so as to be able to take advantage of hydroelectric resources that have zero emissions and simultaneously provide flexibility to integrate additional renewable resources into their systems without generating GHG emissions. Such retail providers do not have to burn fossil fuel to provide spinning or operating reserves insofar as hydroelectric resources serve those functions.

By contrast, entities in southern California that have substantially less access to hydroelectric resources than northern California retail providers require fossil fuel generation to "firm" intermittent renewable resources such as wind generation. Thus, in general, even with equivalent levels of renewable resources, the southern California retail providers will tend to have higher average emissions per kilowatt hour than northern California retail providers. As a result, statewide "benchmarking" is unworkable. If the Commissions or CARB were to desire quantity of GHGs…." *Ibid.* That rationale is nonsense. To the extent that "customers" are people customers do not emit greenhouse gases except to the extent to which they breathe air. (A person emits approximately 2.5 lbs./ CO_2 per day.) Customers are not generators of electricity. Allocating allowances on the basis of the number of a retail providers' customers or the population in a retail provider's service territory would have no rational relationship whatsoever to the retail providers' emissions associated with service to electrical load.

Furthermore, aside from having no rational relation to emissions associated with service to load, allocating allowances on the basis of the number of customers or population in a service territory would fail to accommodate the "widely divergent climatic regions across California…." SMUD Opening Comment at 10. For that reason, as well, allocating allowances on the basis of number of customers or population on a service territory fails to be rational allocation methodology for California.

H. The SCE Proposal to Allocate Emission Allowances on the Basis of Economic Harm Is Too Complex.

SCE advocates allocating allowances "to entities suffering economic dislocation (i.e., harm) because of imposition of GHG regulations." SCE Opening Comment at 14. SCE would allocate allowances to both generators and retail providers. SCE Opening Comment, Appendix at 11-12. SCE proposes, similar to PG&E, that there be an auction *subsequent* to the allocation of auctions to permit the entities that are the points of regulation to obtain allowances. SCE Opening Comment at 13-14. The auction would be independently administered: "An independently administered auction is the appropriate method for redistribution of allowances

to pursue statewide benchmarking for retail providers, some accommodation would be required as proposed by LADWP or as proposed by SCPPA in its Opening Comment. See SCPPA Opening Comment at 28-30.

after their initial assignment." *Ibid* at 25. The value received from the auction would flow "back to the original allowance holders." *Ibid* at 26.

Insofar as the SCE proposal involves an allocation of allowances to parties with a subsequent auction and a return of revenues to the parties, the SCE proposal may be legally suspect for some of the reasons discussed above in connection with other proposals. For example, it appears that SCE proposes that there would be a return of funds to "the original allowance holders" without revenues from an auction being deposited in the Air Pollution Control Fund for appropriation by the Legislature as required by the Cal. H & S Code §38597.

More generally, however, while SCPPA is generally sympathetic to SCE's proposal to allocate allowances initially on the basis of economic harm, SCPPA is concerned that SCE's proposal is overly complex. The determination of who suffers economic harm would be administratively difficult. Furthermore, the multiple step process of administratively allocating allowances to the sufferers of economic harm, subsequently auctioning the allowances by an independent agent, and then returning auction revenues to the original recipients of the allowances appears to be unduly complex.

It seems that one of the primary motivations for SCE's complex multiple step proposal is to avoid having SCE become a point of regulation. The stated objective of SCE's proposal allocation of allowances on the basis of economic harm would seem to be more directly attained if SCE would acquiesce to having retail providers become the point of regulation and to having an allocation among the retail providers on the basis of emissions associated with serving.

V. THE BASE YEAR FOR ADMINISTRATIVELY ALLOCATED ALLOWANCES SHOULD BE A RECENT PRE-AB 32 MULTIPLE YEAR PERIOD.

Various proposals for defining the base year for administratively allocating allowances based on emissions were proffered in opening comments. SCPPA proposed a three year period

2004-2006. That would be long enough (three years) to normalize any anomalies that might have occurred during any particular year. Additionally, insofar as the three years 2004-2006 precede enactment of AB 32, retail providers would get the full benefit of GHG reduction efforts that they might undertake after enactment of AB 32. That would provide an appropriate incentive for retail providers to undertake "early actions" to achieve GHG reductions prior to AB 32 regulations becoming effective on January 1, 2012. SCPPA Opening Comment at 33.

