

**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)

**ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of: Order Instituting       )  
Informational Proceeding on a       )  
Greenhouse Gas Emissions Cap       )

Docket 07-OIIP-01

<b>DOCKET</b>	
07-OIIP-1	
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**COMMENTS OF THE MODESTO IRRIGATION DISTRICT  
ON EMISSION REDUCTION MEASURES, MODELING RESULTS,  
AND OTHER ISSUES**

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AND OTHER ISSUES**

In accordance with Rules of Practice and Procedure of the Public Utilities Commission of the State of California ("CPUC"), and the Administrative Law Judges' Rulings soliciting comments, establishing an outline and setting the schedule for filing<sup>1</sup>, the Modesto Irrigation District ("Modesto ID") hereby files these Comments on certain issues related to the scoping plan for implementation of Assembly Bill (AB) 32 greenhouse gas ("GHG") reductions, including allowance allocation, flexible compliance and non-market based emission reduction measures. Modesto ID also files these Comments with the California Energy Commission ("CEC") in Docket 07-OIIP-01.<sup>2</sup>

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<sup>1</sup> The Assigned ALJs have issued a series of applicable Rulings, including: Administrative Law Judges' Ruling Updating Proceeding Schedule and Requesting Comments on Emission Allowance Allocation Policies and Other Issues dated April 16, 2008; Administrative Law Judges' Ruling Providing Notice of Joint Workshop on Emission Reduction Measures and Opportunity to Provide Comment on Workshop Issues dated April 22, 2008; Administrative Law Judges' Ruling Requesting Comments on Flexible Compliance Policies dated May 6, 2008; Administrative Law Judges' Ruling Requesting Comments on Emission Reduction Measures, Modeling Results, and Other Issues; Incorporating Materials into the Record; and Recommending Outline for Comments dated May 13, 2008; and, Administrative Law Judges' Ruling Modifying Schedule and Correcting Suggested Outline for Comments and Reply Comments dated May 20, 2008.

<sup>2</sup> The CPUC and the CEC may hereinafter jointly be referred to as the "Joint Agencies."

In their May 13, 2008 Ruling, the ALJs provided a suggested outline for parties to use in preparing their comments, but noted that “parties’ are not required to address all issues.” (5/13/08 Ruling, p. 9.) Accordingly, Modesto ID’s Comments will apply the outline numbering and heading conventions provided by the ALJs but do not address every item. Any failure to address a specific point does not indicate Modesto ID’s agreement or disagreement with any articulated position, and Modesto ID reserves the right to present varying positions in the future.

## **I. Summary**

Modesto ID continues to believe that the Joint Agencies should advocate the design of a GHG reductions program that strikes an equitable balance for the entire electric sector. Any recommendations developed by the Joint Agencies must recognize the varied interests of utilities, both private and public, spread throughout the State and protect the interests of all electric and gas utility consumers. The utility industry is an easily identifiable target for emission reduction mandates, and it has repeatedly been noted that the electric sector will certainly be asked to bear more than its proportional share of GHG reduction obligations. Thus it is critical that the industry have an advocate so that compliance with the goals of AB 32 can be achieved while retaining grid and industry stability and without endangering the viability of any existing retail provider.

Each utility is uniquely situated and the most effective emission reduction implementation program will establish an obtainable goal and provide a variety of tools for regulated entities to apply to their own circumstances and determine the best path for achieving reductions. If these tools include a market component that component should be only a single part of the bigger whole and must be carefully harmonized with existing mandates and legislative

structures. As much certainty as possible must be built into the program to allow utilities to successfully plan and manage their resources to meet their service obligations.

