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CALIFORNIA ENERGY COMMISSION
COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON SUPPLEMENTAL INFORMATION SUBMITTED REGARDING ALLOWANCE ALLOCATION ISSUES UNDER AB 32

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I. INTRODUCTION

Pursuant to the ruling of the Administrative Law Judges dated October 15, 2007 (ALJs' Ruling) and guidance dated November 8 and 19, 2007, Pacific Gas and Electric Company (PG&E) provides its comments on supplemental information submitted regarding the allocation of greenhouse gas (GHG) emissions allowances under AB 32. PG&E's comments address supplemental information submitted by (1) the Southern California Public Power Authority (SCPPA), and (2) the South Coast Air Quality Management District (SCAQMD).

II. SCPPA'S SUPPLEMENTAL INFORMATION AND RELATED ARGUMENTS SUBSTANTIALLY OVERSTATE THE POTENTIAL AB 32 COMPLIANCE COSTS TO BE INCURRED BY HIGH-EMITTING UTILITIES

SCPPA submitted supplemental information that it says demonstrates that, if AB 32 allowances were administratively allocated on the basis of retail sales rather than historical emissions, the result would be a wealth transfer of $250-500 million a year from customers of SCPPA members to other California utilities, using 2008 emissions as a base case and assuming an allowance cost of $25-50 per ton.[1/]

Prior to even considering whether SCPPA's analysis is supportable or

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1/ SCPPA Supplemental Information, p. 7.

meaningful, there are threshold questions regarding the accuracy and relevance of SCPPA's "2008 base case" numbers and assumptions.[2/]

First, SCPPA uses 2008 as a base year for considering the impact of allocation methods that would not be used until 2012, the effective date of AB 32 emissions limits and reduction measures. In this regard, PG&E notes that one of SCPPA's principal members, the Los Angeles Department of Water Power (LADWP), voluntarily committed in May, 1991 to reduce its GHG emissions by 20% by 2010.[3/] Assuming LADWP fulfills its voluntary commitment, its 2010 emissions should be 20% below its 1990 levels. LADWP's allowance needs for 2012 thus may be significantly different than the 15.0 MMT assumed by SCPPA for LADWP in its 2008 base case. Consequently, LADWP's allowance "deficiency" as portrayed in SCPPA's Figures 3, 4 and 5, may be significantly less than SCPPA has argued, even assuming allowances are allocated based on retail sales as proposed by PG&E.[4/]

2/ SCPPA assumes that California utilities and other retail providers would need to acquire a total of 82.5 million tons of allowances to cover their emissions under a 2008 base case. (SCPPA, p. 2.) However, the latest draft inventory by ARB staff shows electricity-sector emissions of 110.6 MMT in 1990 and 119.8 MMT in 2004 (Tables 2 and 3, "California 1990 Greenhouse Gas Emissions Level and 2020 Emissions Limit," Air Resources Board, November 16, 2007.) Based on informal information provided by SCPPA, PG&E understands that SCPPA's 82.5 million tons number may have been derived from a combination of "top down/bottoms up" modeling by SCPPA. PG&E has not had sufficient time or access to SCPPA's modeling assumptions to determine the accuracy of the 82.5 million ton number for 2008, but the fact that ARB's number for 2004 is almost 50% higher is a concern. For these reasons, PG&E is unable to conclude that SCPPA's analysis is accurate, supportable or valid, and therefore recommends that it be given little or no weight in this proceeding until such time as SCPPA can provide parties a full explanation of the assumptions and modeling behind the analysis.

3/ Reply Comments of NRDC/UCS/GPI, November 14, 2007, Attachment "Carbon Dioxide Emission Reduction Policy, Joint Statement of Southern California Edison and Los Angeles Department of Water and Power."

4/ PG&E notes that LADWP apparently reaffirmed its 1991 voluntary GHG reduction commitment in May, 2007, when the City of Los Angeles announced its "Green LA" GHG reduction program, which included a voluntary commitment by LADWP to increase its percentage of renewable electricity resources to 20 percent by 2010 and 35 percent by 2020. See "Green LA An Action Plan to Lead the Nation in Fighting Global Warming," City of Los Angeles, May, 2007, p. 4

Second, SCPPA has not taken into account the adverse impact an historical emissions allocation methodology would have on California utilities generally, including SCPPA members, under a ***national*** GHG cap and trade program. As PG&E demonstrated in its supplemental information filed in this proceeding, California electricity customers would pay an extra $2.1 billion a year to acquire emissions allowances under a national program using historical emissions, than they would pay under a national program which allocates allowances based on retail sales.[5/]

