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**Lorraine A. Paskett, Director
Legislative and Regulatory Affairs
Los Angeles Department of Water and Power
111 North Hope Street, Room 1536
Los Angeles, CA 90012
(213) 367-8698 office phone
Email: Lorraine.Paskett@ladwp.com**

**H. David Nahai, Interim Chief Executive Officer
and General Manager
Los Angeles Department of Water and Power
111 North Hope Street, Room 1550
Los Angeles, CA 90012
(213) 367-1320 office phone
Email: David.Nahai@ladwp.com**

**OPENING COMMENTS OF THE
LOS ANGELES DEPARTMENT OF WATER AND POWER
ON THE ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS ON
TYPE AND POINT OF REGULATION ISSUES**

In accordance with Rule 14 of the Rules of Practice and Procedure of the Public Utilities Commission ("CPUC" or "Commission") of the State of California, the Los Angeles Department of Water and Power ("LADWP") hereby files the following Opening Comments submitted in response to the "Administrative Law Judges' Ruling Requesting Comments on Type and Point of Regulation Issues," filed November 19, 2007 , in CPUC Rulemaking R.06-04-009 ("Rulemaking") and California Energy Commission (CEC) Docket # 07-OIIP-1.

I. INTRODUCTION

The LADWP appreciates the opportunity to provide opening comments on issues related to type and point of regulation beyond the first seller. As such, we do not intend to repeat our previous comments on first seller, but will address questions where there may be some points not previously identified. We also recognize that the recommendations the CPUC and CEC adopt and forward to the California Air Resources Board (CARB) are intended to help inform, on behalf of the electric sector, the CARB's AB 32 rulemaking process that encompasses many other sectors and sources of greenhouse gas emissions that may likely be included in an CARB greenhouse gas emissions reduction program. The comments provided below are preliminary, and may adjust as critical factors evolve.

II. SUMMARY OF OPENING COMMENTS

Implementation of AB 32 as a greenhouse gas (GHG) reduction program must address emissions associated with electricity consumed in California, including both in-state generation and imported electricity (i.e. California-only approach). This specific requirement, in the absence of a regional source-based program that includes all sources of emissions in the West, introduces challenges for the California electric sector such as how to accurately quantify 1990 GHG emissions, report and attribute emissions, establish the point of regulation, and allocate emission allowances if a cap-and-trade program is adopted.

Ideally, a source-based approach to regulating GHG emissions would be the most straightforward and consistent. It would also be similar to other emission reduction programs that have applied to electric generation (e.g. U.S. EPA's Acid Rain Program and SCAQMD's RECLAIM program). However, unique obstacles arise in regulating GHG emissions (and specifically carbon dioxide) in the electric sector, including the primary fact that there are currently no direct emission control technologies (i.e. CO₂ controls) available for electricity generation. As such, GHG reduction strategies primarily focus on shifting away from high-carbon resources to low/zero-carbon resources, and avoiding emissions through energy efficiency and demand-side management. The Acid Rain source-based program applies to all power plants with SO_x emissions in all states, and therefore load-based issues with a single-state approach are absent. The RECLAIM source-based program applies only to stationary sources within the South Coast Air Basin, and therefore avoids the import issues associated with having emission sources outside its jurisdiction. A source-based

approach falls short in a California in-state only scenario, because state electricity imports account for a significant source of emissions, now estimated by the ARB as accounting for an estimated 25% of the State's 1990 emission inventory.

The LADWP has reviewed other proposed approaches to the point of regulation in this ruling, including 1) pure source-based for in-state only (excluding imports); 2) deliverer/first seller; 2) source-based in-state and load-based for imports; 3) in-state source-based and CA-owned only for imports; and 4) deferral of a market-based cap-and-trade system. We have concluded that the load-based approach to the point of regulation remains the superior and only feasible approach for a California-only GHG emission reduction program. This would be the case irrespective of whether or not the State elects to implement a cap-and-trade program in the near term. The LADWP recommends that a cap-and-trade program for a California-only program be implemented only if it can be determined to cost-effectively provide the equivalent emission reductions as direct regulation within the same time period. It must also be considered if, and only if, it is broad-based and robust enough to protect against the risks for the electric sector when a cap-and-trade program does not perform the way it is designed and intended (i.e. reliability impacts, market manipulation and gaming, price volatility, credit hoarding, etc.).

A load-based approach to the point of regulation provides greater consistency with other California initiatives for energy efficiency, renewables, and solar. It also helps to preserve reliability, by limiting regulatory compliance to California retail providers, entities that have a vested interest in their retail customers (i.e. as opposed to non-generator marketers under a first seller). A load-based approach minimizes costs to

retail providers by focusing on actual emission reduction measures as opposed to relying only on higher wholesale market prices for electricity to change the dispatch of resources. A load-based approach is consistent with AB 32 by including all generation, both in-state and imported electricity, and would be the least susceptible to legal challenge. Lastly, a load-based approach could be implemented under a direct regulation strategy in the near-term if the ARB determines that it is better to delay participation in a market-based cap-and-trade program until a regional or federal program is in place, and would more readily transition California to a source-based regional or federal cap-and-trade program in the future than other approaches with minimal amount of implementation challenges that might otherwise result from an early California load-based cap-and-trade program transitioning to a regional or federal-based cap-and-trade program.

III. RESPONSE TO SPECIFIC QUESTIONS

3.1. General

Q1. What do you view as the incremental benefits of a market-based system for GHG compliance, in the current California context?

Answer: The current California context would require one to assume that greenhouse gas (GHG) reductions would be focused on a California-only approach, and that reliance on a broader regional effort (i.e. Western Climate Initiative) is still too early in its development to know how effective it may be. The incremental benefits of a market-based system for GHG compliance in this context would be dependent on how broad or limited participation would be by regulated sectors. The currently projected level of emission reductions required to reach Statewide 1990 emission levels by 2020

is approximately 173 million metric tons (MMT)¹. Reduction strategies as outlined in the ARB's Early Action Plan are reflected below. A market-based mechanism would be limited to only a portion of the "Remaining Reductions" listed below, and therefore would be a portion of the 102 MMT reductions that come from the Scoping Plan and Climate Action Team strategies. In order for a market-based mechanism like cap-and-trade to be successful, it must be robust and economy-wide.

