

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA AND THE
CALIFORNIA ENERGY COMMISSION**

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emission Standards into Procurement Policies.

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

Order Instituting Informational Proceeding – AB 32.

CEC Docket No. 07-OIIP-01

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**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
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In accordance with the Administrative Law Judges' ("ALJs") Rulings dated April 16, 2008, May 1, 2008, May 6, 2008, May 13, 2008, and May 20, 2008 in the captioned proceeding, the Southern California Public Power Authority ("SCPPA")¹ respectfully submits this comprehensive comment on the issues raised in the Rulings. In accordance with the Rulings, this comment is being submitted simultaneously to both the California Public Utilities Commission ("CPUC") and the California Energy Commission ("CEC") (jointly "Commissions"). This comment follows the outline that was suggested in the ALJs' May 20, 2008 Ruling.

¹ SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Pasadena, and Riverside.

The Interim Opinion

The Commissions issued an Interim Opinion on Greenhouse Gas Regulatory Strategies (“Interim Opinion”), Decision (“D.”) 08-03-018 on March 13, 2006. The Commissions recommended that the California Air Resources Board (“CARB”) adopt a two-pronged approach to achieving greenhouse gas (“GHG”) reductions for the electric sector under Assembly Bill (“AB”) 32. First, the Commissions recommended that reductions be achieved programmatically through retail provider implementation of energy efficiency measures, the Renewable Portfolio Standard (“RPS”) program, and the Emissions Performance Standard (“EPS”). D.08-03-018 at 31-37. Second, the Commissions determined that the electric sector should be included in a multi-sector cap-and-trade program. D.08-03-018 at 1. The Commissions found that “deliverers” of electricity should be the electric sector entities that would be required to participate in the cap-and-trade program. However, in the Commissions’ view, neither the deliverers nor the electric sector as a whole should be subject to specific caps. Instead, the Commissions proposed that there should be a single cap for the aggregate emissions from all of the sectors that would be included in a California cap-and-trade program. Electric sector deliverers would be required to hold allowances to cover whatever their emissions might be during a given compliance period.

The E3 Results

There has been a significant development since the issuance of the Interim Opinion. The Commissions’ consultant, Energy and Environmental Economics, Inc., (“E3”), has developed a model, the “GHG Calculator,” to project the cost and rate impact of various policy options. E3’s finalized Results and Sensitivities (“E3 Results”) were posted on May 13, 2008 at [http://www.E3.com/GHG/E3_CPUC_GHGResults_13May08%20\(2\).pdf](http://www.E3.com/GHG/E3_CPUC_GHGResults_13May08%20(2).pdf), The E3 Results

provide a critical factual context for assessing the Commissions' recommendation that the electric sector should be included in a single-cap multi-sector cap-and-trade program.

The Commissions conjectured in the Interim Opinion that "a large portion of the emissions reductions in the electricity sector would come from mandated investments in energy efficiency or other demand reduction programs as well as renewable energy goals" with a cap-and-trade program producing "a relatively small portion of the overall emission reductions in the short term." D.08-03-018 at 39. The May 13, 2008 E3 Results demonstrate that even less emission reductions would result from the cap-and-trade program than were pessimistically projected by the Commissions. In fact, the E3 Results show that nearly *no* emissions reductions would be derived from participation in a cap-and-trade program until very high levels of allowance prices--\$100 to \$150/ton CO₂--are reached. Furthermore, the E3 Results also show that existing renewable portfolio standards ("RPS"), energy efficiency programs, Senate Bill ("SB") 1368 emissions performance standards ("EPS"), and projected conversions of simple-cycle gas generation to combined cycle units will result in electric sector emissions in 2020 that are lower than electric sector emissions were in 1990.

Revisiting the Interim Opinion in Light of the E3 Results

Now that the E3 Results are available, SCPPA urges the Commissions to revisit their Interim Opinion recommendation that the electric sector should be required to participate in a single-cap multi-sector cap-and-trade program. The California Air Resources Board ("CARB") has, so far, failed to produce modeling results showing that other sectors will be able to reduce CO₂ emissions at a low cost so as to restrain the cost of allowances in a multi-sector cap-and-trade program. Given the E3 results showing the potential inefficacy of requiring the electric sector to participate in a multi-sector cap-and-trade program except at very high allowance prices

and given the current absence of evidence about the cost of GHG reductions in other sectors, it would be premature to force the electric sector into a multi-sector cap-and-trade program. Thus, SCPPA recommends that the Commissions revisit their Interim Opinion and, upon reconsideration, defer recommending that the electric sector participate in a multi-sector cap-and-trade program. Section I below explains more fully why the Commissions should defer making such a recommendation about electric sector participation in a multi-sector cap-and-trade program at this time.