If a market tool is developed, it must be broad based and all sectors must be responsible for their own fair share of market reductions. Any cap and trade system integrated into the emission reduction program must be designed to avoid cost shifting among sectors and among utilities. Modesto ID does not support a market system for achieving AB 32 goals, but should the Joint Agencies elect to recommend one to the California Air Resources Board (“CARB”) Modesto ID urges consideration of the following design elements:

- Individual sector and/or entity caps
- Administrative allocation of allowances based on historical emissions.
- Auctions should not be used, but if used should be minimal and phased in slowly.
- In the electric sector allowances should be allocated to retail providers to cover carbon emitting resources associated with load served, commensurate with their reduction obligations.
- Compliance periods should be multi-year and the baseline for allocations should be updated to account for all load growth, including normal economic and sector shifting increases, and other situational changes.
- The full value of emission allowances must be used to minimize the cost impact of emission reductions on all consumers.
- All flexible compliance mechanisms should be considered.
- Any transitions (eg. toward allowances based on load or sales, toward auction) must be gradual and carefully monitored as the market matures.
- The market design must include consumer (price) protections.

- Oversight by a single, identified and accountable entity

## **II. General Issues**

Electric sector parties have been asked to comment on program measures designed to achieve emission reductions, without knowing the level of reductions the electric sector will be responsible for achieving. Thus, parties are being asked to comment on the proper pathway to a destination that has not been identified. Sector and entity reduction obligations must be quantified – either in terms of the percent of total reduction attributable or in a fixed reduction value – before comprehensive positions on program design can be formed.

Emission reduction obligations and concomitant allowance allocations must account for load growth experienced by electric retail providers. Load growth can occur through the transfer of existing consumers from other retail providers, through new growth in previously unserved areas, through population and economic growth within the same area, and through electrification as a means of emission reduction by other sectors. In each case baseline values and allowance allocations must be adjusted. For example, in the case of transferred load, the emission factors associated with transferred load should likewise transfer to the new provider, as would any associated allowance allocation. Where emission reduction obligations are transferred from one sector to another the electric sector consumers must be made whole for the shifted costs of the additional reduction burden.

The baseline factors for determining emission allowance allocations must be the same as the factors for determining emission reduction obligations. In each case the baseline must be based on multiple years experience in order to normalize natural fluctuations in weather, water conditions, and similar impacts.

Program mandates must be based on goals and measures that are feasible, cost effective and achievable based on current knowledge, not based on available potential.

The role of carbon fees must not be discounted. See, for example, the February 2008 Congressional Budget Study which summarized “A tax on emissions would be the most efficient incentive-based option for reducing emissions and would be relatively easy to implement.”<sup>3</sup>

Early action and voluntary reductions can be fully recognized through credits factored into established caps and through the lessening of future emission reduction obligations. In other words, a properly factored baseline for reductions will account for reductions already achieved.

Reliability is a key concern in the design of an emission reduction program. The existence of resource adequacy mandates independently of such program neither assures continuous supply nor resolves the shortfalls if supplies willing and able to meet program constraints are unavailable or inaccessible. Potential impacts on reliability must be considered in the program design.

California’s emission reduction program must meld with any regional and federal program ultimately adopted. While it is hoped that such larger scale programs will take their lead from California’s program, California must lead with an eye toward events around it and be sensitive to signals as such broader programs are developed. The goal must be to design a state program that will transition seamlessly into a single overarching system of compliance that ensures consistency of goals without duplication of obligations. California’s program design must include a process for addressing regional and federal developments.

### **III. Allowance Allocation**

#### **A. Detailed Proposal**

It is difficult to assess all the various allowance allocation options since reduction goals have not been clearly identified for the electric sector. Options that appear to present cost

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<sup>3</sup> [www.cbo.gov/ftpdocs/89xx/doc8934/summary.4.1.shtml](http://www.cbo.gov/ftpdocs/89xx/doc8934/summary.4.1.shtml)

effective methodologies under one set of assumptions may pen out quite differently under a different set of assumptions.

Further, the “devil” as they say “is in the detail.” None of the potential allocation options presented to date are fully defined. Any allocation method can be skewed if not properly couched.

