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07-OIIP-1	
DATE	DEC 17 2007
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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the
Commission's Procurement Incentive Framework and to
Examine the Integration of Greenhouse Gas Emissions
Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

California Energy Commission Docket #07-OIIP-01

**REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL
(NRDC), UNION OF CONCERNED SCIENTISTS (UCS), AND GREEN POWER
INSTITUTE (GPI) ON TYPE AND POINT OF REGULATION ISSUES**

December 17, 2007

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I. Introduction and Summary

The Natural Resources Defense Council (NRDC), Union of Concerned Scientists (UCS), and Green Power Institute (GPI) respectfully submit these reply comments in accordance with the "Administrative Law Judges' Ruling Requesting Comments on Type and Point of Regulation Issues" (ALJ Ruling), dated July 19, 2007; the "Administrative Law Judges' Ruling Extending Comment Deadlines and Addressing Procedural Matters," dated November 30, 2007, extending the commenting schedule; and pursuant to Rules 1.9 and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure. NRDC/UCS also concurrently submit these comments to the California Energy Commission (CEC) in Docket #07-OIIP-01, the CEC's sister proceeding to this CPUC proceeding.

NRDC is a non-profit membership organization with a long-standing interest in minimizing the societal costs of the reliable energy services that a healthy California economy needs. In this proceeding, NRDC represents its more than 124,000 California members' interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. UCS is a leading science-based non-profit working for a healthy environment and a safer world. Its Clean Energy Program examines the benefits and costs of the country's energy use and promotes energy

solutions that are sustainable both environmentally and economically. GPI is the renewable energy program of the Pacific Institute, a leading environmental research and advocacy institution that is active in water and energy issues. The GPI has performed pioneering research on the greenhouse gas implications of renewable energy production.

NRDC/UCS continue to believe that California could successfully implement a cap-and-trade program in the electricity sector using either a load-based, first seller, or “hybrid” approach. We urge policymakers to prioritize the relevant criteria, as the appropriate choice for the point of regulation will fall from this prioritization. Further, we urge the CPUC/CEC and CARB to quickly settle on a point of regulation and proceed to developing the more important components of the program – including establishing a tight cap that achieves real emission reductions, distributing allowances in the public interest, and providing strong enforcement.

In these comments, we respond to opening comments filed by parties on December 3, 2007 on the type and point of greenhouse gas (GHG) regulation for the electricity sector to inform the Commissions’ recommendation to the California Air Resources Board (CARB).¹ In order to avoid repeating earlier comments, we do not respond to repeated arguments from parties, and simply incorporate by reference our previous comments.² In summary, our reply comments elaborate on the following key points:

- ◆ There is general consensus among the parties that California should lead and quickly move forward with a cap and trade program, rather than waiting to see how regional and/or federal programs may develop.

¹ These parties included, among others: Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas and Electric Company and Southern California Gas Company (SDG&E/SCG), Division of Ratepayer Advocates (DRA), Southern California Public Power Authority (SCPPA), Los Angeles Department of Water and Power (LADWP), Sacramento Municipal Utility District (SMUD), Western Power Trading Forum (WPTF), Morgan Stanley Capital Group Inc. (MSCG), PacifiCorp, Independent Energy Producers Association (IEP), Constellation New Energy, Inc., and Constellation Energy Commodities Group, Inc. (Constellation), Calpine Corporation (Calpine), Energy Producers and Users Coalition/Cogeneration Association of California (EPUC/CAC), Alliance for Retail Energy Markets (AREM).

² “Opening Comments of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on the ‘First Seller’ Approach and Other Recommendations of the Market Advisory Committee Report,” August 6, 2007; “Reply Comments and Reply Brief of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on the ‘First Seller’ Approach,” August 15, 2007; and “Opening Comments of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on Type and Point of Regulation Issues,” December 3, 2007.