Allocating Allowances

The Commissions recognized in the Interim Opinion that if electric sector deliverers were required to participate in a cap-and-trade program, it would be important to develop an emission allowance allocation policy that would ensure that GHG emission reductions would be accomplished at the lowest cost to consumers with the consumers of all retail providers being treated equitably. Interim Opinion at 8. The Commissions expressly stated that they would keep in mind that some deliverers of electricity are also retail providers and that some retail providers are differently situated from others:

In addressing allocation issues, we keep in mind that some deliverers of electricity to the California grid are also retail providers of electricity for consumers. We also recognize that allocation policy will have an impact on consumer costs. Our intent in developing additional allocation policy recommendations is to ensure that GHG emissions reductions are accomplished equitably and effectively, at the lowest cost to consumers. While we may wish to reward early actions to reduce GHG emissions in advance of 2012 when the AB 32 compliance period begins, it is not our intent to treat any market participants unfairly based on their past investments or decisions made prior to the passage of AB 32.

Interim Opinion at 8. The Commissions added that they would consider “all reasonable options for allocation policy” to take into account the different situation of various retail providers: “We

reiterate our openness to considering all reasonable options for allocation policy that take into account the circumstances of differently-situated entities in the electricity sector, to ensure that all obligated entities have a path for compliance at reasonable cost, consistent with the general principles outlined here.” Interim Opinion at 101 (footnote omitted).

SCPPA’s members are fully resourced retail providers that have a carbon-intensive resource mix. They recognize that they are going to be required to do much more than others programmatically to reduce their carbon footprint. SCPPA appreciates the Commissions’ explicit recognition that some retail providers such as the SCPPA members are differently situated from others. Likewise, SCPPA appreciates the Commissions’ recognition of the need to adopt an allocation policy that assures that the consumers of all retail providers will be treated equitably while minimizing the cost impact that the cap-and-trade program could have for all consumers.

In previous phases of this proceeding, SCPPA proposed a method for allocating allowances on the basis of historical emissions to retail providers as the point of regulation in the electric sector. SCPPA’s proposal was aimed at minimizing the cost of allowances for consumers. However, the Commissions elected in the Interim Opinion to designate deliverers rather than retail providers as the electric sector point of regulation. Now, the Commissions are addressing the task of designing an allowance allocation program that will treat all consumers equitably while minimizing the cost that requiring deliverers to hold allowances may ultimately impose on consumers.

Unfortunately, the task of crafting an allowance allocation program that is equitable to all consumers while minimizing the cost of the program for consumers may be difficult as long as it is assumed, consistent with the Interim Opinion, that deliverers will be point of regulation in the

electric sector. In Section III below, SCPPA addresses some proposals that the Commissions' Staff presented in their Joint CPUC and CEC Staff Paper on the Options for Allocation of GHG Allowances in the Electricity Sector ("Staff Paper") that was attached to the ALJs' April 16, 2008 Ruling. SCPPA appreciates the efforts made by the Staff. The Staff clearly attempted to develop some preferred allowance allocation approaches that would treat the consumers of all retail providers equitably while minimizing the cost of cap-and-trade for all consumers. However, even the most promising of the Staff's preferred approaches raise unresolved issues that need to be addressed before further consideration can be given to the proposals.

Flexible Compliance Mechanisms

SCPPA supports incorporating flexible compliance mechanisms into a California cap-and-trade program, assuming that such a program were to be adopted by the CARB. Banking, borrowing, and offsets are essential for meeting the AB 32 goal of minimizing the cost of the program. Furthermore, flexible compliance mechanisms can assist in meeting programmatic objectives beyond cost containment. For example, banking and borrowing can provide incentives for regulated entities to plan and invest in emission reduction measures for the longer term, and a liberal offsets program can provide incentives to innovation in achieving emission reductions. Safety valves would provide important protection against disequilibrium or illiquidity in allowance markets. An independent market intervention agency could also provide protection against market distortions. For the reasons discussed in Section IV below, SCPPA urges the Commissions and CARB to consider a full suite of measures including banking, borrowing, offsets, safety valves, and an independent market intervention agency to accomplish cost containment as well as other important objectives.

