

DOCKET**07-OIIP-1**DATE MAR 04 2008RECD. MAR 04 2008**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

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

AB 32 Implementation

CEC Docket
07-OIIP-01

**REPLY COMMENTS OF THE ENERGY PRODUCERS AND USERS COALITION
AND THE COGENERATION ASSOCIATION OF CALIFORNIA
REGARDING INTERIM OPINION ON GREENHOUSE GAS REGULATORY
STRATEGIES**

Michael Alcantar
Donald Brookhyser
Alcantar & Kahl LLP
1300 SW Fifth Avenue
Suite 1750
Portland, OR 97201
503.402.9900 office
503.402.8882 fax
mpa@a-klaw.com
deb@a-klaw.com

Counsel to the
Cogeneration Association of California

Evelyn Kahl
Seema Srinivasan
Alcantar & Kahl LLP
120 Montgomery Street
Suite 2200
San Francisco, CA 94104
415.421.4143 office
415.989.1263 fax
ek@a-klaw.com
sls@a-klaw.com

Counsel to the
Energy Producers and Users Coalition

March 4, 2008

**REPLY COMMENTS OF THE ENERGY PRODUCERS AND USERS COALITION
AND THE COGENERATION ASSOCIATION OF CALIFORNIA
REGARDING INTERIM OPINION ON GREENHOUSE GAS REGULATORY
STRATEGIES**

The Energy Producers and Users Coalition¹ and the Cogeneration Association of California² (jointly, EPUC/CAC) submit the following reply comments on the Interim Opinion on Greenhouse Gas Regulatory Strategies pursuant to the February 8, 2008 proposed decision (PD).

I. OVERVIEW AND SUMMARY OF RECOMMENDATIONS

The opening comments highlight the need to consider allowance distribution issues comprehensively and in more detail before any recommendations are made to the California Air Resources Board. In particular, the comments observe that the impacts of an auction on system reliability and price stability have not been adequately evaluated. Deferring consideration of these issues to allow comprehensive recommendations in the Commission's next decision will not delay AB 32 implementation. Instead, additional consideration of these issues will promote compliance with AB 32 objectives. As such, the Commission should refrain from making recommendations on allowance distribution issues until the record is further developed.

¹ EPUC is an ad hoc group representing the electric end use and customer generation interests of the following companies: Aera Energy LLC, BP West Coast Products LLC, Chevron U.S.A. Inc., ConocoPhillips Company, ExxonMobil Power and Gas Services Inc., Shell Oil Products US, THUMS Long Beach Company, Occidental Elk Hills, Inc., and Valero Refining Company – California.

² CAC represents the combined heat and power and cogeneration operation interests of the following entities: Coalinga Cogeneration Company, Mid-Set Cogeneration Company, Kern River Cogeneration Company, Sycamore Cogeneration Company, Sargent Canyon Cogeneration Company, Salinas River Cogeneration Company, Midway Sunset Cogeneration Company and Watson Cogeneration Company.

II. CONCERN EXPRESSED IN COMMENTS ON ALLOWANCE DISTRIBUTION ISSUES HIGHLIGHTS THE PREMATURE NATURE OF AN AUCTION RECOMMENDATION

The parties' opening comments highlight issues that the Commission has failed to address in making its recommendation for a partial auction. As noted below, the impact of an auction on generators in existing or administratively-determined contracts and on allowance price stability will impact the success of the GHG program.

A. Failure of the PD to Address Impact of an Auction on Generators in Existing and Administratively-Determined Contracts Can Threaten System Reliability

The PD's premature recommendation in favor of a partial auction can impact system reliability in contravention of AB 32 objectives. AB 32 specifically requires the Commission to design a GHG regulatory scheme taking system reliability into consideration:

*It is the intent of the Legislature that the State Air Resources Board design emissions reduction measures to meet the statewide emissions limits for greenhouse gases established pursuant to this division in a manner that minimizes costs and maximizes benefits for California's economy, improves and modernizes California's energy infrastructure and **maintains electric system reliability**, maximizes additional environmental and economic co-benefits for California, and complements the state's efforts to improve air quality.³*

Like EPUC/CAC, IEP notes that the PD does not address the impact of an auction on generators in existing contracts.⁴ In particular, IEP notes that the failure of the Commission to address this issue could impact “up to 10,000MW of QF power

³ Cal. Health & Safety Code § 38501(h) (emphasis added).

⁴ IEP Comments on PD, at 7.

