

**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 Commission Docket 07-OHP-01

**DYNEGY COMMENTS ON EMISSION REDUCTION MEASURES,
MODELING RESULTS, AND OTHER ISSUES; INCORPORATING MATERIALS
INTO THE RECORD; AND RECOMMENDING OUTLINE FOR COMMENTS**

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Dated: June 2, 2008

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I. INTRODUCTION

Pursuant to the “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, Dynegy Morro Bay LLC, Dynegy Moss Landing LLC, and Dynegy South Bay LLC (collectively, “Dynegy”) welcome this opportunity to provide comments “on emission reduction measures, the modeling efforts of consultants Energy and Environmental Economics, Inc. (E3), and certain other issues,” all as more fully described in the Ruling.

The questions presented in the ALJs’ Ruling are shown in bold typeface below. Where possible, responses to multiple questions are presented as a single, integrated answer. Questions presented for which Dynegy has no response at this time have been deleted.

II. SUMMARY

ALJs Charlotte TerKeurst and Jonathan Lakritz’s request that parties provide in this Summary section of their comments a succinct summary of positions taken in each of the subsequent sections of their comments.

Dynegy supports the creation of a national GHG emissions reduction program that permits the development of economic and reliable power while simultaneously protecting the nation’s energy security and economic stability with a diverse portfolio of fuel options. Regulation of GHG emissions is best achieved at the national level through an economy-wide carbon tax or a cap and trade program that incorporates as many sectors of the economy as practical.

Although a national program is the best approach to regulate GHG emissions, we understand California is moving ahead to establish its own GHG emission reduction program prior to the adoption of such a program by the federal government. Because California deems it in its best interest to develop its own policy, Dynegy will offer comments on proposals that are currently before California regulators. These comments do not change our position that a national GHG emission reduction program is the preferred alternative.

California has a so-called “Hybrid Market” for the purchase and sale of electricity, or, more precisely, a “Hybrid Procurement System”. In this Hybrid Procurement System, the load serving entities (“LSEs”) act as both (1) buyers of electricity to serve their customers in their monopoly service territories and (2) developers, owners, and operators of existing and new generation to serve those same customers in their monopoly service territories. Thus, with respect to independent power producers (“IPPs”), the California LSEs act as both customer and competitor.

California regulators need to appreciate the potential inequities inherent in such a system. For example, recovery of the allowance costs by IPPs will be subject to market conditions/risk, whereas recovery of the same costs by regulated utility generators may be assured via cost-of-service based ratemaking. Additionally, IPPs may have contracts with utilities which extend beyond 2012 for which there is no clear provision for recovery of such new and additional GHG costs.

LSEs are likely to have more options for achieving carbon reductions than do generators. As there are currently no proven technologies for removing carbon from fossil fuel emissions, a generator's only option for reducing carbon production is to generate less. LSEs, however, can reduce carbon production by shifting purchases to less carbon intensive producers, demand reduction and efficiency programs.

Dynegy unequivocally opposes a system that proposes no cost or other preferential allocations to LSEs while IPPs would be required to purchase allocations from the LSE or other marketers. Such an LSE no cost or preferential allocation scheme clearly is discriminatory, given California's Hybrid Procurement System wherein LSEs also own generating resources. This disparate approach would give LSE-owned generation a distinct competitive advantage over IPP-owned generation with no associated GHG reduction benefits.

Dynegy also opposes a policy that would allot free allowances to LSEs who would, in turn, auction them off to IPPs. LSEs could leverage that position by tying such purchase to an LSE supply agreement and thus reap an unfair advantage over IPPs in the general market and at the bargaining table. Two clear principles emerge. First, any market structure must treat all similarly situated market participants in a non-

discriminatory manner. Second, requiring IPPs to purchase allowances from an LSE is not only anti-competitive but provides no GHG emission reduction benefits.

Existing sources should receive some, if not all, of their allocations based on historic emissions performance, since that historic performance has been, by definition, in compliance with all then-existing regulatory requirements. Such an allocation system will, in part, recognize the reliability benefits conferred by such sources, provide funding for emission reductions investments, and offset some of the loss of market value of these resources.