The Modesto Irrigation District ("MID") proposed using the single year 2006 as the base period. MID Opening Comment at 6. Although 2006 was immediately prior to enactment of AB 32, one year would not be sufficient to eliminate inter-year anomalies.

LADWP proposed a three to five year period "as close to the base period as possible." LADWP Opening Comment at 17. However, that would fail to give credit for "early actions" that retail providers might undertake after enactment of AB 32 but prior to AB 32 regulations becoming effective on January 1, 2012.

PacifiCorp proposes a five year period "prior to the rule's effective start date." PacifiCorp Opening Comment at 15. PacifiCorp proposes, further, that California should "drop data from the years with the highest and lowest emissions for each load serving entity." PacifiCorp's proposed base period suffers from the defect of following the enactment of AB 32, in which case the methodology would not give full credit for "early actions" undertaken after AB 32 enactment but prior to AB 32 regulations become effective on January 1, 2012. However, PacifiCorp's proposal for a five year period with the years of highest and lowest emissions appears to have merit. The PacifiCorp approach would take advantage of the practice typically used by appraisers.

After reviewing the suggestions in the opening comments, SCPPA continues to believe that allowances should be administratively allocated on the basis of emissions data from an immediate pre-AB 32 period so as to give full credit for post-AB 32 but pre-implementation "early action". As for the number of years that should be used for the base period, SCPPA believes PacifiCorp's suggestion should be considered.

A. Base Period Allowances Should Not Be Disturbed Except for Periodic Downward Adjustments to Meet AB 32 Goals.

Once a retail provider's allowance on the basis of emissions is established, the allowance should not be disturbed and except to be adjusted downward periodically. As PacifiCorp proposes:

> For planning purposes, the individual regulated entity's emission allowance allocation methodology (i.e., its ratio of the GHG baseline and subsequent caps compared to other regulated entities), should never be changed, but the forecasted cap available for grandfathered GHG emission allowances could be adjusted periodically.

PacifiCorp Opening Comment at 19.

B. If There Is a Reserve for New Entrants, the Reserve Should Be Small.

Advocates of an administrative allocation of allowances generally suggested that there be a small reserve for new entrants. PacifiCorp proposed a "set aside" of less than three percent for new entrants. PacifiCorp Opening Comment at 9. FPL proposed ten percent. FPL Opening Comment at 12. SCPPA is unsure there is any need for a set aside if retail providers are the point of regulation. The entry of new providers is currently chilled by the freeze on any expansion of direct access in California. Furthermore, allowances would be available through a secondary market under the regulatory approach contemplated by the CPUC in D.06-02-032. However, it seems the sentiment is running in the direction of having some set-aside for new entrants. The PacifiCorp proposal appears to SCPPA to be the most reasonable.

VI. CONCLUSION.

SCPPA recommends that the Commissions adopt a GHG emission allowance allocation methodology which would simultaneously accomplish the twin objectives of *achieving the GHG reduction goal of AB 32* while *minimizing GHG reduction costs for California electricity consumers*. To that end, SCPPA recommends that the Commissions build upon the foundation laid by the CPUC in D.06-02-032 and the Scoping Memo. GHG emission allowances should be administratively allocated to regulated retail providers as the points of regulation in the electric sector for the benefit of the retail providers' customers. The allocation should be based upon recent pre-AB 32 actually experienced emissions, with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionally over time as necessary to achieve the AB 32 GHG reduction goals for the electric sector and for each retail provider by 2020.

Respectfully submitted,

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Dated: November 14, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY REPLY COMMENT ON ALLOWANCE ALLOCATION ISSUES** on the service list for CPUC Docket No. R.06-04-009 and CEC Docket No. 07-OIIP-01 by serving a copy to each party by electronic mail and/or by mailing a properly addressed copy by first-class mail with postage prepaid.

Executed on November 14, 2007, at Los Angeles, California.

/s/ Sylvia Cantos

Sylvia Cantos

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