I. THE COMMISSIONS SHOULD DEFER MAKING A RECOMMENDATION THAT THE ELECTRIC SECTOR SHOULD BE INCLUDED IN A SINGLE-CAP MULTI-SECTOR CAP-AND-TRADE PROGRAM.

Now that the E3 Results have become available, the Commissions should reconsider their March 13, 2008 recommendation that electric sector deliverers should be subject to a single-cap multi-sector cap-and-trade program for California. The combination of what is in the E3 Results as well as what is *not* in the E3 Results vitiates the rationale presented in D.08-03-018 for including deliverers in a single-cap multi-sector cap-and-trade program. These plus other considerations indicate that the Commissions should defer making a recommendation about whether the electric sector should be included in a single-cap multi-sector cap-and-trade program.

A. The E3 Results Fail to Project the Allowance Prices that Could Result from Including the Electric Sector in a Single-Cap Multi-Sector Cap-and-Trade Program.

There is a key piece of information that should be available to the Commissions in order for them to make a reasoned decision about whether the electric sector should be required to participate in a single-cap multi-sector cap-and-trade program. The Commissions should have a projection based on credible modeling about the allowance prices that would be experienced by the regulated entities in the electric sector if they were required to participate in the cap-and-trade program.

The Commission did not have that information when they issued their Interim Opinion, and they still do not have that information. E3 specifically refrained from projecting allowance prices: “**Model does NOT determine the CO₂ market price!**” E3 Results, Slide 20 (emphasis in original). CARB is attempting to model various single-cap multi-sector cap-and-trade scenarios so as to be able to project allowance prices. However, as explained by CARB staff at the CARB “scenarios” workshop held on May 19, 2008, CARB does not yet have projections of

either allowance prices or the effect that projected allowance prices would have on the California economy. CARB hopes to have some preliminary results available by the time CARB releases a draft Scoping Plan on June 26, 2008. Further results may not be available until CARB releases a “supplement” to the draft Scoping Plan in July, 2008.

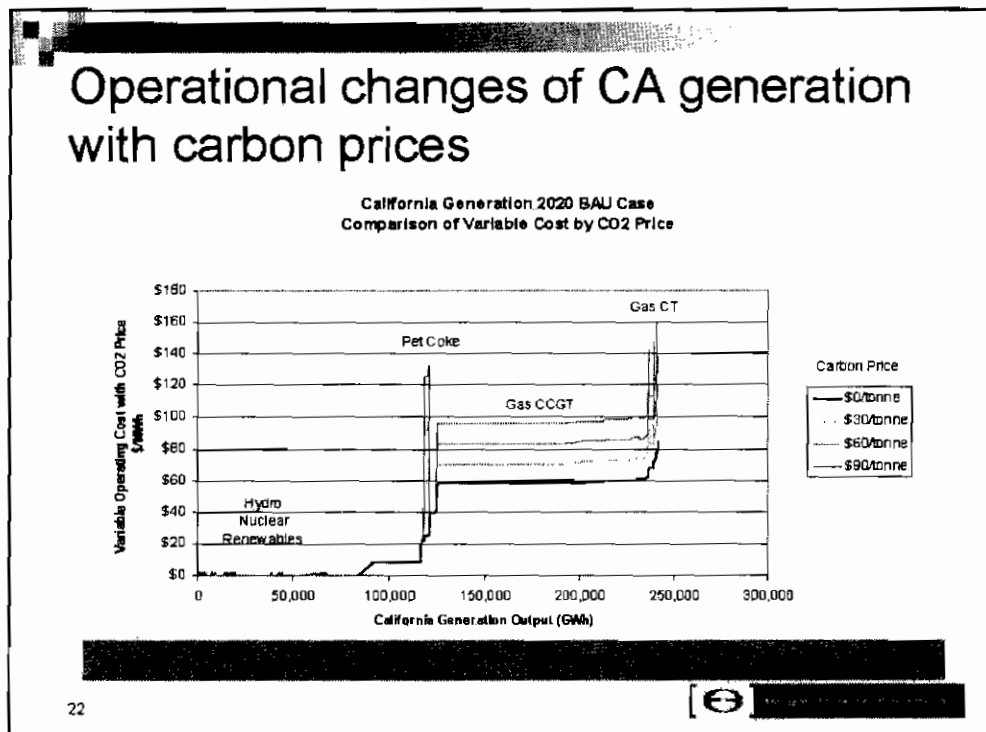
Projecting allowance prices in a multi-sector cap-and-trade program may be difficult. Allowance prices reflect the marginal cost of reducing an additional ton of CO₂, not the average cost of reduction. Thus, allowance prices could be affected by a multiplicity of variables. The level of allowance prices would be affected by the number of sectors that would be included in a single-cap multi-sector cap-and-trade program, and allowance prices would be affected by the cost of emission reductions in the various sectors. Likewise, the allowance prices could be significantly affected by the extent to which offsets are allowed. Allowance prices could also be affected by the glide path that ARB selects in moving from current emission levels to the statutorily mandated AB 32 goal of returning to the 1990 level of statewide GHG emissions by 2020.