If California decides to hold auctions for allowances, it should plan for and prevent auction participants from creating artificial scarcity by buying and retiring allowances. Initially, participation in the auction should be limited to entities in the regulated sectors to prevent speculators from profiting by trying to gain market power in tradable allowances.

III. GENERAL ISSUES

Q3: For any non-market-based emission reduction measures for electricity discussed in your opening comments, are there any overlap or compatibility issues with the potential electricity sector participation in a cap-and-trade program? Explain. (5/13/08)

Any GHG cap and trade program should also include all major sources of GHG emissions, not just one sector and not just major stationary sources in one or a limited number of sectors. Instead, all sectors and all sources large enough to justify regulation that has GHG emissions should be included in GHG regulation. It is also important to treat all similarly situated market participants in a non-discriminatory manner.

Q10: 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)? Explain how your recommendations satisfy any evaluation criteria you propose (5/13/08).

Allowance Allocation: Dynegy is in general agreement with the four evaluation criteria for allowance options identified in the April 16, 2008 Staff Paper: consumer costs, equity among customers, administrative simplicity, and accommodation of new entrants.

Dynegy proposes that a fifth and equally important criteria should be added: Electric System Reliability. To be clear, Dynegy acknowledges that the Staff has clearly identified electric system reliability as a concern. Beyond identifying the issue, it is incumbent upon all to ensure that the issue is addressed with credible assumptions and analysis.

As part of its efforts to satisfy its AB 32 greenhouse gas (“GHG”) objectives and to meet its Renewable Portfolio Standards (“RPS”), the State of California has made a commitment to promote renewable energy technologies. As many workshop participants attested and as the agencies responsible for electric system reliability will confirm in their comments, the intermittent nature of some renewable technologies means that those renewable technologies will need to be “firmed” or backed up with quick starting peaker projects and cycling or “load-following” units to ensure grid reliability. Further, Dynegy recommends that the agencies emphasize the need for electric system reliability in its comments. Specifically, the California Public Utilities Commission (“CPUC”) and the California Energy Commission (“CEC”) should recommend that the California Air Resources Board (“CARB”) examine the California Independent System Operator’s (“CAISO’s”) process on possible retirements of older thermal generating units, the

CPUC's Resource Adequacy proceedings, and the State Water Resources Control Board's ("SWRCB's") proposals related to once-through cooling. The early retirements of aging power plants, the Resource Adequacy proceedings, and the possible partial curtailment or total shutdown of once through cooling units could have grave consequences for electric system reliability, since many of these older, ocean cooled units are located in the center of significant load pockets. As such, these older units provide voltage support and other logical system reliability and, in general, provide the ability to firm up intermittent resources.

Accordingly, Dynegy recommends that the Commission add "Electric System Reliability" as a fifth "Evaluation Criteria of Allocation Options." Developing this fifth Evaluation Criteria to be on par with the four already in Staff's report will certainly take considerable time and effort; however, to present a realistic and credible view of the future, electric system reliability must not simply be "assumed." Reliability must be demonstrated in the plan presented to CARB.

Q11: Address any interactions among issues that you believe the Commissions should take into account in developing recommendations to CARB. (5/13/08)

As discussed above, the Commission must consider the interrelationships between the AB 32 GHG goals, the RPS goals, the admirable drive to increase renewable electric generation, and the need to have quick-starting peaker units to "firm" intermittent renewable resources to ensure grid reliability.

Q12: In establishing policies regarding allowance allocation, flexible compliance, CHP, and emission reduction policies, what should California keep in mind regarding the potential transition to regional and/or national cap-and-trade programs in the future? Are there policies or methods that California should avoid or embrace in order to maximize potential compatibility with other cap-and-trade systems? (5/13/08)

California should be prepared to merge its GHG emission reduction program into the federal program once a federal GHG law is adopted. The oft-stated purpose of California moving ahead with its own GHG program has been to force the adoption of a national GHG cap. Once a federal program is in place, there is no need for Californian to have different rules and regulations on GHG emissions. California ratepayers and businesses should not be unduly burdened by duplicative costs that provide no additional benefits to them.