Potential 2020 Greenhouse Gas Emission Reductions

Reduction Measures	Million Metric Tons
Adopted Strategies (AB 1493, Anti-Idling, etc.)	30 MMT
Discrete Early Action Measures	16 MMT
Other Early Actions	26 MMT
Remaining Reductions (Scoping Plan, CAT)	102 MMT
Total Reductions	Estimated 173 – 174

Source: ARB Early Action Workshop Presentation:
http://www.arb.ca.gov/cc/ccea/meetings/091707workshop/sept2007_ea_workshop_presentation.pdf

It is unlikely that the transportation sector, which accounts for 35% of the 1990 emissions inventory² would be part of a market-based system directly, and it still remains to be determined which of the other sectors effectively lend themselves to a market-based mechanism. These other sectors, besides the electric sector (25%), that need to be evaluated include: residential (7%), commercial (3%), agriculture (5%), and industrial (24%).³ The question that this raises and that will need to be evaluated is whether or not a market for that level of emission reductions is robust enough under a California-only approach to resist the influence of market power and/or manipulation,

¹ ARB, California 1990 Greenhouse Gas Emissions Level and 2020 Limit" (2007)
http://www.arb.ca.gov/cc/ccei/meetings/nov_26_workshop_slides.pdf

² *Ibid.*

³ *Ibid.*

gaming and other potentially negative impacts that would have serious implications for electric sector, particularly system reliability and price volatility.

Q2. Can a market-based system provide additional emissions reductions beyond existing policies and/or programs? If so, at what level? How much of such additional emission reductions could be achieved through expansion of existing policies and/or programs?

Answer: The results of sector, regional, and entity-specific, including CPUC economic modeling for the electric sector are not yet available, so stakeholder responses to this question are primarily qualitative in nature. The LADWP does not support a market-based approach for the electric sector unless it can be demonstrated to provide additional emission reductions at a lower cost than direct reductions. The cost of a market-based program is also dependent on the methodology selected for distributing allowances. It is LADWP's position that an allowance allocation that is based on a high percentage of auction would likely increase compliance costs by diverting funds away from direct emission reduction efforts and redistributing those funds in a manner that may result less emission reductions. This would particularly be the case if any amount of funds were collected from the electric sector and redistributed to other sectors or for other purposes that do not directly reduce electric sector emissions. It would also be the case if the value of allowances were distributed to entities based on criteria that are independent of one's regulatory obligation to reduce emissions. The ARB's scoping plan will provide a better opportunity to address what additional reductions can be achieved through expansion of existing policies and/or programs.

3.2. Principles or Objectives to be Considered in Evaluating Design Options

Public Utilities Commission Staff proposes that the following principles or objectives be used to evaluate GHG program design options and to develop recommendations regarding a GHG regulatory approach. The objectives are not presented in any particular order.

- **Goal Attainment:** Does the approach being considered have any particular advantages in terms of meeting overall emission reduction goals? For example, does the approach have any advantages to promoting energy efficiency, combined heat and power, or renewable energy?
- **Cost Minimization:** Is the approach likely to minimize the total cost to end users of achieving a given GHG reduction target?
- **Compatibility with Wholesale Markets and the Market Redesign and Technology Upgrade:** What are the implications of the approach on efficient functioning of wholesale markets generally and the California Independent System Operator day-ahead and real-time markets?
- **Legal Risk:** Is the approach at greater relative risk of being delayed or overturned in court?
- **Environmental Integrity:** Does the approach mitigate or allow contract shuffling and the leakage of emissions occurring outside of California as a result of efforts to reduce emissions in California?
- **Expandability:** Would the approach integrate easily into a broader regional or national program? A related consideration is the suitability of the approach as a model for a national or regional program.
- **Accuracy:** Does the approach support accuracy in reporting and, therefore, ensure that reported emission reductions are real?
- **Administrative Simplicity:** Does the approach promote greater simplicity for reporting entities, verifiers, and state agency staff? How easy will the program design be to administer?

Q3. Do you agree with this set of objectives? Are there other objectives or principles that you wish to see included? If so, please include your recommendations and reasoning. Finally, please rank the objectives above, and any additional factors you propose, in order of importance.

Answer: The CPUC/CEC's list of design principles listed above is incomplete.

The following criteria should also be included in the design of a GHG emission reduction program for the electric sector.

Preserve Reliability: The most important design principle that is missing and should be included in any greenhouse gas reduction program, and ranked first, is the

preservation of California's electric system reliability. It was the intent of the Legislature that the State Air Resources Board design emissions reduction measures in a manner that improves and modernizes California's energy infrastructure and maintains electric system reliability.⁴ A well designed GHG reduction program should ensure that emission reduction efforts will take reliability into consideration. An emission reduction program that fails to consider reliability will expose California to the risk of repeating the 2001 energy crisis and would be inconsistent with AB 32. The LADWP recommends that the CPUC/CEC include preservation of reliability as the first principle in evaluating program design.

Compatibility with Other Environmental Policies and Goals: Another important principle that is missing is compatibility with other environmental policies and goals. A key reduction strategy for the electric sector is to shift California's resource mix from high carbon resources to low/zero carbon resources. Renewable and natural gas are often referenced in these reduction strategies. However, both alternatives for replacement power pose additional challenges and constraints that warrant close consideration and evaluation of cost impacts in the design of a GHG emission reduction program. Examples include, but are not limited to the following: 1) CEQA compliance for new renewable transmission projects; 2) local air quality regulations for stationary sources like power plants; 3) Section 316(b) Once Through Cooling requirements under the federal Clean Water Act that affect approximately 21 coastal power plants that provide 40 percent of total in-state electricity.

⁴ California Health and Safety Code, Section 38501(h).

In evaluating options for replacement power, these types of additional challenges and constraints must be thoroughly evaluated in the design of a GHG reduction program. The design of a GHG reduction program must fully consider the feasibility and cost-effectiveness of options for replacement power for high carbon resources.

Equity and Fairness: AB 32 states that in adopting regulations to reduce GHG emissions that the ARB shall “Design the regulations, including distribution of emission allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize total benefits...”⁵ The Market Advisory Committee’s recommendations on a Cap-and-Trade program include the design principle of fairness as “assuring that the program avoids causing environmental harm to particular communities, and assuring that compliance costs are spread equitably across sectors and regions.”⁶ Any program design, including the allocation of allowances under a cap-and-trade program, must be done in a way that maintains equity and fairness so that the costs of the program’s implementation are not disproportionately borne by any particular sector or group of entities. This principle would provide for proportionality in the distribution of compliance costs between significant sources that contribute to the State’s GHG emissions, both inter-sector and intra-sector. In particular, the costs of emission reductions should not be carried by one group of sources, while the benefits get attributed to another group of sources. For example, port electrification may provide net emission reductions overall from the transportation sector (i.e. ships). However, the electric sector will have a load shift that will require additional allowances to cover the power system’s load resulting

⁵ California Health and Safety Code, Section 38562(b)(1).