A more realistic scenario than SCPPA's would use business-as-usual emission projections for a future year when AB 32 is implemented, e.g. 2012, but a lesser allocation of allowances based on retail sales. In such a scenario, utilities would have to reduce emissions, which, after all, is the point of the cap-and-trade scheme. All utilities would need to incur costs, beyond "business as usual," to reduce or offset emissions. Relative to PG&E, SCPPA's members might need proportionally larger emission reductions, but SCPPA's members are likely to have more attractive, less expensive emission reduction measures not available to lower emitting utilities, such as "low-hanging fruit" CEE programs that lower emitting utility customers invested in years ago, and opportunities to reduce coal-fired generation that that the lower emitting utilities do not have. Therefore, SCPPA's cost estimates are likely to overstate significant

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("**Transforming the Los Angeles Department of Water and Power: 35% Renewable Energy by 2020** The Los Angeles Department of Water and Power (LADWP) is embarking on the most ambitious transformation of any utility in America. In 2005, Mayor Villaraigosa challenged the department to accelerate plans to generate 20% of its electricity from clean, renewable sources from 2017 to 2010. Since then, LADWP has more than doubled its portfolio of renewable energy by purchasing wind, solar, and geothermal power. Today, through aggressive planning, LADWP is on track to meet the 20% goal with new projects such as the Pine Tree Wind Farm, located in the Mojave Desert.")

5/ PG&E Reply Comments, November 14, 2007, pp. 23- 24.

differences in compliance costs across the utilities by ignoring the fundamental purpose of a market-based cap: achieving significant, permanent reductions in emissions in a cost-effective manner. Instead, SCPPA proposes an historical emissions based allocation which would result in the customers of lower emitting utilities effectively paying for the reductions needed at higher-emitting utilities.[6/]

III. THE RECOMMENDATIONS OF THE SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT REGARDING THE "RECLAIM PROGRAM" SHOULD BE CONSIDERED AND CAN BE MANAGED IN THE DESIGN OF AN AB 32 CAP-AND-TRADE PROGRAM

PG&E welcomes the "lessons learned" from a California specific experience with a cap and trade market and believes many of the observations and conclusions highlighted by the report provided by SCAQMD should be considered in designing a cap-and-trade program under AB 32. As we understand SCAQMD's comments, some of these "lessons learned" from the RECLAIM program may include:

- Recognize that early reductions are important.
- Allow time to develop, test and implement allocation methods.
- There are tensions between capping emissions, fair allocations and program goals that need to be carefully balanced.
- Consider using an average production level over a three to five year period as the basis for allocations, rather than allowing each facility to pick a peak production year.
- Limit the amount of time allowed (if any) for amending past emission

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6/ The differences between the GHG intensity of coal and the GHG intensity of natural gas are significant—roughly 1000 kg CO2 per MWh for coal, compared to just 400 kg CO2 per MWh for a gas-fired combined cycle plant. Unlike SCPPA members, PG&E cannot seek to displace emissions from its coal generation because it does not have any.

reports to reduce the total amount of allocations.

- For a cap-and-trade program that replaces existing and future emission reduction commitments, carefully consider the value of leaving technologically feasible and cost effective requirements in place. Use the market mechanism primarily for compliance requirements that are yet to be defined or have a longer time horizon.
- Avoid giving credit for reductions that would occur anyway due to other rules or programs.

PG&E also recognizes concerns about the functioning of a relatively small, California-only market for CO2 allowances. One of PG&E's goals for cap-and-trade is managing costs to customers while at the same time achieving the long term emissions reductions that a market-based approach offers. PG&E agrees that a small or illiquid market for CO2 allowances, with relatively inelastic demand for and supply of allowances, could have adverse impacts on customer costs. On the other hand, PG&E believes that a GHG cap-and-trade program can be carefully designed to be broad, deep and liquid enough to avoid these problems. In addition, PG&E also believes that flexible compliance and cost mitigation mechanisms can be included in the market design in order to provide a "backstop" for market events or dysfunctions on a contingency basis.

At the appropriate time, PG&E would welcome the CPUC, CEC and ARB scheduling a workshop where SCAQMD and other interested parties can discuss practical design considerations for the cap-and-trade market under AB 32 in more detail.

IV. CONCLUSION

For the reasons stated above PG&E recommends that the CPUC and Energy