IV. ALLOWANCE ALLOCATION

A. Detailed Proposal

Q1: Please explain in detail your proposal for how GHG emission allowances should be allocated in the electricity sector. (4/16/08)

Allocations should be based on historic emissions performance, since that historic performance has been, by definition, in compliance with all then-existing regulatory requirements. Such an allocation system will, in part, recognize the reliability benefits conferred by such sources, provide funding for emission reductions investments, and offset some of the loss of market value of these resources. A transition to a more auction-based system will also allow time required for new retrofit control technologies to develop and be commercialized without the perils of immediately shutting down a significant amount of the state's aging powerplant capacity. A phasing period also gives older facilities time to repower, identify ways to reduce GHG emissions or move into alternative forms of generation. The baseline should be, at a minimum, an average over the last 5 years to account for variations in weather and levels of hydroelectricity availability.

Zero carbon generators should not be included in the allocation of emission allowances. Currently, California has programs in place to encourage the development of renewable technology and is considering the creation of a tradable renewable energy credit (“TREC”). In addition, AB 32 will incentivize LSEs to purchase more renewable projects to reduce their GHG profile. Further, under a “deliverer” approach, the marginal price of power will rise corresponding to the price of allowances. Zero emitting generators will see an increase in profits, a “windfall.” Specifically, under the cap and trade proposed, this increase in dispatch price to cover the cost of credits required for the marginal unit will add immediate and significant windfall profits to these low/no-emitting fossil generators – even though they incur no costs due to the carbon cap.

Staff has recommended that emission-based allocation decline 10% per year and completely end in year 6. (Report, pp. 23-24; see also Table 2.) Dynegy supports the concept of a gradual decline in emissions based allocations as such a transaction period will help ensure that older generation needed for reliability stays online. The phasing period also gives time for repowers, new generation, and new control technology development, assuming that the initial allocation is sufficient. However, Dynegy is concerned that the five-year phase down may be too rapid, especially given that it takes three to five years to develop, license, construct and begin operations for a new power plant and considerably longer for new major transmission projects. Accordingly, Dynegy recommends that the State begin with the administrative allocation of allowances with a plan for the eventual transition to auction some portion of the required allocations over at least a 15 year time period.

Q10: Describe in detail the method you prefer for returning auction revenues to benefit electricity consumers in California. In addition to your recommendation, comment on the pros and cons of each method listed above, especially regarding the benefit to electricity consumers, impact on GHG emissions, and impact on consumption of electricity by consumers. (4/16/08)

The Staff Paper discusses at length how auction proceedings might be used. No one disputes that auction revenues should be used to obtain further GHG reductions that will result in significant, cost-effective reductions in pursuit of the State's goal of reducing GHG emission to 1990 levels by 2020. Dynegy offers the following principles that should help guide in this endeavor:

- Other than low-income and other need-based assistance, auction revenues should not be used for general ratepayer assistance. Ratepayers should not be insulated completely from the costs associated with GHG reductions and revenues should not be used to dampen the price signals associated with GHG reductions.
- GHG reductions resulting from programs implemented with auction revenues should result in GHG reductions that are real, permanent, quantifiable, verifiable, and enforceable as required by AB 32, not one-time reductions. In short, GHG reductions resulting from the auction proceeds should be subject to the same rigorous standards as offsets generated by process improvements or other means with the intent of being banked for trading.
- Auction revenues must be carefully expended so as to not advantage investor owned utilities who are both customers and market participants in the "hybrid" California electricity market. Auction revenues should not be used for programs that directly, indirectly, or cumulatively provide a distinct competitive advantage to the LSE over IPP-owned generation.
- Investments in energy efficiency which result in cost-effective GHG reductions should receive high priority.
- Investments in new technology retrofit programs for proven control technologies should be encouraged. In contrast, investments in the development of new control technologies that are not commercially proven should be avoided, since they result in no GHG reduction benefits and there are other avenues for funding such technology development, such as the PIER program and private sector venture capital.
- Dynegy supports the use of auction revenues to provide assistance to low-income customers. The GHG auction revenues used toward this purpose

should be used to offset that portion of the customers' bills associated with GHG programs and should not be used as general ratepayer assistance.