⁶ Market Advisory Committee, Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California, June 30, 2007, page 18.

from electrification. Retail providers should not be forced to cover the cost of those emission reductions, while the benefits of the emission reductions are attributed to the transportation sector. Retail provider investments in electrification infrastructure should also be given appropriate consideration.

Preserve Wholesale Market Stability: As noted in LADWP's filing on allowance allocation issues, the LADWP recommends that the AB 32 program must be designed to complement and not impede wholesale electric market stability.⁷ This principle is missing from the above list and should be included in the evaluation of a GHG emission reduction program.

Prevent GHG Credit Market Manipulation: As noted in LADWP's filing on allowance allocation issues, the LADWP expressed concerns about the potential for exercising market power in an emissions trading program.⁸ A principle that is missing and should be included in the evaluation of a GHG emission reduction program is the prevention/protection against market manipulation and gaming in emission trading.

Environmental Integrity: The questions posed under the proposed design principle of "environmental integrity" incorrectly focus only on contract shuffling and leakage, which can and should be listed as a separate principle. The design principle of environmental integrity should be consistent with AB 32 and the Market Advisory Committee's recommendations. AB 32 requires that the greenhouse gas emission reductions achieved are real, permanent, quantifiable, verifiable, and enforceable by the

⁷ LADWP, Opening Comments of the LADWP on the ALJ's Ruling Requesting Comments on Allowance Allocation Issues, dated October 31, 2007, page 5.

⁸ *Ibid*, page 9-11.

state board. The MAC's first design principle is environmental integrity in that the design of the program should ensure that specified GHG reduction targets are achieved.⁹

Minimize Environmental Justice Impacts: AB 32 specifically states that the GHG rules, regulations, programs, mechanisms, and incentives "direct public and private investment toward the most disadvantaged communities in California."¹⁰ It also states that in the use of market-based compliance mechanisms to comply with the regulations that the ARB must "consider the potential for direct, indirect, and cumulative emission impacts from these mechanisms, including localized impacts in communities that are already adversely impacted by air pollution."¹¹ The concept of environmental justice was so important to the implementation of AB 32 that the Legislature included specific provisions for the establishment of an Environmental Justice Advisory Committee to advise the ARB in the development of their scoping plan.¹²

The LADWP recommends the following order for the design principles:

1. Preserve Reliability
2. Environmental Integrity (Goal Attainment)
3. Cost Minimization
4. Equity and Fairness
5. Minimize Environmental Justice Impacts
6. Preserve Wholesale Market Stability
7. Prevent GHG Credit Market Manipulation
8. Legal Risk
9. Compatibility with Wholesale Markets and the Market Redesign and Technology Upgrade
10. Compatibility with Other Environmental Policies and Goals
11. Accuracy

⁹ Market Advisory Committee, Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California, June 30, 2007, page 18.

¹⁰ California Health and Safety Code, Section 38565.

¹¹ California Health and Safety Code, Section 38570(b)(1).

¹² California Health and Safety Code, Section 38591(a).

- 12. Minimize Leakage
- 13. Expandability
- 14. Administrative Simplicity

Q4. With a load-based cap-and-trade system, should exports from in-state generation sources be included and accounted for under the cap? Why or why not? If so, how? For example, exports could be captured in a cap-and-trade system by regulating in-state sources that export, or by counting the emissions associated with exported power, without any compliance obligation on the exporter. There may be other options as well.

Answer: AB 32 requires that the ARB review existing and proposed international, federal, and state GHG reporting programs and “make reasonable efforts to promote consistency among the programs established pursuant to this part and other programs.”¹³ A GHG reduction program should protect against double-counting of emissions, which can occur under a load-based system under different scenarios. This should be avoided if emissions for a specific transaction are already attributed to a California retail provider. In the case of export to other states that may also have GHG reporting regulations, as may be the case in the future under the Western Climate Initiative, California must ensure compatibility with those states to ensure that emissions are attributed to the appropriate party. In the case of a load-based regional program, it would be appropriate for emissions to be attributed to the party receiving the energy, regardless of whether they are in-state or out-of-state so long as they were participants in a regional load-based cap-and-trade program.

Q5. How extensive do you view the threat of contract shuffling under a load-based program, given the accessibility of clean resources within the western interconnect? What mechanisms do you propose to combat this possibility? On what basis do you support your position?

Answer: The LADWP does not support the introduction of greater inaccuracy in

¹³ California Health and Safety Code, Section 38530(c)(2).

emissions reporting as an attempt to minimize contract shuffling, as has been recommended with inadequate public consideration in this proceeding with the application of 1100 lbs/MWh default emission factors for known zero-carbon generation resources. Instead, the LADWP recommends that the ARB, CPUC, and CEC convene workshops in 2008 to further publicly discuss and evaluate the potential for contract shuffling and leakage in the electric sector, and identify more appropriate strategies that minimize the occurrence.

A retail provider cannot necessarily dictate the retirement of high carbon resources that it does not own, but it can control its investments in resources and shift those investments to cleaner resources. Under a true source-based program, the very same investments in low/zero carbon generation that are encouraged would be rewarded, as opposed to penalized with the use of default emission factors that create "phantom emissions" that never exist. A cap-and-trade program is dependent on rigorous, accurate and consistent emissions reporting in order to ensure that integrity of the program is preserved. Use of default emission factors for known sources introduces inaccuracy and raises potential legal questions relative to unfair treatment of certain regulated entities, which will compromise the integrity of such program.

Q6. Which of these systems best accounts for all imports? What are the advantages and disadvantages of each potential tracking system in terms of accuracy, cost of development and administration of tracking systems, costs of administration to the parties, and overall costs to ratepayers? Are there alternative tracking approaches that you would recommend, and for what reasons?

Answer: Under a load-based system, the LADWP supports the use of plant-specific emission factors for known sources of electricity imports, such as long-term

power purchase agreements, ownership shares in out-of-state plants, or unit-contingent transactions. For unspecified purchases where the source of generation is unknown, the LADWP supports the use of default emission factors by regional import point (i.e. Northwest, Southwest). The use of NERC e-tags for emissions tracking is inappropriate and inaccurate. The use of regional default emission factors for wholesale transactions would provide greater certainty at the time a transaction occurs.

Q7. If a load-based approach is pursued, would the potential benefits of a full TEAC system be great enough to warrant the start-up and administrative costs?

Answer: No response. The ruling does not provide a description of a TEAC system, nor does it provide a reference to other information, which makes it infeasible to respond to this question at this time.

3.4. Source-based Cap-and-Trade System Design Options

3.4.1. Pure Source-based (GHG Regulation of In-State Generation Only)

Q8. Do you view this approach as compliant with Assembly Bill (AB) 32? Please support your answer.