Generally, however, if a market system is included as part of CARB’s AB 32 implementation program, Modesto ID believes that emission allowances should be allocated to regulated electric sector entities administratively based at least initially on historic emissions and accounting for all types of load growth. Modesto ID does not support auctions; however, if auctions are utilized the auction of allowances should be minimized and delayed until a robust market has matured. All proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency or direct rate relief. Any market system put in place must be closely monitored by a single, identifiable regulatory body to avoid manipulation, fraud and other abuses.<sup>4</sup>

Compliance with AB 32 should be achieved with the lowest possible impact on consumers and emission allowances will play a critical role in meeting this goal. Allocation of the value of allowances should be returned to retail service providers<sup>5</sup> for investment in measures that will reduce the emission reduction program costs ultimately to be borne by their consumers.

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<sup>4</sup> Modesto ID detailed its recommendations in a prior filing with CARB dated April 8, 2008. A copy of that submittal is attached to these comments for your convenience.

<sup>5</sup> The National Association of Regulatory Utility Commissioners (“NARUC”) has recently suggested that value from emission allowances only be assigned to “regulated” utilities. Modesto ID strongly disagrees. First, this is a false distinction. Publicly owned utilities are regulated. Just as the CPUC regulates investor owned utilities popularly elected or appointed governing boards regulate publicly owned utilities. Second, consumers served by publicly owned utilities are equally impacted by the cost of emission reduction programs as consumers served by investor owned utilities. To discriminate against and penalize publicly owned utility customers, and force them to bear an unfair and disproportionate burden for emission reductions constitutes an unlawful cost shift and is bad public policy.

If necessary, acceptable investments and expenditures for such value can be specified as part of CARB's program parameters. Included in any list of investment/expenditure options should be a process for reviewing and allowing additional innovations.

**B. Response to Staff Paper**

If a market system is included as an element of a broader emission reduction program, the design of such market must avoid shifting costs or transferring wealth among consumers of various utilities. Thus, any option that results in such shifting or transfer should be disregarded. The market design must protect electric consumers who will already be bearing a significant portion of the cost of emission reductions.

Allowances should be allocated to cover emitting resources. Thus, allocation should be to all retail providers commensurate with reduction obligations through an emission based methodology or, if a load based allocation is used, through a load based methodology applied only to and weighted for emitting resources. Many significant market problems may be avoided by not allocating allowances where they are not needed for compliance. Allowances that are in excess of the recipient's need should be returned for free to form a bank for use by those that need an interim loan of allowances. Charges for such allowance "loans" can also be used for emission reduction.

As noted above any market system must be phased in slowly and sufficient market protections in place before implementation. Participation in the market should be limited to regulated entities to avoid false pricing signals and other negative market impacts.

Auctions are included as a potential component in every program design proposed by staff. Modesto ID does not support the inclusion of auctions as part of the electric sector's inclusion in a cap and trade system. An auction component will create additional uncertainties which lead to reliability and cost impacts.



However, in the event auctions are implemented, all auction revenue must be dedicated to activities that result in reduced costs for consumers. These revenues can be used to defray the cost of achieving reductions, such as investments in obtaining renewable resources and developing new technology, as well as the cost of obtaining allowances. All these purposes can be most efficiently achieved through the retail provider. Thus, auction revenues should be retained in the electric sector and allocated to all retail providers based on historical emissions. Under no circumstances should auction proceeds be delivered to any general fund authority or otherwise exposed to potential diversion to any purposes other than defraying the cost of achieving AB 32's GHG reduction goals.

#### **IV. Flexible Compliance**

##### **A. Detailed Proposal**

It is premature to eliminate any flexible compliance options. There are numerous uncertainties associated with the design and implementation of any emission reduction program and flexible compliance tools such as offsets and banking are necessary to provide balance to fluctuating allowance prices. Ideally, an emission reduction obligation would be assigned to each regulated entity and that entity would be provided a wide variety of tools for meeting its obligation. Each entity would be given the discretion to apply the tools in accordance with established protocols to achieve the assigned obligation in the manner best suited to the entity's individual circumstances. Thus an emission "budget" is established and regulated entities are provided the flexibility to follow an adjustable "glide path" to meet that budget.

