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

STATE OF CALIFORNIA
ENERGY RESOURCES CONSERVATION
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AB 32 Implementation	Docket No. 07-OIIP-01

COMMENTS OF THE COALITION OF CALIFORNIA UTILITY EMPLOYEES AND CALIFORNIA UNIONS FOR RELIABLE ENERGY ON GREENHOUSE GAS EMISSION ALLOWANCE ALLOCATION METHODOLOGIES AND OTHER MATTERS

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Pursuant to Rule 14.3, the Coalition of California Utility Employees (CUE) and California Unions for Reliable Energy (CURE) offer these comments on the greenhouse gas emissions allowance allocation methodologies and other matters summarized in the Administrative Law Judges' Ruling on May 20, 2008.

We appreciate the opportunity to submit comments at this critical juncture in AB 32 regulatory design. CUE represents unions whose members work at both publicly-owned utilities and investor-owned utilities and thus seeks to ensure that greenhouse gas (GHG) regulations apply fairly to all retail providers of electricity in California. The unions participating in CURE represent members who construct, maintain and operate conventional and renewable energy power plants and photovoltaic generation.

I. SUMMARY

The Commissions' fixation on a market-based mechanism puts the cart before the horse in this process. We continue to be distressed by the Commissions' unwillingness to first evaluate regulatory measures before considering market-based measures, as required by AB 32. We remain unconvinced that the "magic of the market" will solve California's GHG problems more quickly, cheaply or more efficiently than direct regulation, and the Commissions have provided absolutely no evidence or analysis showing that market-based mechanisms would be superior or even effective. Before the details of a market-based strategy are discussed, the Commissions must first weigh direct regulatory programs. By failing to analyze non-market based mechanisms, the Commissions are set to make bad policy and violate the statutory mandates painstakingly negotiated into the language of AB 32.

More importantly, this narrow focus on a market-based mechanism is diverting attention from the programmatic work that is at the core of the state's efforts to reduce GHG emissions. Cap and trade does nothing more than postpone the day when entities will have to focus on implementing actual measures to reduce emissions. The Commissions should rigorously evaluate non-market based regulatory strategies rather than spending more time on cap and trade proposals.

In keeping with the outline provided by Administrative Law Judges Terkeurst and Lakritz, we include a selection of the questions solicited by the Commissions in bold italics with our corresponding response submitted below each question.

II. General issues

Questions 10 and 11 of May 13, 2008 Ruling

What evaluation criteria should be used in assessing each issue area in these comments (allowance allocation, flexible compliance, CHP, and emission reduction measures and policies)?

Of course, the effectiveness in reducing greenhouse gas emissions must be a primary criterion when evaluating each issue area. In addition, the Commissions should make economic benefit to California an explicit criterion for evaluating any policy recommendations. It is critically important that we implement AB 32 in ways that stimulate economic growth in California. We are a model for the United States and the world, and all must see that reducing GHG emissions brings a stronger economy. In this way, we will be a model that others would want to replicate elsewhere.

Address any interactions among issues that you believe the Commissions should take into account in developing recommendations to ARB.

The Commissions should take into account the tenuous situation of some entities, such as the Southern California Munis, who are legally bound to long term coal-fired electric supply contracts, but who are willing to invest significantly in alternative energy and green technology in an effort to reduce their carbon footprints. Cap and trade could disproportionately impact these entities. If an auction is established, the Commission should ensure that the revenue generated would flow back to the utilities so that they could determine how to invest to shrink their carbon footprints. Without this revenue flowing back to the utilities, the entities that should be investing in green technology will have to instead use ratepayer funds to purchase emission allowances.

III. Allowance allocation

A. Detailed proposal
Question 1 of April 16, 2008 Ruling

Please explain in detail your proposal for how GHG emission allowances should be allocated in the electricity sector.

As we stated above, there is neither evidence nor analysis showing that cap and trade is the correct path to address GHG reductions in California. The Commissions should evaluate direct regulations that actually reduce emissions, rather than merely hoped-for economic incentives. However, if the Commissions go forward with the trading scheme and allowance auctions, the bulk of the proceeds from an auction should be allocated directly to the emitting entities because they are the entities that are in most need of the funding to facilitate their efforts to reduce GHG emissions.

B. Response to staff paper on allowance allocation options and other allocation recommendations

We need to focus on creating and implementing *actual* programs to reduce emissions, rather than expending all of our resources designing and overseeing markets that may or may not eventually lead to GHG emissions reductions. In the electricity context, each utility should devise actual programs to reduce GHG emissions, because the utilities are best situated to make the changes needed to cut emissions. If a cap and trade system is adopted, the Commissions should give the revenue directly to the utilities to be used at their discretion for GHG emission reduction activities. Utilities should be given both the obligation to reduce emissions and the freedom to choose the methods for reducing emissions.