Answer: AB 32 requires the ARB to “account for greenhouse gas emissions from all electricity consumed in the state, including transmission and distribution line losses from electricity generated within the state or imported from outside the state.”¹⁴ As such, a pure source-based program for in-state sources only would not be consistent with AB 32 reporting requirements or the California statewide 1990 GHG emissions inventory, which include electricity imports.

¹⁴ California Health and Safety Code, Section 38530(b)(2).

Q9. In light of the relatively high capacity factors of carbon-intensive facilities outside the state, how extensive do you expect the short-term threat of substituting higher-carbon imports for in-state generation to be? Might this possibility be dealt with through specific program design (e.g., allocations, limiting conditions, etc.)?

Answer: See response to Question 8 above.

Q10. Given existing procurement oversight and the prospect for a regional or federal GHG program in the foreseeable future, how extensive do you expect the threat to be of a longer-term shift of production to regions beyond the reach of a California source-based cap-and-trade regime?

Answer: See response to Question 8 above.

Q11. If emissions associated with imported power are excluded from a cap-and-trade program, what policies beyond the existing suite of program including energy efficiency, California Solar Initiative, RPS, and Emission Performance Standard (EPS) do you recommend that California employ to achieve the necessary reductions from the electricity sector?

Answer: See response to Question 8 above.

Q12. As the Public Utilities Commission does not currently have authority to oversee all energy efficiency and renewable procurement programs for all kinds of retail providers (investor owned utilities (IOUs), community choice aggregators (CCAs), electric service providers (ESPs), and publicly owned utilities (POUs)), which agency(ies) should fill in any gaps? Which agency should be responsible for overseeing energy efficiency and renewable procurement for POUs? Would the California Air Resources Board (ARB) have the authority to require certain energy efficiency and renewable targets be met by POUs?

Answer: Oversight function rests with the POU governing boards. For LADWP, like many other publicly owned electric utilities, it is our governing board and City Council that set procurement policy and approve procurement contracts. It is also these governing authorities' responsibility to set electric rates. POUs are defined in Public Utilities Code Section 9604 as a municipality or municipal corporation furnishing electric service, a municipal utility district furnishing electric service, a public utility district

furnishing electric service, an irrigation district furnishing electric service, or a joint powers authority that includes one of these agencies and owns generation or transmission or furnishes electric service over its own or its member's electric distribution system.

POUs include municipalities; joint powers authorities and special districts. Unlike for-profit entities, the IOUs and energy service providers (ESP), over which the CPUC must ensure compliance with various programs, POUs are public entities. Special districts are defined in the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 as "an agency of the state, formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries." Many governing boards have explicit policies requiring that they act in compliance with the law. Because POUs are required to act in accordance with applicable law and many POU governing boards already have specific policies to act in accordance with the law, POUs are already obligated to conduct the operations of their POU in accordance with any mandates of AB 32.

As such, POU governing boards are responsible for approving electric supply plans and the rates that are required to cover the costs of those electric resources whether owned or purchased through contract. Because governing boards are responsible for setting the policy for and/or approving POU procurement decisions, it is POU governing boards that should be the entities charged with ensuring compliance with the requirements of AB 32 while the ARB has statutory authority to enforce emission reduction requirements. At the present time, many governing boards approve

the long-term financial commitments, including contracts to build renewable energy generation. For example, the LADWP governing board must act on all competitive contract awards that exceed \$150,000 dollars. This dollar amount covers all major resource additions. In addition, LADWP's board must act on all purchases, sales and exchanges of electricity for terms longer than eighteen months. For agreements longer than three years, the City Council must act. AB 32 conferred authority to the ARB to develop and enforce an emission reduction program. AB 32 did not delegate or otherwise shift authority away from POU governing boards for procurement, demand side management (DSM) or energy efficiency (EE) program decisions.

Q13. What sources would a source-based system cover? Could it cover California utility-owned facilities located outside of California?

Answer: See response to Question 8 above. AB 32 requires consideration of all electricity imports, not just utility-owned facilities outside of California. This approach would be discriminatory in that it would place greater compliance burden on retail providers that rely on specified electricity imports, to the exclusion of retail providers that rely on unspecified electricity imports, sources that would not be captured under such approach. A source-based system must account for all energy consumed in the state regardless of whether the source is utility-owned or not. Any proposed regulation must be consistent with the statutory enactment. "An administrative agency may not promulgate a rule or regulation that alters or enlarges the terms of a legislative enactment." *Cleveland Chiropractic College v. State Board of Chiropractic Examiners* (1970) 11 Cal.App.3d 25, 34. "If an agency exceeds the limits of its enactment, it is usurping the legislative power, and any rule adopted thereby is invalid." *Proctor v. San*

Francisco Port Authority (1968) 266 Cal.App.2d 675, 684. Any proposal that includes utility-owned imports but excludes other imports would be inconsistent with AB 32.

Q14. Would a strengthened EPS assist in reducing emissions due to California imports? What recommended changes would you make to the EPS?

Answer: See response to Question 8 above.

3.4.2. Deliverer/First Seller

Q15. Please comment on the “First Seller Design Description” paper, which is Attachment A to this ruling. Does the paper accurately describe the deliverer/first seller program? If not, describe your concerns and include an accurate description from your perspective.

Answer: The “First Seller Design Description” paper provides a technical discussion of the first seller and effectively highlights the numerous difficulties associated with quantifying emissions for electricity imports, particularly if NERC e-tags are relied upon for emissions tracking. While the paper provides substantive examples of how a first seller approach is problematic, there are other aspects of the first seller that make it unworkable.

The paper specifically does not discuss the legal issues that burden the first seller approach and make it more susceptible to legal challenge than a load-based point of regulation. LADWP provided extensive comments on the first seller point of regulation, including legal briefs.¹⁵

¹⁵ LADWP, Opening Comments of the LADWP on the ALJs’ Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report, dated August 6, 2007. Reply Comments of the LADWP on the ALJs’ Ruling Requesting Comments and Legal Briefs on Market Advisory Committee Report, dated August 15, 2007. Testimony of LeiLani Johnson Kowal, Environmental Supervisor, at the Joint CPUC and CEC En Banc Hearing on the Market Advisory Committee Report and First Seller Point of Regulation, August 21, 2007.

In general, the first seller approach to the point of regulation is not a true source-based point of regulation, and while it may provide greater accuracy for in-state generation, it also introduces greater opportunity for gaming and market manipulation for electricity imports in comparison to a load-based approach that places the point of regulation on the California retail providers only. The "First Seller Design Description" paper also does not evaluate the difficulty of regulating marketers that do not own generation, a key distinction from a true source-based approach. It also does not assess the potential implications for the wholesale electricity market prices or vulnerability to market manipulation and gaming, critical aspects of the first seller that cannot be ignored. It also does not evaluate the potential impacts on California load-based programs, such as energy efficiency and renewables that are displaced with by a focus on higher market prices to ineffectively influence resource investments.