Given the lack of information about allowance prices and the ultimate economic effects of adopting a single-cap multi-sector cap-and-trade program, it would be reasonable for the Commissions to revisit any decision about requiring the electric sector to participate in a single-cap multi-sector cap-and-trade program. A decision should be deferred until further information becomes available to permit reasoned decision-making that is based on substantial evidence.

B. The E3 Results Show that Including Deliverers in a California Single-Cap Multi-Sector Cap-and-Trade Program Could Raise the Cost of Achieving AB 32 Goals Without Realizing Any Offsetting Emissions Reduction Benefits.

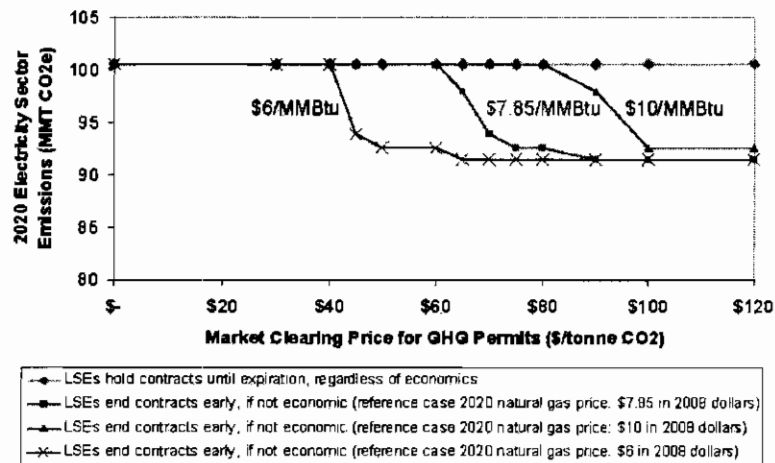
Although the E3 Results do not contain any projections of allowance prices, the E3 Results do show that requiring electric sector deliverers to participate in a California single-cap multi-sector cap-and-trade program would fail to realize nearly any actual emission reduction

benefits without raising allowance prices to very high levels. Including deliverers in a California cap-and-trade program could result in a reduction of GHG emissions by changing the economics of plant dispatch. However, E3 found that California generation facilities “are dispatched in emission order already.” E3 Results, Slide 21. “CO2 price does not change the economic dispatch order in California (much).” E3 Results, Slide 22. Including California generation facilities in a cap-and-trade program would not result in a meaningful change of dispatch until very high allowance cost levels are reached:



E3 Results, Slide 22. Similarly, E3 found that a change in imports of out-of-state fossil (primarily, coal) generation would occur only at high allowance prices:

Change in imports of out-of-state fossil generation with different natural gas and carbon prices