IV. Flexible compliance

B. Scope of market and related issues Question 5 of May 6, 2008 Ruling

Should the market for GHG emission allowances and/or offsets be limited to entities with compliance obligations, or should other entities such as financial institutions, hedge funds, or private citizens be allowed to participate in the buying and selling of allowances and/or offsets?

Non-obligated entities should ***not*** be allowed to buy allowances under any circumstances. If allowed to participate, brokers, hedge funds and other speculators are likely to distort the market. It is estimated that hedge funds and speculators are major drivers behind the soaring prices of oil.[1] Participation by non-obligated entities would distort the market and could sabotage our efforts to establish a workable system to reduce GHG emissions in California.[2]

C. Price triggers and other safety valves Question 6 of May 6, 2008 Ruling

Should California incorporate price triggers or other safety valves in a cap-and-trade system? Why or why not?

There ought not to be any price triggers or safety valves. These mechanisms distort the market and are designed to break the cap, undermining California's efforts to reduce GHG emissions. Only when the price of emission allowances get high will there be any possibility of the kind of investment in a new energy economy that is required. Indeed, this question highlights a major flaw with the reliance on a market price rather than direct regulation: market prices alone do not provide the regulatory certainty required to support the major long term investments needed to transform our energy systems.

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[1] "As much as 60% of today's crude oil price is inflated due to pure speculation driven by large trader banks and hedge funds. It has nothing to do with the convenient myths of Peak Oil. It has to do with control of oil and its price." F. William Engdahl is an Associate of the Centre for Research on Globalization (CRG) and author of A Century of War: Anglo-American Oil Politics and the New World Order.

[2] On the other hand we do not oppose the participation of environmental and civic groups in the trading scheme because they do not have the revenue to impact the trading as significantly as speculators. However, for ease of rulemaking, we recommend that no entities that are not themselves obligated entities, be allowed to procure emissions credits.

D. Linkage
Question 8 of May 6, 2008 Ruling

Should California accept all tradable units, i.e., GHG emission allowances and offsets, from other carbon trading programs?

California's cap and trade program should not be linked with other regional, national or international programs. Linking programs takes the control of our nascent AB 32 regime out of the hands of Californians and provides opportunities for unexpected gaming and market distortions. Further, linking California's programs with outside programs means less control over allowance prices, and will lower allowance prices, thus undermining the high prices needed to stimulate technological innovation and diffusion of those innovations.

Regardless of whether linkage is a good idea for California or not, it would be illegal because it would not comply with the statutory language of AB 32. The statute makes clear that CARB has to be able to enforce any cap and trade program. The language of AB 32 forecloses the ability of a cap and trade program in California to be linked to programs outside of California because AB 32 requires the state board to monitor compliance with and ***enforce*** any rule, regulation, order, emission limitation, emissions reduction measure, or market-based compliance mechanism adopted by the state board.[3] Since CARB would not have the authority or ability to oversee and enforce trading occurring outside of California, such trading could not be legally included as part of the implementation of AB 32.

H. Offsets Questions 21-22 of May 6, 2008 Ruling

Should California allow offsets for AB 32 compliance purposes?

No. The entire concept of using offsets to enable flexible compliance is based upon the false assumption that there are measures that are surplus where no surplus actually exists. Perhaps it could be argued that the 2020 goals leave room for some surplus in the short term, however, in the long-term, nothing is surplus. No stone can be left unturned if we want to meet our 2050 emission reduction goals. We will have to take every possible action to reduce GHG emissions and nothing will be additional or surplus to anything else. This program should not be founded on the principle that there is a surplus of ways to reduce GHG emissions.

Further, offsets would create dramatic administrative burdens associated with assuring their permanence, additionality, quality, quantity, and ongoing verification and enforcement. An example of this is the current debate about how PG&E's ClimateSmart dairy offsets should be evaluated for additionality purposes. (See attached letter from the Agricultural Energy

[3] AB 32 states: "The state board shall monitor compliance with and enforce any rule, regulation, order, emission limitation, emissions reduction measure, or market-based compliance mechanism adopted by the state board pursuant to this division." *Cal. Health and Safety Code § 38580(a).*

Consumers Association.) The issues raised in this letter are only the tip of the iceberg of the kinds of problems CARB will face in evaluating the efficacy of offset programs. Dairy farms are also an example of a sector where GHG reducing measures can be employed using existing technology, and more importantly, could be directly mandated by CARB for every dairy farm within California.