The paper concludes, as does LADWP, that the first seller approach eliminates the option of administrative allocation (i.e. free allocation). The LADWP agrees that the first seller reduces allocation options to pure auction in order to maintain fairness to out-of-state entities. Furthermore, the LADWP believes that retail providers would not legally be able to directly receive the proceeds of the auction on behalf of their retail customers when based on retail sales, an approach that results in the same outcome as administrative allocation to California retail providers only. That is because such distribution would exclude out-of-state entities and be inconsistent with AB 32 provision that allowances be distributed in a manner that is equitable, seeks to minimize costs and maximize total benefits...¹⁸, and the MAC design principle of fairness as

¹⁸ California Health and Safety Code, Section 38562(b)(1).

“...assuring that compliance costs are spread equitably across sectors and regions.”¹⁷

Because the paper does not evaluate legal aspects of the first seller point of regulation, it also doesn't evaluate the legality of an auction without further appropriation by the California Legislature.¹⁸ The ARB may “adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated...The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available by appropriation, by the Legislature, for purposes of carrying out [the Global Warming Solutions Act of 2006].”¹⁹

As such, the first seller approach has significant flaws that make it inferior to a load-based approach and unworkable as a viable option for implementation of AB 32.

3.4.3. Source-based for In-state Generation, Load Based for Imports

Q16. Please describe in detail your view of how this option would work.

Answer: The LADWP does not view this as superior to a load-based approach, and has not had adequate time in this proceeding to provide the appropriate legal and technical review to determine whether this approach is even feasible. The LADWP may provide a response in reply comments to other stakeholders' comments.

¹⁷ Market Advisory Committee, Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California, June 30, 2007, page 18.

¹⁸ LADWP, Opening Comments of the LADWP on the ALJs' Ruling Requesting Comments on Allowance Allocation Issues, dated October 31, 2007.

¹⁹ California Health and Safety Code, Section 38597.

Q17. Do you support such an approach? Why or why not?

Answer: See response to Question 16 above.

Q18. Does this approach have legal issues associated with it? Provide a detailed analysis and legal citations.

Answer: See response to Question 16 above.

Q19. If retail providers are responsible for internalizing the cost of carbon for imported power, all power generated in-state may need to be tracked to load to avoid double regulation of in-state power. Do you agree?

Answer: See response to Question 16 above.

Q20. If that is the case, does a mixed source-based/load-based approach offer any advantages compared to a load-based approach in terms of simplifying reporting and tracking? What if the load-based system uses TEACs? How could imports be differentiated from in-state generation in a way that reduces the complexity of reporting and tracking compared to a load-based approach?

Answer: See response to Question 16 above.

3.5. Deferral of a Market-based Cap-and-Trade System

Q21. How important is it that a cap-and-trade system be included in the near-term as part of the electricity sector's AB 32 compliance strategy?

Answer: In this proceeding, the LADWP has indicated support for a direct regulation as the least cost approach to reducing emissions for the electricity sector and that a cap-and-trade program should appropriately play the role of a secondary method of compliance. As noted in LADWP's response to Question 1 above, the key determining factor in whether or not the electric sector should participate in a cap-and-trade program in the near-term is whether or not the same amount of emissions reductions can be achieved cost-effectively within the same timeframe as any direct emission reduction.

If a California-only market is limited in the number of market participants and volume of emissions to be reduced, it may not be able to resist the influence of market power and/or manipulation, gaming and other potentially negative impacts that would have serious implications for electric sector, particularly system reliability and price volatility. In that case, it is only prudent that the ARB postpone a market-based cap-and-trade program until such time that the program would be robust enough to provide adequate protections for the electricity sector against the risks associated with a market that does not work as designed and intended. The LADWP supports a regional and/or federal GHG reduction program as broader market participation would tend to protect against those risks. The modeling work currently being prepared by stakeholders, and also by the CPUC and E3 should help inform the regulatory agencies and stakeholders about the cost impacts associated with various emission reduction strategies, including market-based compliance options.

Q22. Would your answer to Q12 be different if there is no market-based cap-and-trade system? If so, please explain.

Answer: No. Oversight function rests with the POU governing boards.

Q23. Address the following:

a. How emission reduction obligations could be met if there is no cap-and-trade system for the electricity sector.

Answer: The LADWP supports efforts to directly reduce emissions through changes in the generation resource mix and avoiding emissions through energy and water conservation and demand-side management. The LADWP welcomes further discussion and exploration of opportunities to reduce emissions through partnerships with retail customers, small businesses, the housing industry, local governments and

agencies (including water agencies), and other sectors (e.g., green building, port electrification).

b. How increased programmatic goals would impact rates.

Answer: The economic modeling currently underway by stakeholders and the CPUC and E3, if developed with accurate data and assumptions, should help inform the CPUC and CEC regarding the potential impacts to rates of various emission reduction strategies, including increased programmatic goals like energy efficiency and renewables.

c. How deferral of a cap-and-trade program for the electricity sector would facilitate or hinder California's integration into a subsequent regional or federal program.

Answer: California has identified itself as a leader in reducing greenhouse gas emissions by: 1) adopting AB 32 and other policies supporting GHG reductions; and 2) continuing to encourage other states to develop GHG reduction goals and programs. Deferral of a cap-and-trade program may help facilitate California's integration into a regional or federal program by minimizing any transitional difficulty that would otherwise arise if California's program structure was different from a federal program. Deferral may also help in that the State may continue to pursue direct emission reductions for the electric sector under a load-based approach without introducing the complexities and potential flaws that have been identified with a California-only cap-and-trade program. Regardless of a deferral, it is critical that California continue to play a leadership role in the development of a regional and federal GHG reduction program.

Q24. How deferral of a cap-and-trade program for the electricity sector would facilitate or hinder California's integration into a subsequent regional or federal program.

Answer: See response to Question 23(c) above.

Q25. If neither a regional system nor a national system is implemented within a reasonable timeframe, should California proceed with implementing its own cap-and-trade system for the electricity sector? If so, how long should California wait for other systems to develop before acting alone?

Answer: The LADWP may provide a response in reply comments to other stakeholders' comments.

Q26. What flexible compliance mechanisms could be integrated into a non-market based GHG emission reduction approach?