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

Q8: The staff paper describes an option that would allocate emission allowances directly to retail providers. If you believe that such an approach warrants consideration, please describe in detail how such an approach would work, and its potential advantages or disadvantages relative to other options described in the staff paper. Address any legal issues related to such an approach, as described in Questions 2 – 4 above. (4/16/08)

Dynegy opposes this approach. California's "hybrid" electricity market, wherein LSEs are both customers or generation and generators, makes such an approach wholly unsuitable.

Allocation of allowances to retail providers would create a competitive advantage for such providers and a competitive disadvantage for IPPs if allowances are freely allocated to retail providers while IPPs are required to buy their allowances in an auction. This bifurcated system creates a price advantage for the entities that receive no-cost allowances. Since many of these entities compete with IPPs to build new generation, it would create an incentive for retail providers to build their own generation rather than seek it through competitive solicitations. It is important for the CPUC and CEC to be aware of this potential problem and to treat all similarly-situated market participants in a non-discriminatory manner. Similarly, revenues should not be used to offset consumer costs or otherwise blunt the market price signal associated with GHG reductions.

Q9: Please address the effect that each of the allowance allocation options discussed in the staff paper, or in the articles attached to the staff paper, or in your own or other parties' opening comments, would have on economic efficiency in the economy, and the economic incentives that each option would create for market participants. (4/16/08)

The CEC and CPUC should carefully consider the impact of each of the allowance allocation options discussed in the Staff Paper on electric reliability. If insufficient allowances are available to carbon-based fossil fuel generators in an auction or through no-cost allocations, it will put continued operation of these sources at risk. If there are insufficient new zero-emitting sources to make up for this lost capacity, electricity reliability will be at risk.

Q10: Describe in detail the method you prefer for returning auction revenues to benefit electricity consumers in California. In addition to your recommendation, comment on the pros and cons of each method listed above, especially regarding the benefit to electricity consumers, impact on GHG emissions, and impact on consumption of electricity by consumers. (4/16/08)

Dynegy supports a program that initially allocates allowances to affected entities based on historical emissions and gradually phases into an auction. Once the auction is in effect, proceeds from the auction should be spent based on the following guidelines:

- Other than low-income and other need-based assistance, auction revenues should not be used for general ratepayer assistance. Ratepayers should not be insulated completely from the costs associated with GHG reductions and revenues should not be used to dampen the price signals associated with GHG reductions.
- GHG reductions resulting from programs implemented with auction revenues should result in GHG reductions that are real, permanent, quantifiable, verifiable, and enforceable as required by AB 32, not one-time reductions. In short, GHG reductions resulting from the auction proceeds should be subject to the same rigorous standards as offsets generated by process improvements or other means with the intent of being banked for trading.
- Auction revenues must be carefully expended so as to not advantage investor owned utilities who are both customers and market participants in the “hybrid” California electricity market. Auction revenues should not be used for programs that directly, indirectly, or cumulatively provide a distinct competitive advantage to the LSE over IPP-owned generation.
- Investments in energy efficiency which result in cost-effective GHG reductions should receive high priority.

- Investments in new technology retrofit programs for proven control technologies should be encouraged. In contrast, investments in the development of new control technologies that are not commercially proven should be avoided, since they result in no GHG reduction benefits and there are other avenues for funding such technology development, such as the PIER program and private sector venture capital.
- Dynegy supports the use of auction revenues to provide assistance to low-income customers. The GHG auction revenues used toward this purpose should be used to offset that portion of the customers' bills associated with GHG programs and should not be used as general ratepayer assistance.

Q11: If auction revenues are used to augment investments in energy efficiency and renewable power, how much of the auction proceeds should be dedicated to this purpose? (4/16/08)

The majority of the auction revenues should be used to increase energy efficiency levels in the residential, commercial and industrial communities and to invest in new technology that will reduce GHG emissions from fossil generation. No commercial technologies exist today that can reduce or remove CO₂ from fossil-fuel generators exhaust gas. In order for the State to reach the ambitious GHG reduction goals outlined in AB 32 and the Governor's executive order, new control technology will be needed and should be a priority investment for auction revenues.