- ◆ The Commissions have an adequate record to decide the point of regulation for a cap and trade program.
- ◆ California should strive to establish a model on the most important design elements of a cap and trade program, such as establishing a tight cap that achieves real emission reductions, distributing allowances in the public interest, and providing strong enforcement.
- ◆ If the Commissions defer a cap and trade program, contrary to our recommendation, we agree with LADWP that the Commissions should recommend caps on individual retail providers, in order to achieve AB 32's statewide limit on GHG emissions.
- ◆ The Commissions should expand regulatory programs to complement a cap and trade program.
- ◆ A load-based cap provides stronger incentives for investments in energy efficiency and renewable energy – the two most important currently available strategies for achieving long-term emissions reductions.
- ◆ The Commissions should continue to focus on the criteria where the various points of regulation differ in order to rule on this issue.

II. There is general consensus among the parties that California should lead and quickly move forward with a cap and trade program, rather than waiting to see how regional and/or federal programs may develop.

Irrespective of the different points of regulation advocated by the parties, there is general consensus that California should take a leadership role and move forward with its pursuit of a cap and trade program (e.g., Constellation at 17, DRA at 22-23, GPI at 9, IEP at 5 and 13, PG&E at 27, SCE at 16, SCPA at 35,-36, WPTF at 1). As LADWP notes, “California has identified itself as a leader in reducing greenhouse gas emissions,”³ and Calpine also notes, “Assembly Bill (‘AB’) 32 clearly expects the State to take a leadership role with respect to the reduction of GHG emissions and set an example for other states, and the nation, to follow.”⁴ Given this general consensus for action, we urge the Commissions to eliminate the “complete deferral” option of simply waiting for a regional and/or federal program and instead move forward in designing a GHG cap and trade program, while continuing to participate in both regional and federal discussions.

³ LADWP at 23.

⁴ Calpine at 2.

III. The Commissions have an adequate record to decide the point of regulation for a cap and trade program.

DRA states that “the CO₂RC methodology presented by Western Resource Advocates (WRA) is a compelling one that merits further exploration”⁵ and suggests a further assessment of the CO₂RC method by the Market Advisory Committee and additional opportunity for parties to comment.⁶ This delay is not necessary. Rather than representing an entirely different point of regulation than those already being considered in this proceeding, the CO₂RC proposal is another method of implementing a load-based point of regulation. The CO₂RC proposal is very similar to the load-based system with tradable emission attribute certificates (TEACs) proposed by the Western Power Trading Forum, with allocation of GHG allowances to retail providers.

Since the CO₂RC proposal is fundamentally a load-based approach, it possesses many of the same pros and cons of a load-based point of regulation approach that NRDC/UCS identified in their opening comments.⁷ In addition, the CO₂RC proposal does not eliminate the dispute over allowance distribution. DRA, referring to the WRA paper, claims that a distinct advantage of the CO₂RC proposal over other options is that it “eliminates the need to determine allowance allocations in a fair and equitable manner.”⁸ However, the CO₂RC proposal still raises the same issues that have already been discussed in parties’ comments on allowance allocation. In effect, the CO₂RC proposal changes only the metrics, and not the substance, of the allowance allocation debate. Under the CO₂RC proposal, the debate simply shifts from the number of allowances each retail provider should receive to the number of CO₂RCs that each retail provider is required to hold for GHG compliance.

The Commissions now have an extensive record from parties’ comments on the merits of a load-based point of regulation. Rather than expending additional time to consider the CO₂RC method, the Commissions should quickly decide upon a point of regulation based on the existing record. If the Commissions choose to pursue a load-based approach, there will still be additional time in this proceeding to consider the

⁵ DRA at 1.

⁶ DRA at 25.

⁷ For a summary of the performance of the load-based approach under various criteria, see NRDC/UCS’ December 3, 2007 opening comments, p. 23-24.

⁸ DRA at 24.

benefits of pursuing a CO₂RC method or other emissions tracking mechanism in implementing the load-based approach. We urge the Commissions to decide upon a point of regulation based on the existing record in this proceeding, and then proceed to develop the other critically important components of the program – including establishing a tight cap that achieves real emission reductions, distributing allowances in the public interest, and providing strong enforcement.