Maintaining a broad spectrum of flexible compliance options for sectors that are made or choose to bear a disproportionate burden for reduction is especially critical to successfully maintaining service obligations.

### **C. Price Triggers and Other Safety Valves**

If an emission allowance market is implemented, caps on allowance prices, at least initially, will protect consumers and provide certainty that will encourage continued participation in the California electricity market.

### **D. Linkage**

Any systems with which California trades, be it trading allowances or offsets or otherwise, must have established protocols commensurate with California standards.

### **E. Compliance Periods**

Multi-year compliance periods are necessary to ensure normalization of water conditions and the availability of hydro resources, of weather, and of other fluctuating impacts. A minimum of three years is consistent with other market systems.

Updating the baseline for each compliance period will help account for growth issues and technological advances.

### **F. Banking and Borrowing**

Again, Modesto ID urges the Joint Agencies not to eliminate any flexible compliance options before a more detailed scoping design has been developed.

### **H. Offsets**

Modesto ID supports the Comments submitted by the California Municipal Utilities Association on the subject of offsets.<sup>6</sup>

Although a hybrid system provides the broadest coverage while maintaining quality control over the program, it is too early in the design process to determine whether and at what level a cap on offsets may be beneficial. Providing a broad base of offset options will help

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<sup>6</sup> Letter to Kevin Kennedy from Bruce McLaughlin dated April 18, 2008. A copy of the letter is attached to these Comments for your convenience.

control emission allowance prices absorbed by utility consumers. Thus, offsets from outside California, and potentially outside the U.S. should be considered to the extent they meet or are equivalent to California standards. Again, in setting its standards California must be aware of standards being developed on a regional, national and even international level to ensure the California program is able to interact with such broader programs.

An offset program must include protections against gaming and speculating by non-regulated entities.

**V. Treatment of CHP**

MID does not forecast CHP load in its service area at this time

**VI. Non Market Based Emission Reduction Measures (Other than CHP) and Emission Caps**

**A. Electricity Emission Reduction Measures**

The two main non-market reduction measures identified for the electricity sector are energy efficiency and renewable procurements. It is well recognized that emission reduction goals cannot be reached without these measures – the question is whether additional mandates must be imposed. Additional energy efficiency and renewable resources procurement mandates are unnecessary and would be counterproductive to the goals of AB 32.<sup>7</sup>

Utilities will look to energy efficiency and renewable resources by necessity to meet their emission reduction obligations. However, the optimal mix of resources and reduction measures to achieve emission goals may differ for each utility depending on size of load, location, nature of load, weather impacts, and other factors.

All energy efficiency and renewable procurement goals must be realistic and achievable without creating undue hardship on consumers.

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<sup>7</sup> See Comments of the Modesto Irrigation District on Interim Opinion on Greenhouse Gas Regulatory Strategies dated February 28, 2008.

Increasing renewable procurement goals may cause transmission and reliability issues for the State of California. In workshops held in September, 2007 the California Independent System Operator concluded that the current statewide renewable portfolio standard (“RPS”) goal of twenty percent can be met without adverse transmission impacts; however, assuming a large portion of renewable energy would come from wind projects, an increase in the RPS target to thirty-three percent could adversely impact system reliability. Additional wind generation will likely require additional regulation capacity and supplemental energy resources due to intermittency and new transmission projects. Intermittent resources must be firmed or shaped by other available resources – load must be served even when the wind does not blow. These firming resources are generally fossil fuels. Additionally, unlike fossil fuels, most renewable resources cannot be shut down in times of higher than forecast generating conditions if load is low; thus, renewable resources may be forced to curtail operations in low load, heavy hydro conditions. Moreover, increased RPS mandates will put additional pressure on a renewables market where many utilities have already experienced difficulty in acquiring renewable resources and have already fallen behind their RPS targets.