Q12: If auction revenues are used to maintain affordable rates, should the revenues be used to lower retail providers' overall revenue requirements, returned to electricity consumers directly through a refund, used to provide targeted rate relief to low-income consumers, or used in some other manner? Describe your preferred option in detail. In addition to your recommendation, comment on the pros and cons of each method identified for maintaining reasonable rates. (4/16/08)

Dynegy supports the use of auction revenues to provide assistance to low-income customers. The GHG auction revenues used toward this purpose should be used to offset that portion of the customer's bills' associated with GHG programs and should not be used as general ratepayer assistance. Auction revenues should not be used for general ratepayer assistance. Ratepayers should not be insulated completely from the costs

associated with GHG reductions and revenues should not be used to dampen the price signals associated with GHG reductions. Rather than provide refunds, the State should use the auction proceeds to invest in additional energy efficiency measures which will reduce ratepayers use of electricity and reduce their total monthly electric bill.

Q13: If you prefer a combination of methods for returning auction revenues, describe your preferred combination in detail. (4/16/08)

See response to question 10.

V. FLEXIBLE COMPLIANCE

A. Detailed proposal

Q1: Please explain in detail your comprehensive proposal for flexible compliance rules for a cap-and-trade program for California as it pertains to the electricity sector. Address each of the cost containment mechanisms you find relevant including those mentioned in this ruling and any others you would propose. (5/6/08)

In designing a cap and trade program for California, the CEC, CPUC and CARB should give impacted industries the greatest number of tools to meet the GHG emission reduction goals. Flexibility is key to meeting those goals. Affected industries need to have as many tools as possible available so they can figure out what works best for them to reduce GHG emissions.

Dynegy proposes that the following tools should be part of the final GHG regulation adopted by the CARB.

- Banking - Banking is an important tool in a cap and trade program. Sources that reduce their overall GHG emissions through modernization, process changes or other technologies should be allowed to bank those credits. There should be no expiration of banked allowances.
- Early Action Recognition- There must be recognition for early action before 2012. Many companies have already repowered or replaced their facilities or plan to do so before the start of the GHG program. Their efforts should be recognized.

- **Offsets** - Offsets should be allowed as long as they are quantifiable and verifiable. They are an important tool in GHG emission reduction efforts, especially in sectors where reductions are limited due to technology constraints, reliability concerns or due to cost. In addition, the use of offsets should not be limited. A ton of CO₂ is the same throughout the economy and should be valued the same regardless of where it occurs. Offsets should be allowed from all sources, including sources from within the cap and indirect emissions in sectors covered by the cap. Finally, California should recognize offsets from other trading systems as long as they are quantifiable and verifiable.
- **Flexible Compliance Periods** – Flexibility is needed in compliance periods to allow for changes in electricity usage due to variable weather patterns and fluctuations in the availability of hydroelectricity in any given year.

B. Scope of market and related issues

Q1 (a): Discuss how your proposal would affect the environmental integrity of the cap, California's ability to link with other trading systems, and administrative complexity. (5/6/08)

Q1 (b): Address how your various recommendations interact with one another and with the overall market and describe what kind of market you envision being created. (5/6/08)

Q1 (c): Describe and specify how unique circumstances in the electricity market may warrant any special consideration in crafting flexible compliance policies for a multi-sector cap-and-trade program. (5/6/08)

Q1 (d): If your recommendations are based on assumptions about the type and scope of a cap-and-trade market that CARB will adopt, provide a description of the anticipated market including sectors included, expected or required emission reductions from the electricity sector, and the role that flexible compliance mechanisms serve in the market, e.g., purely cost containment, catalyst for long-term investment, and/or protection against market failures. (5/6/08)

Q4: To what extent should the recommendations to the CARB for flexible compliance in the electricity sector depend on the ultimate scope of the multi-sector cap-and-trade program and other market design issues such as allocation methodology and sector emission reduction obligations? Can the Commissions make meaningful recommendations on flexibility of market operations when the market itself has not yet been designed? Why or why not? (5/6/08)

Many of the suggestions Dynegy has made for flexible compliance assume a cap and trade market is created and has broad coverage. Dynegy supports the creation of a GHG cap and trade program that includes all major sources of GHG emissions, not just one sector and not just major stationary sources in one or a limited number of sectors.