Answer: The LADWP recommends that consideration be given to flexibility that may be needed if key emission reduction strategies for the electric sector encounter delays in implementation due to circumstances that are beyond the control of the regulated entities, such as regulatory constraints posed by other environmental policies and regulations. As mentioned above, new renewable energy projects often require extensive CEQA analysis and review for new transmission to support those projects. Greater reliance on in-state natural gas resources may face other challenges, particularly for coastal plants that are subject to Once-Through Cooling regulations that require either retirement, retrofit, or repowering to include alternative cooling. These other types of environmental policies and regulations may result in sector-wide constraints and deserve consideration if flexibility in the compliance schedule is warranted in a non-market (i.e. direct regulation) approach.

Q27. If a market-based cap-and-trade system is not implemented for the electricity sector in 2012, how would you recommend addressing early actions that entities may have undertaken in anticipation of a market?

Answer: Entities that took early actions to reduce their GHG emissions have reduced their regulatory compliance burden under AB 32 and thus their compliance costs, irrespective of whether or not they did so in anticipation of a market. It is unclear that any further actions are warranted.

3.6. Recommendation and Comparison of Alternatives

Q29. Submit your comprehensive proposal for the approach California should utilize regarding the point of regulation and whether California should implement a cap-and-trade program at this time for the electricity sector. If you recommend that another approach be considered besides those detailed above, propose it here. If you recommend one of the above options, give as detailed a discussion as possible of how the approach would work.

Answer: At this time, the LADWP supports direct regulation through changes in the generation resource mix and avoidance of emissions through energy and water conservation and demand-side management as the least cost approach to reducing emissions for the electricity sector. A cap-and-trade program should appropriately play the role of a secondary method of compliance in as much as it can cost-effectively provide for equivalent emission reductions over the same time period. While a true source-based approach would be the most straightforward, it is not feasible to implement for AB 32, which requires that the ARB to account for emissions from all electricity consumed in the state, including electricity imports. The LADWP continues to view a load-based approach as being superior and the only viable point of regulation for a California-only GHG emission reduction program, given the legal obstacles associated with other approaches to the point of regulation, like the first seller, that are more

susceptible to legal challenges.

A load-based approach to the point of regulation complements existing load-based policies and programs, and would be consistent for compliance with either direct reductions or a market-based program in a California-only program like AB 32. A load-based approach would also maintain consistency and offer a smoother transition to a regional or federal source-based GHG cap-and-trade program by minimizing transitional challenges associated with shifting from a load-based market structure to a source-based market structure where the value of allowances has already been distributed to regulated entities in a manner that is inconsistent with a source-based structure. Lastly, a load-based approach for a California-only program minimizes the potential for market manipulation and gaming and reduces the risks associated with market volatility.

Q29. Address and compare how each of the alternatives identified in the above questions, and the proposal you submit in response to the preceding question, would perform relative to each of the principles or objectives listed above and any other principles or objectives you propose. For each alternative, address important tradeoffs among the principles.

Answer: The LADWP may provide a response in reply comments to other stakeholders' comments.

IV. CONCLUSION

The LADWP appreciates the opportunity to provide these opening comments to the CPUC and CEC for your consideration.

Dated: December 3, 2007 Respectfully submitted,

/s/ LORRAINE A. PASKETT

Lorraine A. Paskett, Director
Legislative and Regulatory Affairs
111 North Hope Street, Room 1536
Los Angeles, CA 90012
(213) 367-8698 Office Phone
Email: Lorraine.Paskett@ladwp.com

/s/ H. DAVID NAHAI

H. David Nahai, Interim Chief Executive Officer
and General Manager
Los Angeles Department of Water and Power
111. North Hope Street, Room 1550
Los Angeles, CA 90012
(213) 367-1320 Office Phone
E-Mail: David.Nahai@ladwp.com

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached:

OPENING COMMENTS OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER ON THE ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS ON TYPE AND POINT OF REGULATION ISSUES

on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list, updated November 30, 2007. See attached service list. I served a copy of the document on those without e-mail addresses by mailing the document by first-class mail addressed as follows:

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VIA OVERNIGHT MAIL
Commissioner President Michael R.
Peevey
California Public Utilities Commission
State Building, Room 5218
505 Van Ness Avenue
San Francisco, CA 94102

VIA OVERNIGHT MAIL
ALJ Jonathan Lakritz
California Public Utilities Commission
State Building, Room 5020
505 Van Ness Avenue
San Francisco, CA 94102

VIA OVERNIGHT MAIL
Commission Chair Jackalyne Pfannenstiel
California Energy Commission
1516 Ninth Street, MS-29
Sacramento, CA 95814-5512

VIA OVERNIGHT MAIL
ALJ Charlotte TerKeurst
California Public Utilities Commission
State Building, Room 5117
505 Van Ness Avenue
San Francisco, CA 94102

Executed this 3rd day of December 2007, at Los Angeles, California.

/s/ LEILANI JOHNSON KOWAL

LeiLani Johnson Kowal, Environmental Supervisor
Legislative and Regulatory Affairs
Los Angeles Department of Water and Power
111 N. Hope Street, Room 1536
Los Angeles, CA 90012
Phone: 213-367-3023
E-Mail: Leilani.Johnson@ladwp.com

CPUC R. 06-04-009 Service List

Sent via e-mail to:

abb@eslawfirm.com
 abonds@thelen.com
 achang@nrdc.org
 adamb@greenlining.org
 aeg@cpuc.ca.gov
 agc@cpuc.ca.gov
 agrimaldi@mckennalong.com
 aimee.barnes@ecosecurities.com
 ajkatz@mwe.com
 akbar.jazayeri@sce.com
 akelly@climatetrust.org
 alan.comnes@nrgenergy.com
 aldyn.hoekstra@paceglobal.com
 alho@pge.com
 amber@ethree.com
 amsmith@sempa.com
 andrew.bradford@constellation.com
 andrew.mcallister@energycenter.org
 andy.vanhorn@vhcenergy.com
 anita.hart@swgas.com
 annabelle.malins@fco.gov.uk
 Anne-Marie_Madison@TransAlta.com
 annette.gilliam@sce.com
 apak@sempraglobal.com
 amo@recurrentenergy.com
 atrial@sempa.com
 atrowbridge@daycartermurphy.com
 Audra.Hartmann@Dynergy.com
 aweller@sel.com
 bbaker@summitblue.com
 bbeebe@smud.org
 bblevins@energy.state.ca.us
 bcragg@goodinmacbride.com
 bdcapo@caiso.com
 bernardo@braunlegal.com
 beth@beth411.com
 Betty.Seto@kema.com
 bill.chen@constellation.com
 bill.schrand@swgas.com
 bjeider@ci.burbank.ca.us
 bjl@bry.com
 bjones@mjbbradley.com
 bkc7@pge.com
 blm@cpuc.ca.gov
 bmcc@mccarthyllaw.com
 bmcquown@reliant.com
 Bob.lucas@calobby.com
 bpotts@foley.com
 bpurewal@water.ca.gov
 brabe@umich.edu
 brbarkovich@earthlink.net
 BRBC@pge.com
 brenda.lemay@horizonwind.com
 burtraw@rff.org
 bushinskyj@pewclimate.org
 bwallerstein@aqmd.gov
 C_Mamay@lbl.gov
 cadams@covantaenergy.com

