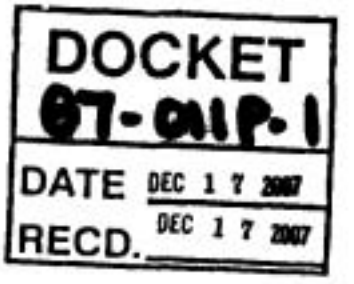
BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND THE CALIFORNIA ENERGY COMMISSION

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	CPUC Rulemaking 06-04-009 (Filed April 13, 2006) Energy Commission Docket 07-OIIP-01

COMMENTS OF KERN RIVER GAS TRANSMISSION COMPANY ON TYPE AND POINT OF REGULATION ISSUES FOR THE NATURAL GAS SECTOR



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Pursuant to the Administrative Law Judges' Ruling Requesting Comments on Type and Point of Regulation Issues for the Natural Gas Sector dated November 28, 2007, Kern River Gas Transmission Company (Kern River) respectfully submits these comments relating to regulation of greenhouse gas (GHG) emissions in the natural gas sector.

I. DISCUSSION

Kern River first observes that the term "Natural Gas Sector" is extremely broad and could encompass multiple aspects of natural gas production and supply. Kern River is an interstate natural gas pipeline that transports natural gas from receipt points in southwestern Wyoming and Utah to delivery points in Utah, Nevada and California. Kern River's original pipeline system was placed in service in 1992; significant expansion projects have been undertaken by Kern River in the ensuing years, in part to meet significant growth in demand for natural gas in California. The Kern River pipeline system currently totals 1,680 miles, with 154 miles in Wyoming, 712 miles in Utah, 276 miles in Nevada and 538 miles in California. Between 2004

and 2006, deliveries of natural gas through the Kern River pipeline system increased from 487,068 million dekatherms to 625,586 million dekatherms—more than a 28 percent increase in a three year period.

As an interstate transporter of natural gas, Kern River does not hold title to the gas it transports. Kern River transports natural gas owned by third parties to other pipelines, commercial facilities, electric power plants, industrial facilities, and local distribution companies in California. Kern River does not consume any gas within California in its operations or as an end user and therefore has no direct emissions of GHG in California. Indirect emissions, in the form of fugitive emissions, are de minimis, given the age of the Kern River pipeline. Kern River has no ability to influence the efficiency of the end use of gas. In the context of interstate natural gas pipelines, the Kern River system is akin to an interstate highway system—the roadway is there to enable travelers from one point to another; the roadway itself does not influence what travelers do once they reach their destination.

Kern River urges the California Public Utilities Commission, California Energy Commission, and the California Air Resources Board to carefully consider potential implications of regulation of the broadly-defined natural gas sector as it implements the requirements of Assembly Bill 32. California is already highly dependent on natural gas as the source of baseload electric generation—a situation exacerbated as a result of the adoption of the emissions performance standard requiring that all long term contracts and new generation meet an emissions performance standard for carbon dioxide of 1,100 lbs/MWh. California's population is projected to continue to increase. So, regardless of an aggressive renewable portfolio standard and additional energy efficiency and demand side management requirements, the state's demand for additional baseload electric supplies will increase. It is therefore critical to ensure that

natural gas supplies continue to be available at reasonable cost for all uses, including electric generation, industrial, commercial, and residential purposes.

II. Questions to be Addressed in Comments

General

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

Kern River believes that natural gas will serve as an important bridge fuel under any GHG regulatory scheme. The carbon footprint of the natural gas industry, and the natural gas transmission (i.e., pipeline) industry in particular, is minimal. Nationwide, natural gas pipelines account for less than 1 percent of GHG emissions. As such, Kern River does not believe that there is any incremental benefit to be realized as a result of regulating the natural gas pipeline segment of the natural gas sector.

Q2. Can a market-based system for the natural gas sector 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?

Kern River supports an economy-wide approach to GHG regulation that recognizes and accommodates the unique features of different sectors in the economy. However, California has already made significant policy decisions that encourage the use of natural gas over higher carbon alternatives. These policy decisions have made California highly dependent on natural gas for electricity generation. While there may be opportunities in California for end-use efficiency in the utilization of natural gas, it is difficult to conclude at this point that a market-based system for the natural gas sector in general would provide additional emissions reductions.