Instead, all sectors and all sources large enough to justify regulation and that have GHG emissions should be included in GHG regulation.

The CPUC and CEC can and should make recommendations to the CARB on the type of flexible options that are available to affected industries. The Commissions have an obligation to inform the CARB of the impact on the electric industry if the market is limited or narrow in scope and make recommendations to CARB that ensure electric reliability is maintained while the State works on reducing GHG emissions.

Q5: 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? If non-obligated entities are allowed to participate in the market, should the trading rules differ for them? If so, how? (5/6/08)

If California decides to auction a portion of the GHG emission allowances, the market should initially be limited to entities that have to comply with the GHG emission reduction obligation. Dynegy is concerned that the pool of GHG emission allowances is too small to allow auction participants to create artificial scarcity by buying and retiring allowances. As the auction progresses, entities in regulated sectors will be vying for a limited number of allowances that will decline in each consecutive year. If insufficient allowances are available for purchase and alternative compliance options are limited, it could cause reliability concerns if critical generation units are unable to obtain sufficient allowances to meet their compliance obligation. Because of these concerns, Dynegy recommends that, initially, participation in an auction should be limited to those entities that have a compliance obligation.

The offset market does not have the same scarcity issues associated with it as the allowance market as long as the program is not artificially constrained. As long as offsets

are quantifiable and verifiable, there should not be limitations on who can acquire them or where they are located. The inclusion of flexible compliance options through the use of offsets will help alleviate some of the scarcity and reliability concerns Dynegy has with the auctioning of allowances.

C. Price triggers and other safety valves

Q6: Should California incorporate price triggers or other safety valves in a cap-and-trade system? Why or why not? Would price triggers or other safety valves affect environmental integrity and/or the ability to link with other systems? Address options including State market intervention to sell or purchase GHG emission allowances to drive allowance prices down or up; a circuit breaker or accelerator which either slows down or speeds up reductions in the emission cap until allowance prices respond; and increasing or decreasing offset limits to increase or decrease liquidity to affect prices. Address how these various strategies would be utilized in conjunction with other flexible compliance mechanisms. (5/6/08)

Q7: Should California create an independent oversight board for the GHG market? If so, what should its role be? Should it intervene in the market to manage the price of carbon? If such an oversight board were created, how would that affect your recommendations, e.g., would the oversight board obviate the need to include additional cost containment mechanisms and price-triggered safety valves in the market design? (5/6/08)

The risks of gaming, hoarding and other unknown threats are strong arguments for California to put in place a safety valve, in the form of a price cap on the cost of credits, to assure price certainty and stability. Uncertainty, volatility, and potentially very high prices for CO₂ credits would adversely impact generators, putting up barriers to investment in new projects. Volatility is the profit mechanism for traders – not for wholesale generators dependent upon physical assets. And extreme prices will force fossil generators to decrease operations, possibly to shutdown: without the ability to earn a profit, there will be no capital dollars available for new investment.

D. Linkage

- Q8: Should California accept all tradable units, i.e., GHG emission allowances and offsets, from other carbon trading programs? Such tradable units could include, e.g., Certified Emission Reductions, Clean Development Mechanism (CDM) credits, and/or Joint Implementation credits. (5/6/08)**
- Q9: If so, what effects could such linkage have on allowance prices and other compliance costs of California obligated entities? Under what conditions could linkage increase or decrease compliance costs of California obligated entities? To what extent would linkage subject the California system to market rules of the other systems? What analysis is needed to ensure that other systems have adequate stringency, monitoring, compliance, and enforcement provisions to warrant linkage? What types of verification or registration should be required? (5/6/08)**
- Q10: If linkage is allowed, should it be unilateral (where California accepts allowances and other credits from other carbon trading programs, but does not allow its own allowances and offsets to be used by other carbon trading programs) or bilateral (where California accepts allowances and other credits from other carbon trading programs and allows its allowances and offsets to be used by other carbon trading programs)? (5/6/08)**
- Q11: If linkage is allowed, should allowances and other credits from other carbon trading programs be treated as offsets, such that any limitations applied to offsets would apply to such credits? If not, how should they be treated? (5/6/08)**

California should recognize and accept emission reductions from other trading programs as long as the reductions are quantifiable and verifiable. Linking to other systems will further the goal of transitioning to a national program and enable companies to seek out the most cost-effective emission reductions. Linkage will only be effective if it is bilateral and if there are no limitations or discounts on credits obtained in other jurisdictions.