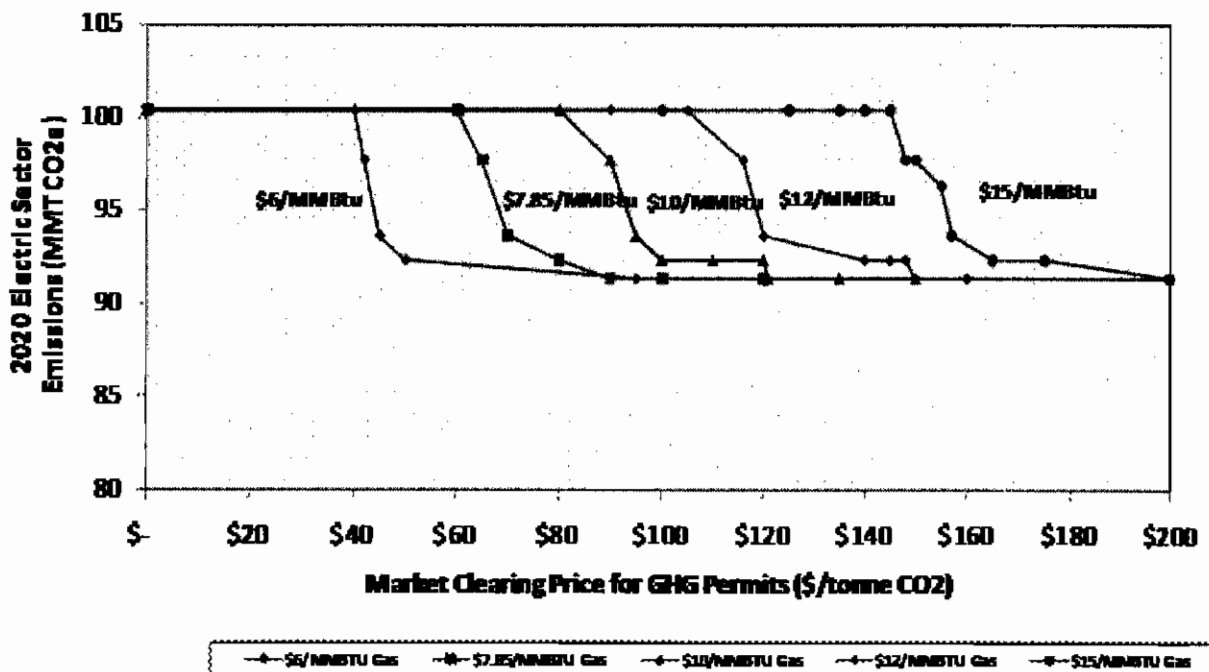
23

Scenario: 20% RPS, 'Mid goals' of EE



Estimate of GHG emissions reductions

E3 Results, Slide 23. If gas prices are assumed to be at or beyond today's prices of nearly \$12/MMBtu, even higher allowance prices would be required to alter the dispatch of coal-fired generation:



If allowance prices of approximately \$100/tonCO₂ were assumed, the electric sector would be required to pay approximately \$98 billion during the 2012 to 2020 period, or approximately \$10.9 billion per year for allowances.

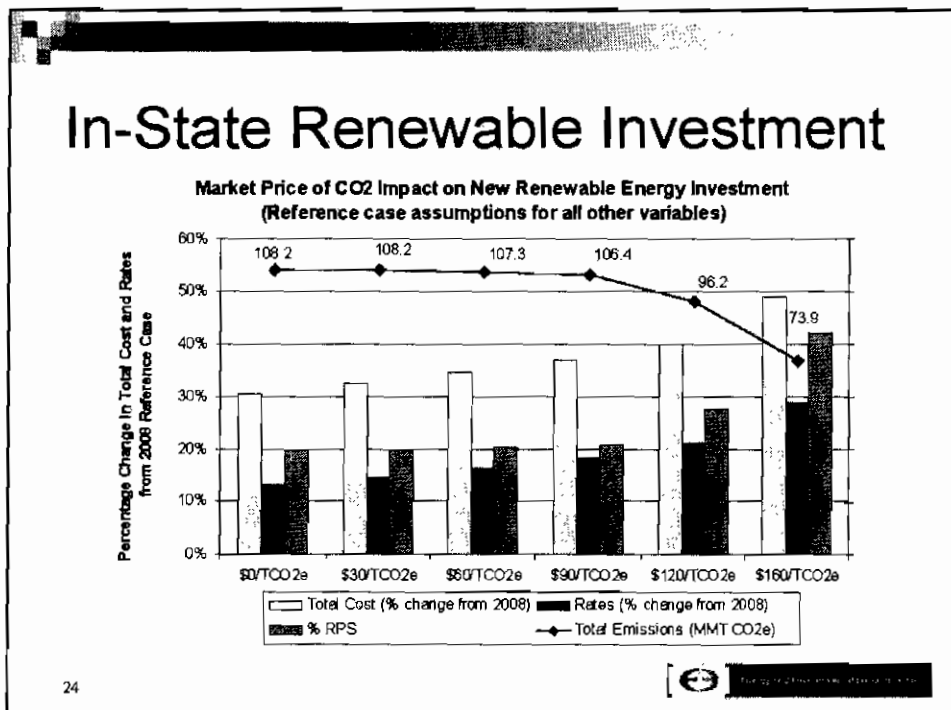
High allowance prices were not intended by the Legislature when it promulgated AB 32. Although the Legislature clearly and unequivocally expressed its intent that the AB 32 GHG reduction goal shall be met, the Legislature also made it clear that the goal shall be met in such a way as to minimize costs. AB 32 requires that the AB 32 GHG emission reduction goals shall be “implemented in an *efficient and cost-effective* manner.” CARB shall “[d]esign the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to *minimize costs* and maximize the total benefits to California....” Cal. H&S Code § 38562 (b) (1) (emphasis added).