The CEC staff addressed the issue of reasonableness of proposed energy efficiency targets for investor and publicly owned electric utilities in compliance with AB 2120 mandates at its September 17, 2007 workshop. The CEC developed recommended goals for each utility. These recommendations were based on technical, economical and feasible achievability of utility targets. Modesto ID’s governing board has adopted the CEC recommended energy efficiency target of 140 GWh by 2020 as its long-term goal.

Previously the Joint Agencies adopted recommendations that CARB impose mandatory minimum energy efficiency and renewable portfolio levels and require publicly owned utilities

such as Modesto ID to comply with programs and goals adopted by the CPUC. As noted above and in previous filings by Modesto ID and others, special mandates for publicly owned utilities are improper. However, if new energy efficiency and renewable procurement standards are to be initiated, CARB must develop its own regulations through its own procedures and collaborative process. It cannot simply rubber stamp and impose CPUC mandates on publicly owned utilities. The CPUC cannot exert jurisdiction over publicly owned utilities through such a back door. Publicly owned utilities that will be impacted must be involved in developing the standards that will apply to them.

Additional mandated reduction measures incorporated into any AB 32 program design must set realistic and achievable goals based on current knowledge and availability. New measures should also be consistent with existing legislative structures.

#### **C. Annual Emission Caps for the Electricity and Natural Gas Sectors**

Sector and entity specific reduction goals need to be established before caps can be set and a program effectively designed to achieve such goals.

### **VII. Modeling Issues**

#### **C. Results Reported by E3**


The modeling performed by E3 as presented at the May 6, 2008 workshop provides no guidance or insight for the majority of utilities that are in the aggregated groups. Although the model results may show “trends” and indicate “stressors” it cannot indicate impacts to individual utilities that are included into the northern or southern averages. The E3 model provides no way to determine various impacts on Modesto ID from any one of the various market designs tested.

### **VIII. Conclusion**

Modesto ID is fully committed to reducing its emission levels and meeting the goals of AB 32. It has participated in the Joint Agencies and CARB AB 32 program scoping

proceedings. Modesto ID's total energy requirement for 2008 is forecasted to be approximately 2,770 GWh, representing almost one percent of overall California requirements, and 3.5 percent of load served by publicly owned utilities. Without additional increases created by the AB 32 program itself, Modesto ID anticipates that for the next ten years it will experience load growth of almost 2.8 percent annually, factoring in energy efficiency. Modesto ID's energy efficiency savings for 2008 are estimated to be 37 GWh in accordance with the targets adopted by Modesto ID's governing board as recommended by the CEC. Modesto ID's governing board has also adopted renewable targets in compliance with existing laws. Modesto ID forecasts that in 2008 approximately eleven to twelve percent of its sales will be met by renewable resources. Any program to meet AB 32 GHG emissions reduction goals must be designed to allow electric utilities, such as Modesto ID, to serve its existing and growing load reliably and economically. Consumers must be protected from unwarranted rate increases.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'Joy A. Warren', with a long horizontal line extending to the right.

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April 18, 2008

Mr. Kevin Kennedy  
Chief, Program Evaluation Branch  
California Air Resources Board

**Re: Comments of the California Municipal Utilities Association to Questions Presented  
at the AB 32 Technical Stakeholder Working Group Meeting on Offsets**

Dear Mr. Kennedy,

Please accept the following comments of the California Municipal Utilities Association ("CMUA") to the questions presented by the Framework for Discussion ("Framework") relating to the AB 32 Technical Stakeholder Working Group Meeting conducted on April 4, 2008. CMUA responds to the five questions listed on page 4 of the Framework.