E. Compliance periods

- Q12: What length of compliance periods should be used? Should compliance periods remain the same throughout the 2012 to 2020 period? Should compliance periods be the same for all entities and sectors? Should dates be staggered so that not all obligated entities have the same compliance dates? (5/6/08)**

Q13: Should compliance extensions be granted? If so, under what circumstances? (5/6/08)

Compliance periods should be flexible enough to account for fluctuations in weather patterns and hydroelectricity supply conditions.

F. Banking and borrowing

Q14: Should entities with California compliance obligations be allowed to bank any or all tradable units, including allowances, offsets, or credits from other carbon trading programs? Should entities that do not have compliance obligations be able to bank tradable units? If so, for how long and with what other conditions? Should allowances, offsets, or credits from other carbon trading programs banked during the program between 2012 and 2020 be recognized after 2020? If the California system joins a regional, national, or international carbon trading program, how should unused banked allowances, offsets, or credits from other carbon trading programs be treated? (5/6/08)

Flexibility in compliance options is needed to help California attain its ambitious GHG emission reduction goals. Entities that have California compliance obligations should be allowed to bank tradable allowances, offsets and credits from other trading programs. To prevent gaming and hoarding, entities that do not have a compliance obligation should not be able to bank allowances.

Q15: Should limitations be placed on banking aimed at preventing or limiting market participants' ability to "hoard" allowances and offsets or distort market prices? (5/6/08)

See response to question 14.

Q16: Should entities with compliance obligations be allowed to borrow allowances to meet a portion of their obligation? If so, during what compliance periods and for what portion of their obligation? How long should they be given to repay borrowed allowances? Should there be penalties or interest payments? Should there be other conditions on borrowing, such as limitations on the ability to borrow from affiliated entities? Also address the extent to which borrowing might affect environmental integrity and emission reductions. (5/6/08)

Yes, borrowing should be permitted. Any mechanisms that provide flexibility for fossil-fuel generators to achieve compliance with GHG emission reduction goals,

including borrowing of credits, should be maximized until such time that alternative compliance approaches exist.

H. Offsets

Q21: Should California allow offsets for AB 32 compliance purposes? (5/6/08)

Q22: 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? (5/6/08)

Offsets are an important compliance tool in meeting GHG emission reduction goals and should be allowed. As long as the emission reductions associated with the offsets are quantifiable and verifiable there should not be geographic limitations on the use of the offsets.

Q23: Should voluntary GHG emission reduction projects, i.e., projects that are not developed to comply with governmental mandates, be permitted as offsets if they are within sectors in California that are not within the cap-and-trade program? In particular, should voluntary GHG emission reduction projects within the natural gas sector in California be permitted as offsets, if the natural gas sector is not yet in the cap-and-trade program? (5/6/08)

Voluntary GHG emission reductions are another flexible compliance tool and should be permitted as offsets. In the case of the natural gas sector, as long as the projects are quantifiable, verifiable and not created by ratepayer or government funded programs, they should be allowed to be counted as offsets.

Q24: Should there be limits to the quantity of offsets? If so, how should the limits be determined? (5/6/08)

Offsets should not be limited. No commercial technologies exist today that can reduce/remove CO₂ from fossil-fuel generators exhaust gas. The only mechanism for California fossil generators to comply with CO₂ reduction caps is through offsets. Thus the availability of offsets in any source-based cap and trade program adopted by

California should be maximized, at least until such point that alternative compliance approaches/technologies are available. Valid offsets as wide in nature and geographic scope as possible should be allowed. Discount factors should not be applied to offsets.

