**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) AND THE UNION OF CONCERNED SCIENTISTS (UCS) ON THE PROPOSED "INTERIM OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES"

March 4, 2008

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1. Introduction and Summary

The Natural Resources Defense Council (NRDC) and the Union of Concerned Scientists (UCS) respectfully submit these reply comments, in accordance with Rules 14.3, 1.9, and 1.10 of the California Public Utilities Commission's (CPUC or Commission) Rules of Practice and Procedure, on the February 8, 2008 proposed decision of President Peevey and Chairman Pfannenstiel, "Interim Opinion on Greenhouse Gas Regulatory Strategies" (Proposed Decision or PD). The PD presents the Commissions' recommendations to the California Air Resources Board (CARB) for the greenhouse gas (GHG) emission regulatory strategies for the electricity and natural gas sectors under AB 32. 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.

In these comments, we reply to parties' opening comments on the PD submitted on February 28, 2008. We continue to strongly urge the Commissions to revise the PD to recommend that the natural gas sector be included in a multi-sector cap-and-trade system, *in addition to* the PD's current recommendations to expand regulatory programs. We also urge the Commissions to clarify that all allowance distribution options will be considered in the next phase of the proceeding. In summary:

- Most parties agree that the natural gas sector should be included in a multi-sector cap-and-trade program, in addition to regulatory programs for the sector.

- The PD should be modified to acknowledge the legitimate concerns of several parties about various allowance distribution options and should clarify that these concerns will be considered in the next phase of this proceeding.
- Many parties agree that a 33% RPS is a necessary complementary policy to a cap-and-trade program for the electricity sector.

2. Most parties agree that the natural gas sector should be included in a multi-sector cap-and-trade program, in addition to regulatory programs for the sector.

Of the twelve other parties who commented on natural gas in their opening comments, most agree with NRDC/UCS that the natural gas sector should be included in a cap and trade system, in addition to regulatory programs for the sector.[1] Many of these parties mention the benefits of the added liquidity and flexibility of including the natural gas sector in a cap-and-trade program,[2] and several mention the many options for emission reductions that exist in the natural gas sector.[3] FPL Energy and Environmental Defense also agree with NRDC/UCS that the PD's statement that CARB has not yet developed reporting protocols for natural gas is an insufficient rationale for excluding the sector from a cap-and-trade program.[4]

Even PG&E, one of the few parties that supports excluding the natural gas sector, enumerates the benefits of a "multi-sector cap and trade program."[5] In order to truly be a multi-sector program, a cap-and-trade program must include more than the electricity sector. The parties are largely in agreement that the Commissions should recommend that ARB include the natural gas sector in a multi-sector cap-and-trade program, in addition to programmatic strategies for the sector, and the PD should be amended in this regard.

[1] *See* Southern California Edison Comments, 7 (Feb. 28, 2008); Southern California Public Power Authority Comments, 13 (Feb. 28, 2008); Indicated Producers Comments, 1-2 (Feb. 28, 2008); Independent Energy Producers Comments, 10-11 (Feb. 28, 2008); FPL Energy Comments, 6 (Feb. 28, 2008); Environmental Defense Comments, 4 (Feb. 28, 2008); Community Environmental Council Comments, 6 (Feb. 28, 2008); *See also* PG&E Comments, 6 (Feb. 28, 2008). In addition, EPUC/CAC suggested that CHP should be included in a cap-and-trade program as its own sector. *See* EPUC/CAC Comments, 2, 4 (Feb. 28, 2008).
[2] *See* Southern California Edison Comments, 6 (Feb. 28, 2008); Indicated Producers Comments, 1-2 (Feb. 28, 2008); Independent Energy Producers Comments, 11 (Feb. 28, 2008); FPL Energy Comments, 6 (Feb. 28, 2008).
[3] *See* Southern California Edison Comments, 7 (Feb. 28, 2008); Southern California Public Power Authority Comments, 13 (Feb. 28, 2008); Community Environmental Council Comments, 6 (Feb, 28, 2008).
[4] FPL Energy Comments, 6 (Feb. 28, 2008); Environmental Defense Comments, 4 (Feb. 28, 2008).
[5] PG&E Comments, 2 (Feb. 28, 2008).

3. The PD should be modified to acknowledge the legitimate concerns of several parties about various allowance distribution options and should clarify that these concerns will be considered in the next phase of this proceeding.