1. Should California have an offsets program for compliance purposes?

CMUA agrees with the Framework statement that a properly structured offsets mechanism could provide flexibility in compliance options, lower the overall compliance costs, and encourage additional reductions beyond business as usual. (p.5) The Framework also states that offsets will, "in general," come from sources outside the cap. Therefore, CMUA believes that the CARB should follow equitable criteria to determine which sectors or activities will be outside the cap and eligible to provide offsets to sectors under the cap. For instance, any sector that is shown to have uniformly measurable and verifiable emissions should be brought into the proposed cap-and-trade program along with the electric sector. Hence, a properly structured offsets mechanism would minimize or eliminate the chance that windfall profits would flow to other sectors from electric sector.

2. What should the project approval and qualification process be for approving projects?

CMUA supports the hybrid approach as generally described in the Framework. (p.7) The hybrid approach could provide certainty and credibility by establishing a standards-based list of eligible offset project types. Since not all offset opportunities can be forecast or imagined by the regulations, the hybrid approach should also provide the chance for an entity to petition for offset approval on a project-by-project basis.

3. Should there be quantitative limits on the use of offsets for compliance purposes?

The quantity of offsets should not be limited as long as they provide emission reductions that are real, additional, quantifiable, permanent, verifiable, and enforceable. Accordingly, the CARB should not

restrict any regulated entity from pursuing an offset project that meets these stated criteria and is able to provide the least-cost option for compliance.

4. Should California establish limits or preferences on the location of projects that could be used to generate credits within the offsets system?

In terms of climate change being a global phenomenon, it follows that any quantifiable GHG emission reduction would have the same utility in reducing the atmospheric GHG concentration regardless of the offset's location. In terms of public policy, it may be legitimate to give preference to local offsets that keep the money within California and provide local co-benefits (e.g., positive environmental justice impacts). Overall, CMUA supports the use of offsets as a flexible compliance mechanism. Therefore, CMUA does not support limiting the geographical scope of offsets to the extent that they would become unavailable or cost-prohibitive.

5. Should California discount credits from offset projects?

CMUA agrees with the second point presented in the Framework (p.11) in that discounts *will* improperly penalize legitimate offset projects that do, in fact, produce real, additional, quantifiable, permanent, verifiable, and enforceable reductions. Therefore, CMUA does not support discounts but rather supports rigorous standards for offset qualification (using the hybrid approach discussed above), measurement, and verification.

Dated: April 18, 2008

Respectfully submitted,



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April 8, 2008

**To: THE CALIFORNIA AIR RESOURCES BOARD  
Assembly Bill 32 Technical Stakeholder Working Group**

**From: Modesto Irrigation District**

**Subject: COMMENTS OF THE MODESTO IRRIGATION DISTRICT ON  
ALLOWANCE ALLOCATION ISSUES**

The Modesto Irrigation District ("Modesto ID") appreciates the opportunity to provide its comments ("Comments") on greenhouse gas (GHG) emission reduction allowance allocation issues. At its March 17, 2008 Program Design Technical Stakeholder meeting staff of the California Air Resources Board ("ARB") provided a Framework for Discussion of issues related to the distribution of allowances within a cap-and-trade-system. ARB presented four questions related to the allocation of emission allowances, and Modesto ID responds to these questions below.

Modesto ID generally recommends that in a market based system implemented to meet emission reduction goals under AB 32 emission allowances should be allocated administratively based at least initially on point of regulations' historic emissions and accounting for forecasted as well as mandated load growth. Auction of allowances should be minimized and delayed until a robust market has matured. Proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency. Any market system put in place must be closely monitored by a single, identifiable regulatory body to avoid manipulation, fraud and other abuses.