Requiring deliverers to participate in a single-cap cap-and-trade program for California as envisioned by the Commissions in their Interim Opinion would have the clear potential to *raise* the costs of the AB 32 implementation program to high levels before attaining any meaningful emission reductions through changing the order of dispatch. In the absence of tangible data about the availability of and cost of emission reduction measures in other sectors that could put downward pressure on allowance prices without reaching the levels required to affect the order of dispatch, the Commissions should reconsider and defer making any judgment about requiring the electric sector to be included in multi-sector cap-and-trade program.

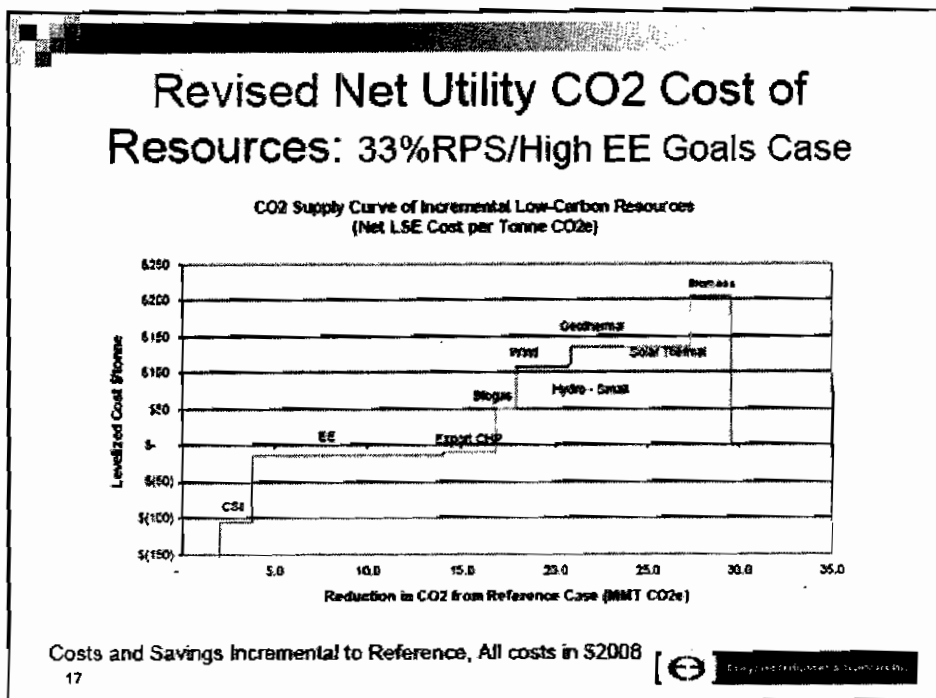
C. Including the Electric Sector in a Cap-and-Trade Program Would Be Likely to Make Incremental Renewable Generation Economic Only at High Allowance Prices.

Inclusion of deliverers in a cap-and-trade program also could contribute to reducing greenhouse gas emissions by making it economic to invest in low-GHG renewable energy resources beyond those that are projected to be installed under the existing policies that are

assumed in E3's Reference Case. If incremental low-GHG resources became economic, the resources would be more likely to be installed without reliance on increased programmatic mandates. However, similar to E3's findings about the level of allowance prices that would be required to affect dispatching in California, E3 found that investments in renewable resources above the Reference Case on an economic basis without enhanced programmatic mandates would occur only at very high allowance prices exceeding \$100/ton CO₂.



E3 Results, Slide 24. The high allowance prices that would be required to induce investment in incremental renewable resources were further shown by E3 as follows:



E3 Results, Slide 17. This slide shows that wind and geothermal investments above those that are projected in E3's Reference Case would only be made economic at allowance prices exceeding \$100/tonCO₂. The current 20 percent RPS is expected to exhaust the lower-cost renewable project opportunities that are identified in E3's analysis.

