

<b>DOCKET</b>	
07-011P-1	
DA1	DEC 17 2007
RECD.	DEC 17 2007

**DOCKET 07-011P-01  
CALIFORNIA ENERGY COMMISSION  
REPLY COMMENTS OF PACIFIC GAS AND  
ELECTRIC COMPANY (U 39 E) ON TYPE AND POINT  
OF REGULATION ISSUES UNDER AB 32**

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Dated: December 17, 2007

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**I. INTRODUCTION**

Pursuant to the ruling of the Administrative Law Judges dated November 9, 2007 (ALJs' Ruling), Pacific Gas and Electric Company (PG&E) provides its reply comments on issues relating to the type and point of regulation under AB 32.

**II. MOST COMMENTERS CONTINUE TO PREFER THE "FIRST SELLER" APPROACH TO OTHER ALTERNATIVES**

The opening comments indicate that parties from a broad and growing cross-section prefer the "first seller" approach to other alternatives. All three major California investor-owned utilities support a form of the first seller approach,<sup>1/</sup> as do key generators and marketers.<sup>2/</sup> Environmental groups support or do not oppose the first seller approach.<sup>3/</sup> Most significantly, the California Independent System Operator filed the comments of its Market Surveillance Committee (CAISO MSC) supporting the first seller approach and opposing a load-based cap.<sup>4/</sup> The CAISO MSC is the key oversight committee charged with monitoring power markets in California to ensure transparency, efficiency and liquidity and to prevent manipulation and disruption.

This continuing robust support for the first seller approach, even when compared

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<sup>1/</sup> PG&E, p. 2; SCE, p. 18; SDG&E/SoCal Gas, p. 15.

<sup>2/</sup> Calpine, p. 1; WPTF, p. 2; Constellation, p. 19; Morgan Stanley, p. 12; AReM, p. 2; EPUC/CAC, p. ; Powerex, p. 1.

<sup>3/</sup> Environmental Defense, p. 1; NRDC/UCS, p. 22.

<sup>4/</sup> CAISO Market Surveillance Committee, pp. 2-3.

to various “hybrid” approaches suggested in the ALJs’ Ruling, is an important turning point in this proceeding. If California is to move forward with a regulatory design for AB 32 that garners support from key participants in the electric sector, it must do so using the first seller approach – no other California-only approach is matched by such broad-based support.

On the other hand, the primary opposition to the first seller approach appears to come from publicly owned utilities, such as LADWP and SCPPA, who are the least dependent in the near term on transparent, well-functioning wholesale power markets. This appears to be because, by their own admission,<sup>5/</sup> LADWP and SCPPA are more “fully resourced” than other load-serving entities in California, partly due to their interests in out-of-state coal-fired power plants. LADWP and SCPPA appear to be less exposed currently to the electricity market distortions and opacity associated with a load-based cap, and thus more willing to embrace it as an alternative to the first seller approach.

PG&E does not begrudge that LADWP and SCPPA over the near term may have less dependence on dynamic forward power markets than other California utilities. However, over the longer term, that dependence is bound to grow, as the costs and regulatory constraints on high-emitting power plants force them to seek lower-emitting resources in open markets. And in the longer run, maintaining and enhancing the

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<sup>5/</sup> SCPPA Comments on Market Advisory Committee Report, August 6, 2007, p.2.

liquidity, reliability and competitiveness of forward power markets in California and the West is a high priority for the State as a whole. This is why the recommendations of the CAISO Market Surveillance Committee, on top of those of the Governor's Market Advisory Committee, are extremely important in this proceeding. Both support the first seller approach as providing a better foundation for wholesale power markets, and both identify significant conflicts between a load-based cap and a well-functioning wholesale power market.

For these reasons, PG&E recommends that the views of the CAISO Market Surveillance Committee, the Governor's Market Advisory Committee, and the broad spectrum of other supporters of the first seller approach be given great weight and precedence over the opposition of LADWP and SCPPA.

### **III. THE CONTINUED OPPOSITION OF LADWP TO THE FIRST SELLER APPROACH IS INCONSISTENT WITH ITS SUPPORT FOR A NATIONAL OR REGIONAL SOURCE-BASED APPROACH**

Another reason why the opposition of LADWP to the first seller approach should be discounted is that it apparently supports a source-based approach at the regional and federal levels.<sup>6/</sup> Two of the primary "selling points" of the first seller approach are that it is identical to a source-based approach for in-state generation, and that it is most easily expandable to a regional or national source-based program. Given these facts, the position of LADWP appears illogical and irreconcilable. PG&E can only speculate as to why LADWP advocates such mutually contradictory points of regulation under AB 32 and a national or regional program. However, the mutual contradiction is another reason why LADWP's opposition to the first seller approach should be given little credence.

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<sup>6/</sup> LADWP, p. 2; also Opening Comments on Market Advisory Committee Report, August 6, 2007, p. 9.

#### **IV. EPUC/CAC'S DESCRIPTION OF THE BENEFITS OF COMBINED HEAT AND POWER IS FLAWED**

EPUC/CAC include in their comments various policy recommendations on how combined heat and power (CHP) resources could play a positive role in achieving greenhouse gas emissions reductions under AB 32 if a cap-and-trade system is deferred.<sup>7/</sup> Among other things, EPUC/CAC propose that a portfolio "set-aside" be considered for CHP facilities, similar to the current Renewable Portfolio Standard.<sup>8/</sup> PG&E strongly disagrees with EPUC/CAC's characterization of the GHG reducing benefits of CHP, and therefore disagrees with EPUC/CAC's suggestion that policymakers mandate a "set-aside" for CHP resources. PG&E believes that, based on economic modeling of costs and benefits, CHP resources may be an ineffective and costly means of reducing GHG emissions. In fact, for a low emitting utility such as PG&E, the firm baseload product provided by CHP may crowd out other low or no carbon baseload and intermittent resources, and actually increase the overall carbon footprint of PG&E's low emitting portfolio. However, rather than engage in a more detailed debate on the merits in these comments, PG&E expects to provide its views on CHP in the economic modeling phase of this proceeding.

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<sup>7/</sup> EPUC/CAC, pp. 11- 12.

<sup>8/</sup> *Id.*, p. 12.

## **V. CONCLUSION**

For the reasons stated above PG&E recommends that the CPUC and Energy Commission adopt and recommend the first seller approach as the preferred type and point of regulation under AB 32.

Respectfully Submitted,

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By: \_\_\_\_\_/s/\_\_\_\_\_

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