Compliance with AB 32 should be achieved with the lowest possible impact on ratepayers. In any cap-and-trade system that is adopted emission allowances will play a critical role in meeting this goal. Allocation of allowances within the electric sector must account for growth of electric load, due both to electrification of other sectors and to increases in population. Free direct emission allowances should be provided to the electric sector, reduced on a periodic basis to achieve the overall emission reduction required from the electric sector. Allowances that are in excess of the recipient's need should be returned for free to form a bank for use by those that need an interim loan of allowances. Charges for such allowance "loans" can also be used for emission reduction.

## **BACKGROUND**

Modesto ID is an irrigation district, organized and operated under the laws of the State of California, which undertakes both electric and water operations. It is a vertically integrated publicly owned utility providing electric services to over 110,000 customers in California's Central Valley. With regard to its electric operations, Modesto ID owns and operates facilities for the generation, transmission, distribution, purchase and sale of electric power and energy at wholesale and retail. Modesto ID is a fully integrated, fully resourced, credit worthy utility. Modesto ID served a peak summer load of almost 700 MW and had retail sales of over 2,500 GW-hours in 2006. Modesto serves this load through a mixture of owned and purchased resources, including wind, hydro, natural gas and coal generation. Modesto ID's projected annual average load growth over the next twenty (20) years is forecast to be 2.79%. Modesto ID is located in the central San Joaquin Valley where population growth has been consistently higher than the State average. The forecast growth is consistent with Modesto ID's historical load growth which has averaged 3% over the last 25 years.

## RESPONSES TO QUESTIONS

### *Question 1: What method should we use to distribute the allowances?*

Emission allowances should be allocated administratively, in the pattern of the existing acid rain allowance mechanism. This will allow the market to develop gradually. A one hundred percent allocation method can be ratcheted down over time toward an auction once the trading platform has matured. The acid rain example indicates that such a market would likely take at least five years to establish, after which time a gradual creation and building of an emission allowance auction could occur.

Allowances should be allocated administratively based at least initially on point of regulations' historic emissions and accounting for forecasted as well as mandated load growth. AB 32 was signed into law in 2006; this seems a logical base year for emission based allocations to be determined. The system design must provide the flexibility for regulated entities to factor mandated activities into meeting their emission reduction obligations. Thus, early reduction activities, including those undertaken in response to mandates and related or similar programs, such as energy efficiency and renewable portfolio standards, should not be discounted in determining reduction obligations and related needs for emission allowances.

Modesto ID's recommended methodology would provide for a proportional impact to regulated entities. Those having a higher carbon resource mix would necessarily bear a larger burden for carbon reductions; however, all sector participants would bear the burden of accomplishing the state mandates. Where apportionment of allowances are based, at least initially, on historical emission levels and include allocation for future forecasted load growth at least through the regulatory period, allowances would be allocated where they are needed and no disparate impact should result.

If an auction process is developed, it will be important to ensure that the overall market system for emissions be established and matured, and that emission allowance trading be developed and experienced, prior to initiation of the auction process. It is also important that any market based system not provide any windfall or any undue burden for the regulated entities. The system should not create a market power or bias among competitors. Nor should it shift responsibilities among industry sectors. The market must be stable and have integrity.

Market system design and the allocation of allowances must be consistent with existing laws and should incorporate emission reductions achieved through existing and future mandatory schemes. For example, renewable resources obtained to meet mandatory renewable portfolio standards and conservation measures obtained through required energy efficiency spending must be taken into account. Such system must balance any shifting of emission reductions from one sector to another. Of significant importance, allowance distribution must be designed to balance emission reductions achieved through fuel switching and other electrification measures.

Whether the cap-and-trade system designs incorporates an administrative allocation or an auction, the distribution of emission allowances must be coordinated with the compliance period in a manner that permits regulated entities to incorporate the market system into their business planning and to structure their compliance programs in the most cost efficient and effective manner.