californiadockets@pacificorp.com
 carla.peterman@gmail.com
 carter@ieta.org
 case.admin@sce.com
 cathy.karlstad@sce.com
 cbasket@enemroc.com
 cbreidenich@yahoo.com
 cchen@ucsusa.org
 cem@newsdata.com
 cf1@cpuc.ca.gov
 cft@cpuc.ca.gov
 charlie.blair@delta-ee.com
 chilen@sppc.com
 cjlw5@pge.com
 ckmitche11@sbcglobal.net
 ckrupka@mwe.com
 clarence.binninger@doj.ca.gov
 clark.bernier@rlw.com
 clyde.murley@comcast.net
 cmkehrein@ems-ca.com
 colin.petheram@att.com
 cpe@cpuc.ca.gov
 cpechman@powereconomics.com
 cswoollums@midamerican.com
 curt.barry@iwpnews.com
 curtis.kebler@gs.com
 Cynthia.A.Fonner@constellation.com
 cynthia.schultz@pacificorp.com
 daking@sempa.com
 Dan.adler@calcef.org
 danskopec@gmail.com
 dansvec@hdo.net
 dave@ppallc.com
 david.zonana@doj.ca.gov
 david@branchcomb.com
 david@nemtzw.com
 davidreynolds@ncpa.com
 dbrooks@nevpc.com
 deb@a-klaw.com
 deborah.slone@doj.ca.gov
 dehling@kling.com
 derek@climaterestory.org
 dhecht@semptratading.com
 dhuard@manatt.com
 diane_fellman@fpl.com
 dietrichlaw2@earthlink.net
 dil@cpuc.ca.gov
 dkk@eslawfirm.com
 dks@cpuc.ca.gov
 dmacmull@water.ca.gov
 dmetz@energy.state.ca.us
 dnehaus@semprautilities.com
 douglass@energyattorney.com
 dseperas@calpine.com
 dsh@cpuc.ca.gov
 dsoyars@sppc.com
 dtibbs@aes4u.com
 dwang@nrdc.org
 dwood8@cox.net

dws@r-c-s-inc.com
 echiang@elementmarkets.com
 edm@cpuc.ca.gov
 egw@a-klaw.com
 ehadley@reupower.com
 ej_wright@oxy.com
 ek@a-klaw.com
 ekgrubaugh@iid.com
 ELL5@pge.com
 elvine@lbl.gov
 emahlon@ecoact.org
 emello@sppc.com
 epoole@adplaw.com
 epowers@arb.ca.gov
 e-recipient@caiso.com
 etiedemann@kmtg.com
 ewolfe@resero.com
 ez@pointcarbon.com
 farrokh.albuyeh@oati.net
 fiji.george@elpaso.com
 filings@a-klaw.com
 fjs@cpuc.ca.gov
 fstern@summitblue.com
 fwmonier@tid.org
 gbarch@knowledgeinenergy.com
 gblue@enxco.com
 george.hopley@barcap.com
 ghinners@reliant.com
 GloriaB@anzaelectric.org
 glw@eslawfirm.com
 gmorris@emf.net
 gpickering@navigantconsulting.com
 gregory.koiser@constellation.com
 grosenblum@caiso.com
 gsmith@adamsbroadwell.com
 gxl2@pge.com
 harveyederpspc.org@hotmail.com
 hayley@turn.org
 hronin@water.ca.gov
 hgolub@nixonpeabody.com
 hoerner@redefiningprogress.org
 hs1@cpuc.ca.gov
 hurlock@water.ca.gov
 HYao@SempraUtilities.com
 hym@cpuc.ca.gov
 info@calseia.org
 jack.burke@energycenter.org
 james.keating@bp.com
 janill.richards@doj.ca.gov
 jarmstrong@goodinmacbride.com
 jason.dubchak@niskags.com
 jbf@cpuc.ca.gov
 jbw@slwplc.com
 jchamberlin@strategicenergy.com
 jci@cpuc.ca.gov
 JDF1@PGE.COM
 jdhe@eslawfirm.com
 jdoll@arb.ca.gov
 jeanne.sole@sfgov.org

CPUC R. 06-04-009 Service List

jeffgray@dwt.com
 jen@cmt.org
 jenine.schenk@apses.com
 jennifer.porter@energycenter.org
 JerryL@abag.ca.gov
 Jesus.Arredondo@nrgenergy.com
 jf2@cpuc.ca.gov
 jgill@caiso.com
 jgreco@caithnessenergy.com
 jhahn@covantaenergy.com
 jimross@r-c-s-inc.com
 jj.prucnal@swgas.com
 jjensen@kirkwood.com
 jk1@cpuc.ca.gov
 jkarp@winston.com
 jkloberdanz@semprautilities.com
 jlaun@apogee.net
 jleslie@luce.com
 jluckhardt@downeybrand.com
 jm3@cpuc.ca.gov
 jnm@cpuc.ca.gov
 jody_london_consulting@earthlink.net
 Joe.paul@dynegy.com
 john.hughes@sce.com
 johnredding@earthlink.net
 jol@cpuc.ca.gov
 josephhenri@hotmail.com
 joyw@mid.org
 jsanders@caiso.com
 jscancarelli@flk.com
 jsqueri@gmssr.com
 jst@cpuc.ca.gov
 jtp@cpuc.ca.gov
 julie.martin@bp.com
 jwiedman@goodinmacbride.com
 jwmctamaghan@duanemorris.com
 jxa2@pge.com
 karen@klindh.com
 karla.dailey@cityofpaloalto.org
 Kathryn.Wig@nrgenergy.com
 kbowen@winston.com
 kcolburn@symbioticstrategies.com
 kdusel@navigantconsulting.com
 kdw@woodruff-expert-services.com
 keith.mccrea@sablauw.com
 kellie.smith@sen.ca.gov
 kelly.barr@srpnet.com
 ken.alex@doj.ca.gov
 ken.alex@doj.ca.gov
 kenneth.swain@navigantconsulting.com
 kerry.hattevik@mirant.com
 kevin.boudreaux@calpine.com
 kfox@wsgr.com
 kgough@calpine.com
 kgrenfell@nrdc.org
 kgriffin@energy.state.ca.us