Let's steer clear of the significant economic waste and bureaucratic nightmare inherent to offset verification and instead simply control emissions now for every dairy and other "potential offset project" in California. In fact, if we allow offsets, we could have the perverse effect of reducing the incentive for investment and innovation in the electricity sector by allowing that sector to rely on outside offsets, i.e. dairies.

Finally, because offsets are not necessarily limited geographically, they can undermine copollutant gains that could be achieved by technological innovation at the point of generation. Reducing copollutants is an explicit goal of AB 32 that should be given serious consideration by the Commissions because it is particularly relevant to the electricity sector.

If offsets are permitted, what types of offsets should be allowed? Should California establish geographic limits or preferences on the location of offsets? If so, what should be the nature of those limits or preferences?

If offsets are allowed, they should be geographically limited to California. Emitting entities should only be allowed to offset a tiny fraction, at most, of their emissions. Further, any investments by California emitters should be designed to bring economic benefits to California.

I. Legal issues
Question 27 of May 6, 2008 Ruling

Under AB 32, is it permissible for GHG emission allowances from non-California carbon trading programs or offsets from GHG emission sources outside of California to be used instead of GHG emission allowances issued in California? Please consider especially the provisions of Health and Safety Code Sections 3805[sic], 38550, and 38562(a) added by AB 32.

As with linkage, CARB cannot oversee and enforce offsets outside of California. AB 32 requires all measures to be enforceable by CARB.[4] The language of AB 32 forecloses the possibility of a cap and trade program in California utilizing offsets regionally, nationally or internationally.

VI. Non-market-based emission reduction measures (other than CHP) and emission caps

A. Electricity emission reduction measures
Question 5 of May 13, 2008 Ruling

What percentage of emission reductions in the electricity sector should come from programmatic or regulatory measures, and what percentage should be derived from market-based measures or mechanisms?

100% of emissions reduction measures should be programmatic or regulatory. Cap and trade is a diversion. The bottom line is that California must reduce its GHG emissions now. Direct regulation is the fastest way to limit emissions. Direct reduction approaches provide regulatory certainty needed for long-term investment that would not otherwise exist under a

[4] *Cal. Health and Safety Code § 38580(a).*

volatile market. Changes in energy demand, fuel-price fluctuations, and a variety of other factors could cause demand for allowances to fluctuate significantly. Price volatility in allowance markets may in turn deter long-term investments in low-carbon technologies that have high up-front costs. The long-term payoffs of making such investments will be very uncertain if the future price of CO_2 is unknown. Cap and trade is also likely to have many hidden costs because revenues will flow to market participants, speculators and consultants rather than directly to programs that reduce GHG emissions.

Direct regulation is preferable because it is transparent, simple and does not provide the myriad opportunities for cheating and skyrocketing costs for consumers.

II. CONCLUSION

We strongly disagree with the Commissions' treatment of market-based mechanisms as a pre-ordained centerpiece of AB 32 implementation. AB 32 provides California with a breathtaking opportunity to reduce our GHG emissions and become an economic model for others to emulate. We must be very careful to avoid creating a system that benefits market participants at the expense of the California economy and environment. Let's do this with straightforward, accountable and efficient, direct regulations.

Dated: June 2, 2008

Respectfully submitted,

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I, Bonnie Heeley, declare that on June 2, 2008, I served copies of the attached Comments of the Coalition of California Utility Employees and California Unions for Reliable Energy on Greenhouse Gas Emissions Allowance Allocation Methodologies and Other Matters via courier, email or U.S. Mail as follows:

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Executed at South San Francisco, CA on June 2, 2008.

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Bonnie Heeley

Agricultural Energy Consumers Association

May 21, 2008

Honesto Gatchalian
California Public Utilities Commission, Energy Division
505 Van Ness Avenue
San Francisco, California 94102

Re: Draft Resolution G-3410, Manure Management Projects for ClimateSmart

Dear Mr. Gatchalian:

On May 15, 2008, the Energy Division of the California Public Utilities Commission (CPUC) held from the CPUC's agenda a revised Draft Resolution G-3410 (Resolution) in response to Pacific Gas and Electric Company (PG&E) Advice Letter 2846- G/3075-E, to fund manure management projects for the ClimateSmart program. The CPUC subsequently issued an amended Draft Resolution (ADR). The Agricultural Energy Consumers Association (AECA), as well as Sustainable Conservation and California Farm Bureau Federation (Joint Parties) hereby respond to the ADR.