Basic Design Questions: Scope of GHG Regulation

Q4. Should GHG emissions from the natural gas sector be capped under AB32? Are there certain sources of emissions within the sector that should be exempt from an enforceable cap?

If GHG emissions from the natural gas sector are capped, emissions resulting from transport of natural gas should be exempt. As stated below in response Q5(c), gas transporters have adequate existing incentives to maximize efficiency and minimize emissions. Given California's growing population and its increasing use of natural gas in lieu of higher carbon alternatives, caps on GHG emissions from natural gas transportation could result in supply constraints to end users.

Q5. For each of the following sources of GHG emissions, state whether the sources described should be subject to an enforceable cap and, if so, whether the cap should be covered by a cap-and-trade approach or only by programmatic measures. For sources you recommend covering programmatically, what specific programmatic actions should be taken? For sources you recommend covering in a cap-and-trade program, are there specific programmatic measures that should be undertaken as complementary to the cap-and-trade program?

a. **Natural gas combustion in the residential, commercial, and small industrial segments of the natural gas sector.**

   Regulation of natural gas in the residential segment in California would be difficult, if not impossible, if what is contemplated, for example, is having every homeowner with a natural gas furnace subject to an enforceable cap.

b. **Natural gas combustion by natural gas vehicles.**

   Natural gas vehicles should not be subject to an enforceable cap implemented through a cap-and-trade approach.

c. **Combustion-related emissions from operating the infrastructure (including infrastructure related to proprietary operations) used to deliver natural gas to end users within the State.**

GHG emissions from the infrastructure used to transport natural gas should not be capped. Interstate natural gas pipelines commonly use a small percentage of the gas transported to fuel the compressors needed to transport the gas. The more efficient a pipeline's use of this gas, the more attractive its services are in the marketplace. Pipelines therefore have a powerful market incentive to minimize the amount of gas (and resultant emissions) necessary to transport gas. In addition, federal and local air permit regulations already govern the emissions of these compressors. Given California's increasing use of natural gas in lieu of higher carbon alternatives, caps on GHG emissions on natural gas transportation could result in supply constraints to end users, even where those end uses would result in lower emissions than alternatives. This additional layer of regulations could therefore conflict with California's existing policy encouraging the use of natural gas.

d. Fugitive emissions, including from pipelines, storage facilities, and compressor stations.

Fugitive emissions should not be subject to an enforceable cap implemented through a cap-and-trade program. By their very nature, fugitive emissions are difficult to measure and reduce. Rather, detecting and repairing leaks that reduce fugitive emissions should be incentivized and used as the basis for offset programs.

Q6. For the sources you recommend exempting from an enforceable cap, how would emission reductions be achieved?

See responses above.

Basic Design Questions: Point of Regulation

Q8. If you believe that the natural gas sector and other sources of emissions related to combustion of natural gas should be included in a cap or a cap-and-trade system, where should the compliance obligation be placed: upstream, as close to the fuel source as possible (for example, on natural gas processing plants and pipelines) or midstream/downstream (large point sources and, for smaller users, the local distribution company level)? If you suggest another option for assigning responsibility, please describe in detail.

Downstream cap and trade programs implemented for other pollutants have proven effective for large stationary sources; however, different approaches are needed for smaller emission sources since a conventional cap and trade program for these small sources would be too complex and unwieldy for regulators and consumers.

The compliance obligation should be placed at the point closest to the entity or segment most able to achieve reductions in the most economically feasible way with the lowest administrative burden. Kern River does not believe that the compliance obligation should be on interstate natural gas pipelines. Placing the point of compliance on natural gas pipelines would be akin to regulating electric transmission lines rather than the electricity generator or the user of electricity.

Deferral of a Market-based Cap-and-Trade System and Coordination with Other States

The next best use and the one that offers immediate opportunities for slowing carbon emissions growth and diversifying our fuel mix comes from government and private investments in energy efficiency, renewable energy, and increasing the efficiency of our existing fossil fuel generation. What we should seek to avoid, however, is enacting rules that will force our customers, your constituents, to spend money on short-term emissions reductions that do not provide a long-term path to a low carbon future.