IV. California should strive to establish a model on the most important design elements of a cap and trade program, such as establishing a tight cap that achieves real emission reductions, distributing allowances in the public interest, and providing strong enforcement.

Several parties note the importance of California serving as a model and integrating into a future federal cap-and-trade program (e.g., PG&E, SCE, SDG&E/SCG, DRA, Constellation, WPTF, Morgan Stanley). Although, like many parties, we believe the future federal program will most likely be source based, the primary federal bill to cap global warming emissions that is currently moving forward in Congress (S. 2191, the Lieberman-Warner Climate Security Act) has a point of regulation for the electric sector different from any being considered in this proceeding.⁹ Regardless of the point of regulation selected at the federal level, if the system is of comparable stringency, we believe that it will be in California's best interest to integrate with the federal cap and trade program (and not maintain a separate one based on a different regulatory model), while of course continuing the state's traditional role in administering the many programs that directly spur global warming solutions (such as aggressive energy efficiency programs and standards, renewables procurement, etc.). We urge the Commissions to strive to establish a model on the most important design elements of a cap and trade program (e.g., establishing a tight cap that achieves real emission reductions, distributing allowances in the public interest, and providing strong enforcement), rather than putting

⁹ The Lieberman-Warner Climate Security Act was approved by the U.S. Senate Environment and Public Works Committee on December 5, 2007. In it, the point of regulation for the electricity sector differs depending on the fuel source; any electricity generator facility that uses more than 5000 tons of coal would be regulated, and natural gas, including that used for electricity generation, would be regulated upstream at the processors.

too much effort into trying to predict the ultimate point of regulation for a federal program.

V. If the Commissions defer a cap and trade program, contrary to our recommendation, we agree with LADWP that the Commissions should recommend caps on individual retail providers, in order to achieve AB 32's statewide limit on GHG emissions.

LADWP states that “a load-based approach could be implemented under a direct regulation strategy” that would involve placing caps on the retail providers in the state but not allow trading of allowances between entities. If the Commissions decide to defer a cap and trade program, contrary to our recommendation, we agree with LADWP that the Commissions should recommend caps on individual retail providers' GHG emissions. Reliance on intensity-based programmatic regulations alone may not be sufficient to ensure that the statewide limit on absolute emissions established by AB 32 is met. Individual entity caps, coupled with strong enforcement of those caps, would provide certainty that the GHG emissions reductions required by AB 32 are indeed met. As no party recommends complete deferral of any capped program, we recommend the Commissions remove this option from consideration.

VI. The Commissions should expand regulatory programs to complement a cap and trade program.

In their comments, some parties seem to assume that the state will adopt a cap-and-trade program or regulatory programs, but not both. Many parties who advocate a cap-and-trade approach state that this should be the primary means of achieving emissions reductions, and that it is superior to regulatory programs (e.g., AReM at 2; Constellation at 2 and 11; PG&E at 26; SDG&E at 13, 14). However, as NRDC/UCS explained in our opening comments, any cap-and-trade program should be part of an integrated package of policies to meet the AB 32 statewide limit and would be expected to contribute a relatively small portion of the overall emission reductions needed to meet the 2020 limit. Under any point of regulation approach laid out in the ALJ Ruling, regulatory programs will be needed and also should be expanded to reduce customer

costs, ensure maximum GHG emissions reductions, advance technologies, and meet other goals outlined in AB 32. We support PacifiCorp's call for "more stringent energy efficiency mandates" (p. 3), in addition to other expansions of regulatory programs, including those suggested in NRDC/UCS' December 3, 2007 opening comments.¹⁰

VII. A load-based cap provides stronger incentives for investments in energy efficiency and renewable energy – the two most important currently available strategies for achieving long-term emissions reductions.