The Joint Parties appreciate the changes made by the Commission to the draft resolution. PG&E's ClimateSmart program is a potentially attractive opportunity to capture additional revenue for some dairy entrepreneurs while reducing methane emissions that would otherwise occur. PG&E and the CPUC are at the forefront of this issue. Careful consideration of the particulars of how the CPUC will implement this program for manure management projects is essential. While there are opportunities in existing GHG markets for dairy operators to sell their carbon reduction value, the CPUC has appropriately recognized that agreements between California's investor-owned utilities and dairies are important to accelerating both renewable energy and climate change goals. The ADR represents a thoughtful revision over the previous version. Joint Parties are hopeful that with one additional adjustment, it will create an outstanding model other States can follow, by strengthening the program through diversifying the GHG reduction strategies and by ensuring program integrity.

The opportunity to credibly mitigate emissions is specifically delineated in the Livestock Protocol developed by the California Climate Action Registry (CCAR) and centers on activities that destroy methane that otherwise would have been emitted from the dairy operations. It requires using "biogas control systems" defined and certified by CCAR . The allowable "biogas control system" options under the protocol include biogas digesters that produce electricity, biomethane pipeline injection and flaring methane from covered manure ponds.

We appreciate that the CPUC has acknowledged potential complexity of the "financial viability" tests included in the original draft Resolution and eliminated two of the "test" criteria. The CPUC Resolution, rightfully looking at the integrity of the additionality consideration, has offered a pared down financial viability test. The remaining sixth "test" is as follows:

> *Absent ClimateSmart or other offset program support, would the project be financially viable by virtue of the other value streams the project provides? These value streams include but are not necessarily limited to revenues received for selling energy or biogas into the RPS program (e.g. via the feed-in tariff program adopted in D.07-07-027) and the avoided energy costs associated with producing electricity to meet onsite load.*

We believe that by framing the question this way the CPUC opens up a “Pandora’s Box” of issues that neither PG&E nor the CPUC have anticipated or will find useful in evaluating the “additionality” question.

The CPUC has stated, "If a project makes economic sense absent ClimateSmart or other offset program support and the project host is economically rationale, it is not unreasonable to think the project would be undertaken absent that support, . . . " (Amended draft Resolution , pg 12) The Joint Parties believe that this is a mistaken assumption applied here and is contradicted by actual livestock industry experience to date. Many potential "carbon mitigation" projects on dairy operations are financially viable but aren't being done and some projects that are not financially viable are being pursued. The CPUC relies on an "Economic rationality" assumption (Amended draft Resolution, pg12). We agree it can be a useful construct, but other factors over ride it. Factors such as peculiar financial, technological and regulatory risks that defy quantification affect these new technologies, which operate under an unorthodox business model.[1]

But even where "economic rationality" is an accurate assumption, there are practical problems that obviate its relevance. This is exemplified by the biomethane pipeline injection option to reduce emissions. The two biomethane projects that have been approved in California are among only a handful under development across the United States. Because the terms of the contracts for the biomethane are confidential and not transparent, at least to potential investors, and the cost of running each facility largely uncertain (because there is so little experience operating them), the proposed financial viability test can't be used - the technology is too new in this application.

It is not that ClimateSmart funding won't serve as an incentive for some dairymen to undertake a "biogas control system" that otherwise would not have done the project. ClimateSmart funding can make that difference in many cases. But that is not the question the CPUC has asked.

It is worth noting that an unintended consequence of CPUC adoption of the ADR with the financial test would be that a dairy may be precluded from marketing its GHG reductions, as certified by CCAR, only to the voluntary enrollees of the PG&E ClimateSmart Program. Yet if the financial viability test remains in the final resolution, this may be the likely outcome.

In summary, applying "economic rationality" in the manner proposed by the CPUC to dairy facilities interested in the ClimateSmart program is not a valid additionality test for the reasons state above. The valid question for the Commission is whether there are real incremental GHG reductions, as certified by CCAR, which would not have otherwise occurred but for ClimateSmart funding. That is a different test. We believe the existing regulations approved by the Commission are adequate. But we would trust the recommendation of the EAG on this issue and would recommend they participate in review of the ClimateSmart participants under the Livestock Protocol option.

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[1] It is worth noting that a 2006 California Energy Commission report, "Dairy Methane Digester System Program Evaluation" looked at, among other things, the economics of biogas digesters. One of the surprising findings was the wide range in payback period. The range spanned from 5 to almost 50 years with payback averaging over 16 years. However, new regulations may double original costs estimates. Even where 50% grant funding was available to cover capital cost, and economic analysis showed an attractive return, only about 2% of California’s dairies applied for funding. The other dairies were not interested and most are still not interested even as other sources of funding and financing have opened up.

As a final observation it should be recognized that the financial viability standard required by this ADR for dairies is not required for the existing forestry protocols, nor should it be.

Thank you for considering our recommendations.

Sincerely,

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Service List for R.06-02-012 (via electronic mail)

Service List for A.06-01-012 (via electronic mail)