(cogeneration and renewable) for the duration of their existing contracts.”⁵ It further notes that these resources provide grid reliability, promote California’s renewable portfolio standard goals and provide clean power for the state.⁶ Sempra Global additionally observes that the ability of a regulated entity to comply with GHG mandates could have serious implications on the energy sector and the economy.⁷ Finally, the WTPF and AReM, concerned about the impact of auctions on generators, voice the need for further consideration of these issues.⁸ In short, an auction can have a significant impact on the availability of generators in existing contracts or subject to administrative contracts. Since AB 32 requires the consideration of system reliability in designing the state’s GHG regulatory scheme, it is necessary to address this issue before recommending an auction.

B. Failure of the PD to Adequately Address Impacts of Partial Auction on Allowance Price Stability Can Impact the Ability of a Cap-and-Trade Market to Provide Cost-Effective Emissions Reductions

The PD recommends a partial auction, in part, on the basis that certain flexible compliance mechanisms will temper allowance price volatility.⁹ The PD does not, however, evaluate the efficacy of these compliance mechanisms. As explained below, the failure to adequately address the threat of price volatility can adversely impact the usefulness of the cap-and-trade program to further AB 32 objectives.

The PD observes that several measures can be used to mitigate price volatility of allowances in an auction.¹⁰ In particular, the PD observes that the use of

⁵ *Id.*

⁶ *Id.*

⁷ Sempra Global Comments on PD, at 3-4.

⁸ WTPF and AReM Comments on PD, at 5.

⁹ See PD, at 7 and 85.

¹⁰ See *id.*

“flexible compliance alternatives,” such as banking or borrowing of allowances, allowance price floors or ceilings and offsets, can be used to temper allowance price volatility.¹¹ Like EPUC/CAC, NRDC observes that the mitigation tools, referenced in the PD, have not been adequately evaluated:

Since flexible compliance mechanisms, including offsets, have not been fully discussed in this proceeding and are reserved for a later portion of this proceeding, the PD should not prejudge the use of offsets in a cap-and-trade system.

As further noted by NRDC, the PD itself states that it will “*continue to explore these options and plan to address them in a later decision in this proceeding.*” Given that the Commission has not adequately evaluated the tools proposed to mitigate price volatility, it is not clear that these tools can indeed limit price volatility. Price volatility can significantly impact an entity’s willingness to rely on the cap-and-trade market as a compliance tool. This, in turn, can directly impact the state’s ability to achieve AB 32 mandates.

To ensure that the cap-and-trade market will result in cost-effective GHG reductions, it is necessary to evaluate the ability of the referenced flexible compliance mechanisms to temper allowance price volatility. To allow for such an evaluation the Commission must develop a record on this issue and include its recommendations in a future decision. Pending this additional consideration, recommendations in support of an auction are premature.

III. DEFERRING CONSIDERATION OF ALLOWANCE DISTRIBUTION ISSUES TO NEXT COMMISSION DECISION WILL NOT DELAY AB 32 IMPLEMENTATION

The PD notes that allowance distribution issues will be addressed in more detail in its next decision following the Commission’s efforts to secure more

¹¹ See *id.*

information on these important issues.¹² This indicates that deferring consideration of allowance distribution recommendations will not delay the implementation of AB 32. In fact, the above discussion demonstrates that there are several issues that the Commission must still consider in order to conclude that an auction would *promote* AB 32 objectives. In short, there is good reason for the Commission to defer its consideration of allowance distribution issues.

Respectfully submitted,

A handwritten signature in black ink that reads "Evelyn Kahl". The signature is written in a cursive, flowing style.

Evelyn Kahl
Michael Alcantar

Counsel to the Energy Producers and
Users Coalition and the Cogeneration
Association of California

March 4, 2008

¹² See PD, at 85-86.

CERTIFICATE OF SERVICE

I, Karen Terranova hereby certify that I have on this date caused the attached **Reply Comments of the Energy Producers and Users Coalition and the Cogeneration Association Of California Regarding Interim Opinion on GHG Regulatory Strategies** in R.06-04-009 to be served to all known parties by either United States mail or electronic mail, to each party named in the official attached service list obtained from the Commission's website, attached hereto, and pursuant to the Commission's Rules of Practice and Procedure.

Dated March 4, 2008, at San Francisco, California.

A handwritten signature in dark ink, appearing to read "Karen Terranova", with a long horizontal flourish extending to the right.

Karen Terranova