Van Horn Consulting provides three papers that present arguments in favor of a source-based or first-seller point of regulation.¹¹ Many of the specific arguments advanced in the papers have previously been submitted in this proceeding by proponents of source-based regulations, and we do not repeat our earlier responses to those arguments here. We focus on the papers' claims in regards to one of the highest priority criteria that we support, goal attainment. We appreciate the efforts of the authors of these papers to advance the discussion on the point of regulation in California, but are concerned by the undue emphasis the authors place on short-term competitive market dynamics and emissions reductions at existing sources, rather than focusing on the long-term, retail provider-driven investments that are necessary to achieve the deep emissions reductions required in 2020 and beyond. We also disagree with the notion that a source-based approach will result in the same level of retail provider investment in energy efficiency and renewable energy as a load-based approach.

Dallas Burtraw's paper contends that a load-based approach would diminish the incentives to reduce emissions at existing sources through biomass cofiring, heat rate improvements, and changes to unit dispatch.¹² Although a source-based approach may create stronger incentives for generating companies to harvest such emission reduction opportunities at existing facilities, the ambitious goals of AB 32 cannot be accomplished by marginal, near-term changes to the existing operations of California's generating supply. To the contrary, the two most significant, currently available strategies for enabling long-term emissions reductions in the electric sector – energy efficiency and

¹⁰ NRDC/UCS at 13-14, and GPI at 9.

¹¹ Van Horn Consulting Attachments A, B, and C.

¹² Van Horn Consulting Attachment B at 14.

renewable energy – both require fundamental changes to organizational choices for investments by retail providers. A load-based approach – by placing the compliance responsibility on retail providers and thus creating additional incentive for them to identify low-cost emission reduction opportunities among their choices from the full range of demand and supply-side investments available to retail providers in California and the west – is the best way to maximize investments in these long-term emissions reduction strategies.

The members of the Market Surveillance Committee paper “see no reason why California’s regulated utilities will be more likely to pursue these newly cost-effective [energy efficiency] programs under one emissions regulatory system than another,” given the extensive regulations and incentives that already exist in California.¹³ This argument ignores the reality of utility behavior under regulation. A load-based approach is more likely to result in greater utility investment in energy efficiency for the same reason that a source-based approach is more likely to result in greater generator investment in heat rate improvements. Entities will respond to direct regulation by more aggressively pursuing emissions reduction strategies that are within their control. Until California retail providers harvest 100% of the cost-effective efficiency potential in the state – a goal that is still far from reality – there will exist additional opportunities to achieve low cost emissions reductions. A load-based approach directly regulates retail providers, including publicly owned utilities that have historically underinvested in efficiency compared to their IOU counterparts, and will maximize energy efficiency investments that will enable California to meet AB 32 emissions limits at the least possible cost.

VIII. The Commissions should continue to focus on the criteria where the various points of regulation differ in order to rule on this issue.

Some parties suggest additional criteria beyond those listed by the ALJ Ruling to be considered in evaluating the different type and point of regulation approaches – e.g., grid reliability (NCPA at 2), fairness (SCPPA at 10), technological innovation (PG&E at 4). While these are important factors the Commissions should consider in designing the overall program, the Commissions should only consider these additional criteria in the

¹³ Van Horn Consulting Attachment C at 6.

current phase if the various point of regulation approaches differ with respect to these factors. In other words, additional criteria are only useful in this phase if they assist the Commissions in determining the best point of regulation.

IX. Conclusion

NRDC, UCS, and GPI appreciate the Commissions' efforts to examine the various approaches proposed for regulating the GHG emissions of the electric sector, and we urge the Commissions and CARB to settle the point of regulation as quickly as possible and proceed to address the more important design elements, including the level of the cap, allowance distribution, and enforcement.

Dated: December 17, 2007

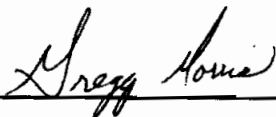
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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Reply Comments of the Natural Resources Defense Council (NRDC), Union of Concerned Scientists (UCS), and Green Power Institute (GPI) on Type and Point of Regulation Issues"** in the matter of **R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on December 17, 2007 at San Francisco, California.



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