Although we continue to support auctions as the preferable method of allowance distribution, we also recognize the legitimate concerns raised by several parties about auctions, regardless of how large a role any auction may have in the final program design. These parties who express concern about auctions in their opening comments include the Los Angeles Department of Water and Power (LADWP), the Northern California Power Agency (NCPA), California Municipal Utilities Association (CMUA), and the Southern California Public Power Authority (SCPPA). LADWP objects to auctions because it is concerned that revenues will be "recycled to other sector or out-of-sector participants and away from municipal activities to reduce GHG emissions."[6] SCPPA is concerned that for publicly-owned utilities (POUs) who are both deliverers and retail providers, "payments for emission allowances would represent an additional cost to the POUs that would not contribute in any way to reducing their earlier footprint. The money spent on allowances would represent nothing more than a wealth transfer away from the POUs to whomever might receive auction proceeds."[7] NCPA argues for "considering the implications of the auction structure and governance" and "any allocation methodology not result in a shift of costs to utilities that have already expended considerable resources in procuring low-GHG emitting resources."[8] The PD should acknowledge these concerns raised by several parties, and explicitly state that these concerns and potential solutions merit further analysis and will be explored further in the next phase of the proceeding.

We believe that in any allowance distribution system, the allowance value should be used for public benefits and the purposes of AB 32. We agree with several parties, including LADWP, that the primary focus of the cap-and-trade program should be to achieve emission reductions and that the revenues collected from an auction should not be diverted from those and other purposes of AB 32. Thus, we urge the Commissions to clarify in the PD that a substantial portion of auction proceeds should be used in ways that achieve emission reductions and benefit electricity customers in California. Accordingly, we also urge the Commissions to modify the

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[6] LADWP at 9.
[7] SCPPA at 5.
[8] NCPA at 7, 8.

PD to emphasize the need to design any auction to avoid a simple transfer of funds to the state's general fund.

In order to address the concerns raised by LADWP and others regarding the potential transfer of auction revenues to other parties or sectors and their desire to invest in GHG emissions reductions in their own service territory, we urge the Commissions to specifically request comment from parties on the self-directed compliance option presented by NRDC/UCS earlier in this proceeding that attempted to address this distributional issue and how to ensure that proceeds will be used to benefit electricity consumers.[9] In this "use it or lose it" proposal, auction funds would never leave a retail provider who is also a deliverer and instead be reserved for the retail provider's investments in GHG emission reductions, subject to oversight and verification that the investments meet appropriate criteria guided by AB 32.

While still acknowledging the potential benefits of and role for auctions, the PD should be modified to explicitly state that it will not prejudge the discussions about allowance distribution options that will occur in the next phase of the proceeding and that the concerns of all parties, along with potential solutions to these concerns, will carefully considered.

4. Many parties agree that a 33% RPS is a necessary complementary policy to a cap-and-trade program for the electricity sector.

Many parties, including the Center for Energy Efficiency and Renewable Technologies (CEERT), California Wind Energy Association/Abengoa Solar/Ausra/Brightsource Energy (CalWEA et al.), Green Power Institute, and Community Environmental Council, agree with NRDC/UCS that a 33% Renewables Portfolio Standard (RPS) is necessary to meet AB 32 and the state's other public policy goals. CalWEA et al. states that a 33% RPS will "promote the confidence the [renewable energy] industry needs to make a strong commitment to California for the next twelve years" and "put greater emphasis on the need to plan the rest of the system accordingly."[10] As CEERT also notes, "the benefits of renewables are not limited solely to creating an energy supply that reduces GHG emissions."[11] Thus, the PD should be modified to recommend the adoption of a statewide 33% RPS as an essential complementary policy to the electric sector cap-and-trade program.

[9] See NRDC/UCS Comments on Allowance Allocation Issues, October 31, 2007, pp. 10 and 21.
[10] CalWEA et al. at 5 and 6.
[11] CEERT at 6.

5. Conclusion

NRDC/UCS appreciate the opportunity to submit these reply comments on the Proposed Decision. Along with most parties, we urge the Commissions to modify the PD to recommend that CARB include the natural gas sector as part of a cap-and-trade program, in addition to implementing programmatic strategies within the sector, to meet the AB 32 goals. We urge the Commissions to adopt the PD with the modifications discussed herein, at their upcoming meetings on March 12 and 13, 2008 and then proceed to expand the programmatic strategies and to develop the more important components of the cap and trade program – including distributing allowances in the public interest, establishing a tight cap that achieves real emission reductions, and providing strong enforcement.

Dated: March 4, 2008

Respectfully submitted,

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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) and the Union of Concerned Scientists (UCS) on the Proposed 'Interim Opinion on Greenhouse Gas Regulatory Strategies'" 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 March 4, 2008 at San Francisco, California.

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