***Question 2: How should allowance value be used? And, if the allowance value should be used to ease the costs of regulation for entities, who should receive them and how many allowances should each entity receive?***

Any monies accumulated through a market based system, whether through auction process, market enforcement, or some other mechanism such as an emission allowance loan

program, should be applied toward emission reduction goals in a manner that will help retail providers minimize the rate impact reduction mandates will cause. Proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency. The value of allowances should be apportioned to reduce impact to utility ratepayers who will bear the burden of emission reductions both directly and indirectly.

Modesto ID supports administrative allocation of emission allowances based initially on historical emissions attributed to the point of regulation, using consistent calculation of emissions at all measuring points. Historical emissions could be calculated based on the regulated entities' 2006 emission footprint. Adjustments would be required for early reduction activities undertaken by the entities. Adjustments would also be required to account for electrification activities undertaken to reduce emissions in other sectors and other anticipated electric load growth. This methodology will ensure that allowances are apportioned where they are needed.

Market power advantages and market manipulation are a significant concern with any market based system. Any such system must be monitored and enforced by a single identifiable regulator that will assume responsibility for avoidance of market skewing activities and fraud.

***Question 3: How should allowances be distributed to new entities and how should entities that cease operating in California be treated?***

New market entrants would receive allocations from those sources initially receiving "credit" for the emission source or load being served by the entrant. Allowances should follow the load being served or the emissions being replaced, and should be administratively reallocated

to new market entrants from such load or emissions. Where new load or emissions are created by the new market entrant, allowances can be loaned from a bank as mentioned above.

***Question 4: How should the methods of distributing allowances in a cap-and-trade program change in future years?***

Allocations should be updated based on reports submitted to the market regulator. Ideally, no new reporting requirements would be needed. Adjustments would be required to account for load growth, both in terms of forecasted customer growth and electrification of other sectors. In addition, adjustments would be required for load balances (types of customers served by the provider) and climate impacts to load. Other forecasted or mandated load growth should likewise be accounted for.

Transition to a load based or other per capita allocation method is appropriate after the market system has matured and sufficient time for regulated entities to integrate their reduction programs into their long term planning.

Gradually, after the market system is well established, and regulated entities have had sufficient time to incorporate reduction obligations into their long term business planning, an emission based allowance allocation could transition to another allocation methodology. Time must be provided for such transition in order to ensure electric resource adequacy and reliability are protected and rate impacts are equalized.

**CONCLUSION**

Modesto ID generally recommends that in a market based system implemented to meet emission reduction goals under AB 32, emission allowances should be allocated administratively based at least initially on point of regulations' historic emissions and accounting for forecasted as well as mandated load growth. Auction of allowances should be minimized and delayed until a

robust market has matured. Proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency. Any market system put in place must be closely monitored by a single, identifiable regulatory body to avoid manipulation, fraud and other abuses.

Respectfully Submitted,

/s/

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## CERTIFICATE OF SERVICE

I, Linda Fischer, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On June 2, 2008, I served the attached:

### **COMMENTS OF THE MODESTO IRRIGATION DISTRICT ON EMISSION REDUCTION MEASURES, MODELING RESULTS, AND OTHER ISSUES**

on the service list for R.06-04-009 by serving a copy of each party by electronic mail, or by mailing a properly addressed copy by first-class mail with postage prepaid to each party unable to accept service by electronic mail.

Copies were also sent by first-class mail with postage prepaid to Commissioner Peevey and Administrative Law Judges Charlotte F. TerKeurst and Jonathan Lakritz.

A copy was also sent by first-class mail with postage prepaid to the California Energy Commission, Docket Office, MS-4, Re: Docket No. 07-OIIP-01, 1516 Ninth Street, Sacramento, CA 95814-5512.

Copies were also submitted by email to the CEC docket office at [docket@energy.state.ca.us](mailto:docket@energy.state.ca.us) and to project manager Karen Griffin at [kgriffin@energy.state.ca.us](mailto:kgriffin@energy.state.ca.us).

A copy of the service list is attached hereto.

Executed on June 2, 2008, at Modesto, California.



Linda Fischer



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