kjinnovation@earthlink.net
 kjsimonsen@ems-ca.com
 kkhoja@thelenreid.com
 klatt@energyattorney.com
 kmills@cbbf.com
 kmkiener@fox.net
 kowalewskia@calpine.com
 krd@cpuc.ca.gov
 kyle.l.davis@pacificorp.com
 kyle.silon@ecosecurities.com
 kyle_boudreaux@fpl.com
 lars@resource-solutions.org
 Laura.Genao@sce.com
 lcottle@winston.com
 ldecarlo@energy.state.ca.us
 leilani.johnson@ladwp.com
 liddell@energyattorney.com
 lisa.c.schwartz@state.or.us
 lisa_weinzimer@platts.com
 llorenz@semprautilities.com
 llund@commerceenergy.com
 lmh@eslawfirm.com
 Lorraine.Paskett@ladwp.com
 lpark@navigantconsulting.com
 lrdevanna-rf@cleanenergysystems.com
 lrm@cpuc.ca.gov
 lschavrien@semprautilities.com
 ltenhope@energy.state.ca.us
 ltt@cpuc.ca.gov
 marcel@turn.org
 marcie.milner@shell.com
 mary.lynn@constellation.com
 mclaughlin@braunlegal.com
 mdjoseph@adamsbroadwell.com
 mflorio@turn.org
 mgarcia@arb.ca.gov
 mhyams@sfgwater.org
 Mike@alpinenaturalgas.com
 mjd@cpuc.ca.gov
 mmattes@nossaman.com
 mmazur@3phasesRenewables.com
 monica.schwebs@bingham.com
 mpa@a-klaw.com
 mpryor@energy.state.ca.us
 mrw@mrwassoc.com
 mscheibl@arb.ca.gov
 mwaugh@arb.ca.gov
 nenbar@energy-insights.com
 ner@cpuc.ca.gov
 nes@a-klaw.com
 nlenssen@energy-insights.com
 norman.furuta@navy.mil
 notice@psrec.coop
 npedersen@hanmor.com
 nsuetake@turn.org
 nwhang@manatt.com

obartho@smud.org
 obystrom@cera.com
 ofoote@hkcf-law.com
 pbarthol@energy.state.ca.us
 pburnich@arb.ca.gov
 pduvair@energy.state.ca.us
 pepper@cleanpowermarkets.com
 phanschen@mofo.com
 Philip.H.Carver@state.or.us
 philm@scdenergy.com
 pjazayeri@stroock.com
 ppettingill@caiso.com
 pseby@mckennalong.com
 psp@cpuc.ca.gov
 pssed@adelphia.net
 pstoner@lgc.org
 pthompson@summitblue.com
 pvalien@thelen.com
 pw1@cpuc.ca.gov
 pzs@cpuc.ca.gov
 rachel@ceert.org
 ralph.dennis@constellation.com
 ram@cpuc.ca.gov
 randy.howard@ladwp.com
 randy.sable@swgas.com
 rapcowart@aol.com
 rhelgeson@scppa.org
 RHHJ@pge.com
 rhwiser@lbi.gov
 richards@mid.org
 rick_noger@praxair.com
 rita@ritanortonconsulting.com
 rkeen@manatt.com
 rkmoore@gswater.com
 rmccann@umich.edu
 rmiller@energy.state.ca.us
 rmm@cpuc.ca.gov
 rmorillo@ci.burbank.ca.us
 robert.pettinato@ladwp.com
 Robert.Rozanski@ladwp.com
 roger.montgomery@swgas.com
 roger.pelote@williams.com
 rogerv@mid.org
 ron.deaton@ladwp.com
 rprince@semprautilities.com
 rreinhard@mofo.com
 rrtaylor@srpnet.com
 rsa@a-klaw.com
 rschmidt@bartlells.com
 rsmutny-jones@caiso.com
 rwinthrop@pilotpowergroup.com
 ryan.flynn@pacificorp.com
 S1L7@pge.com
 saeed.farrokhpay@ferc.gov
 samuel.r.sadler@state.or.us
 sandra.carolina@swgas.com

CPUC R. 06-04-009 Service List

Sandra.ely@state.nm.us
sas@a-klaw.com
sasteriadis@apx.com
sbeatty@cwclaw.com
sberlin@mccarthy.com
sbeserra@sbcglobal.net
scarter@nrdc.org
scohn@smud.org
scott.tomashefsky@ncpa.com
scottanders@sandiego.edu
scr@cpuc.ca.gov
sdhilton@stoel.com
sellis@fypower.org
sendo@ci.pasadena.ca.us
sephra.ninow@energycenter.org
sgm@cpuc.ca.gov
slins@ci.glendale.ca.us
sls@a-klaw.com
smichel@westernresources.org
smindel@knowledgeinenergy.com
smk@cpuc.ca.gov
snewsom@semprautilities.com
spauker@wsgr.com
sscb@pge.com
ssmyers@att.net
steve.koemer@elpaso.com
steve@schiller.com
stevek@kromer.com
steven.huhman@morganstanley.com
steven.schleimer@barclayscapital.com
steven@iepa.com
steven@lipmanconsulting.com
steven@moss.net
svn@cpuc.ca.gov
svongdeuane@semprasolutions.com
svs6@pge.com
tam@cpuc.ca.gov
tburke@swater.org

tcarlson@reliant.com
tcx@cpuc.ca.gov
tdarton@pilotpowergroup.com
tdillard@sierrapacific.com
THAMILTON5@CHARTER.NET
thunt@cecmail.org
tiffany.rau@bp.com
tim.hemig@nrgenergy.com
todil@mckennalong.com
Tom.Elgie@powerex.com
tomb@crossborderenergy.com
tomk@mid.org
trdill@westernhubs.com
troberts@sempra.com
UHelman@caiso.com
vb@pointcarbon.com
vitaly.lee@aes.com
vjw3@pge.com
vprabhakaran@goodinmacbride.com
vwelch@environmentaldefense.org
wbooth@booth-law.com
westgas@aol.com
william.tomlinson@elpaso.com
wsm@cpuc.ca.gov
wtasat@arb.ca.gov
www@eslawfirm.com
wynne@braunlegal.com
ygross@sempraglobal.com
zaiontj@bp.com

Sent via U.S. Mail to:

KAREN EDSON
CAISO
151 BLUE RAVINE ROAD
FOLSOM, CA 95630

MARY MCDONALD
CAISO
151 BLUE RAVINE ROAD
FOLSOM, CA 95630

MATTHEW MOST
EDISON MISSION MARKETING &
TRADING, INC.
160 FEDERAL STREET
BOSTON, MA, 02110-1776

THOMAS MCCABE
EDISON MISSION ENERGY
18101 VON KARMAN AVE., SUITE 1700
IRVINE, CA, 92612