Q11. In developing recommendation to ARB, should the Public Utilities Commission and the Energy Commission give consideration to actions other states may take regarding the regulation of natural gas sector GHG emissions? If so, how?

Kern River believes that the Public Utilities Commission and Energy Commission should give consideration to actions other states may take regarding regulation of natural gas sector GHG emissions. Failing to do so has the potential to put significant pressure on natural gas

supplies and costs that may disproportionately impact natural gas users in California or restrict the ability to participate in a multi-state trading system.

Q12. Is it important that the regulation of California natural gas sector GHG emissions be consistent with actions taken by other states?

Yes. See response to Question 11.

Q13. Would deferral of a cap-and-trade program for the natural gas sector facilitate or hinder California's integration into a subsequent regional or federal program?

Kern River does not believe that deferral of a cap-and-trade program would hinder California's integration into a subsequent regional or federal program, and, in fact, deferral now may ease integration into subsequent programs.

Q14. 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 natural gas sector? If so, how long should California wait for other systems to develop before acting alone?

Kern River disagrees with the fundamental premise of this question - that California should proceed with a cap-and-trade system for the natural gas sector to the exclusion of other potential methods to reduce GHG emissions. Kern River also takes issue with the overly-broad definition of "natural gas sector." As stated previously herein, Kern River believes that natural gas is an important bridge fuel as technology development advances to integrate low-carbon technologies. As such, California should wait until such time as these technologies are commercially available and deployable at a reasonable cost before regulating GHG emissions from the natural gas sector.

A15. If a market-based cap-and-trade system is not implemented for the natural gas sector in 2012, how would you recommend addressing early actions that entities may undertaken in anticipation of a market?

Consideration should be given to providing credit or offset value for verifiable early actions to reduce GHG emissions, such as those that are implemented under the Environmental Protection Agency's Natural Gas STAR program.

Relationship to GHG Regulatory Approach in the Electricity Sector

Q16. For purposes of natural gas GHG regulation under AB 32, does it matter what is decided regarding electricity sector type and point of regulation? For example, would a load-based cap for the electricity sector necessitate a similar type of cap for the natural gas sector, with local distribution companies as the point of regulation? If applicable, explain the relationships you see between the electricity and natural gas sectors for AB 32 purposes.

As stated previously, downstream cap and trade programs implemented for other pollutants have proven effective for large stationary sources. However, a cap and trade program on the natural gas sector if combined with a cap and trade system on the electricity sector would amount to a double enforcement on natural gas fired plants generating electricity, especially if "natural gas sector" is read to include natural gas transportation.

Q17. If the electricity sector is not included in a California (or wider) cap-and-trade system, could/should the natural gas sector be included? What are your reasons?

The natural gas sector in general and the natural gas transmission sector in particular should not be included in a cap and trade system regardless of whether the electricity sector is included in a similar system. The natural gas sector is not in a position to control or influence the efficiency with which delivered gas is consumed by end users. While existing market pressures provide incentives for gas transporters to minimize the volume of gas consumed in transport (and resultant emissions), total emissions from transport are driven primarily by the volume of gas transported, not the efficiency of the transporter. Given California's preference for natural gas over higher carbon alternatives, the volumes transported and emissions from

transportation may reasonably be expected to increase. An additional layer of regulations on the transport of gas could result in gas supply constraints and thereby conflict with existing policy encouraging the use of natural gas.

Q18. What implications might there be for fuel switching if GHG emissions for one sector (electricity or natural gas) are capped and GHG emissions for the other sector are not? Would such fuel switching likely lead to an overall decrease, or increase, in GHG emissions?

The implications of fuel switching are integral to any consideration of emissions caps in the electricity or natural gas sector. Through its adoption of the emissions performance standard requiring all long term contracts and new generation to meet an emissions performance standard for carbon dioxide of 1,100 lbs/MWh, the state of California has established a policy preference for natural gas over higher carbon alternatives. Caps on emissions from natural gas transportation could lead to restrictions in natural gas supply, which could result in usage of higher carbon alternatives and more resultant emissions.

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