Q25: How should an offsets program be administered? What should be the project approval and quantification process? What protocols should be used to determine eligibility of proposed offsets? Are existing protocols that have been developed elsewhere acceptable for use in California, or is additional protocol development needed? Should offsets that have been certified by other trading programs be accepted? Should use of CDM or Joint Implementation credits be allowed? (5/6/08)

The Kyoto/CDM process is complicated and is currently proving to be too burdensome to allow timely review and approval of projects.

Q26: Should California discount credits (i.e. make the credits worth less than a ton of CO₂e) from some offset projects or other trading programs to account for uncertainty in emission reductions achieved? If so, what types of credits would be discounted? How would the appropriate discount be quantified and accounted for? (5/6/08)

Discount factors should not be applied to offsets. A one ton reduction of CO₂e should be worth one ton credit of CO₂e, especially given the global nature of CO₂.

VI. NON-MARKET-BASED EMISSION REDUCTION MEASURES (OTHER THAN CHP) AND EMISSION CAPS

A. Electricity emission reduction measures

Q1: What direct programmatic or regulatory emission reduction measures, in addition to current mandates in the areas of energy efficiency and renewables, should be included for the electricity and natural gas sectors in CARB's Assembly Bill (AB) 32 scoping plan? (5/13/08)

Q2: Are there additional regulations that CARB should promulgate in the context of implementing AB 32, that would assist or augment existing programs and policies for emission reduction measures in the electricity and natural gas sectors? (5/13/08)

The lack of availability of control technology for GHG limits what can be done through regulatory mandates to reduce emissions from California's existing electric

generation fleet. Reductions can only be had through reduced usage, repowerings, replacements and retirement of existing units. All of these options have an impact on the reliability of the system. The best use of regulatory mandate would be to order additional investments in energy efficiency and increased procurement of renewable resources. Additionally, we encourage the State to work with the federal government to create investments in and incentives for the creation of new CO2 control technologies.

B. Natural gas emission reduction measures

Q1: What direct programmatic or regulatory emission reduction measures, in addition to current mandates in the areas of energy efficiency and renewables, should be included for the electricity and natural gas sectors in CARB's Assembly Bill (AB) 32 scoping plan? (5/13/08)

See answer to Q4 below.

Q2: Are there additional regulations that CARB should promulgate in the context of implementing AB 32, that would assist or augment existing programs and policies for emission reduction measures in the electricity and natural gas sectors? (5/13/08)

See answer to Q4 below.

C. Annual emission caps for the electricity and natural gas sectors

Q4: The scope of this proceeding includes making recommendations to CARB regarding annual GHG emissions caps for the electricity and natural gas sectors. What should those recommendations be? What factors (e.g., potential effectiveness of identified emission reduction measures, rate impacts for electricity and natural gas customers, abatement cost in other sectors, anticipated carbon prices) should the Commissions consider in making GHG emissions cap recommendations? If sufficient information is not currently available to recommend cap levels, what cap-related recommendations should the Commissions make to CARB for inclusion in its scoping plan? (5/13/08)

Electric reliability should be a major consideration for CARB in determining how the natural gas and electricity sectors meet the targets and timelines for the state's GHG emission reduction goals. Targets and timelines should be closely aligned with

technology developments. If CARB mandates emission reductions earlier than sufficient renewable generation can be developed or emission reduction technologies can be implemented, electrical reliability will be negatively impacted. Ultimately, the final GHG program should have enough flexibility built into it so that CARB can adapt the GHG program to address changing patterns in electricity and natural gas consumption and innovations in technology.

Dated: June 2, 2008

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CERTIFICATE OF SERVICE

I hereby certify that on June 2, 2008, I served a copy of the “*Dynegy Comments on Emission Reduction Measures, Modeling Results, and Other Issues; Incorporating Materials into the Record; and Recommending Outline for Comments*” on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list as required in this Rulemaking. On June 2, 2008 I also served this same document on the California Energy Commission in Docket No. 07-OIIP-01 as directed in the May 20, 2008 California Public Utilities Commission Ruling in R.06-04-009. Those parties without email addresses or from which I received a delivery failed message were served by first-class mail with postage prepaid.

Executed on June 2, 2008 at Sacramento, California.


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R.06-04-009
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