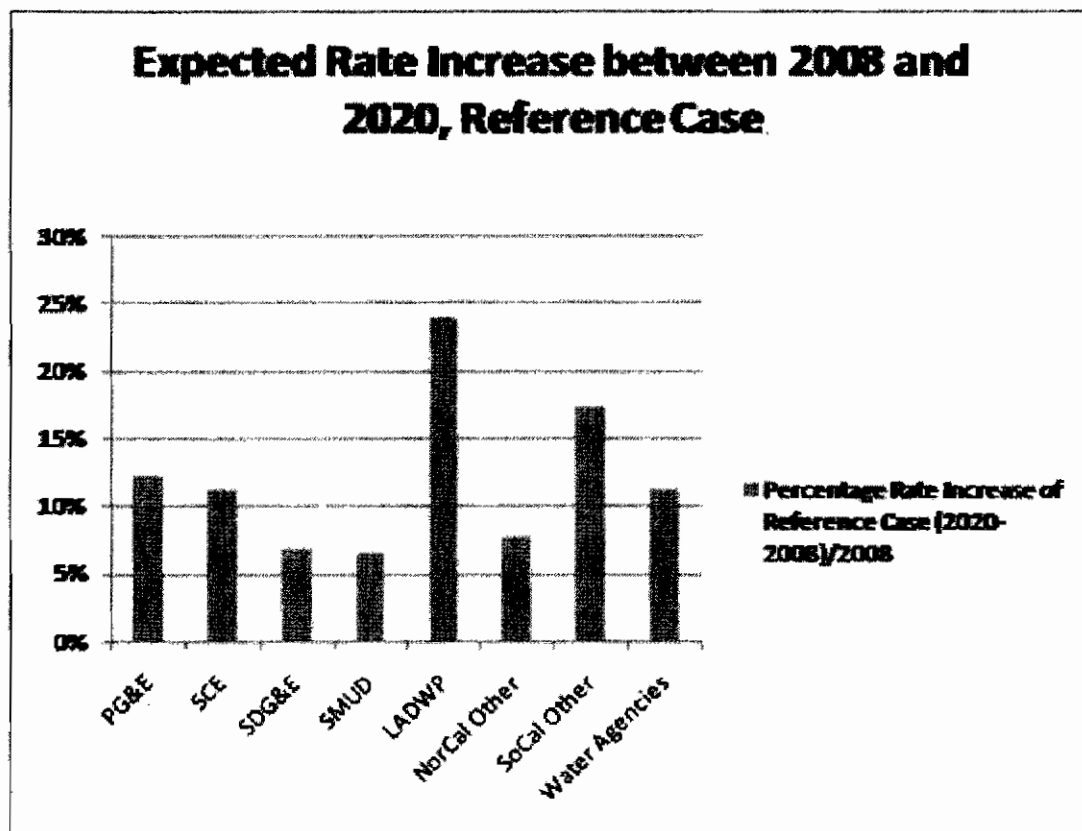
D. The E3 Results Show that Programmatic Measures Can Be Used to Attain AB 32 Goals.

While the E3 Results show that including the electric sector would fail to cause any significant change in dispatching and would fail to make incremental renewable projects economic except at very high allowance levels, the E3 Results show that programmatic measures can be used to attain AB 32 goals. The E3 Reference Case assumes a 20 percent RPS and “business as usual” energy efficiency programs. E3 found that under the Reference Case, 2020 emissions for the electric sector would be reduced to 108.2 MMtCO₂. E3 Results, Slide 14. Thus, utilizing only existing programs, the electric sector would achieve an emissions level

below its 1990 level, 110.6 MMtCO₂, by 2020. See CARB Staff Report, California 1990 Greenhouse Gas Emissions Level and 2020 Emissions Level at 6 (November 16, 2007).

E3 recognized that the electric sector might be asked to do more than reduce its emissions to 1990 levels by 2020. E3 examined what it called a “high goals” case that assumed achieving a 33 percent RPS and attainment of a maximum of economic energy efficiency. Assuming these higher programmatic objectives, 2020 electric sector emissions would be reduced to 78.6 MMtCO₂, 71 percent of the electric sector’s 1990 emission level.

SCPPA recognizes that achieving AB 32 goals programmatically will impose the high burden on SCPPA members. E3 examined the change in retail provider rates from 2008 through 2020 that would be required to cover retail provider funding of E3 Reference Case measures. The highest burden would fall on the SCPPA members’ ratepayers, including the Los Angeles Department of Water and Power:



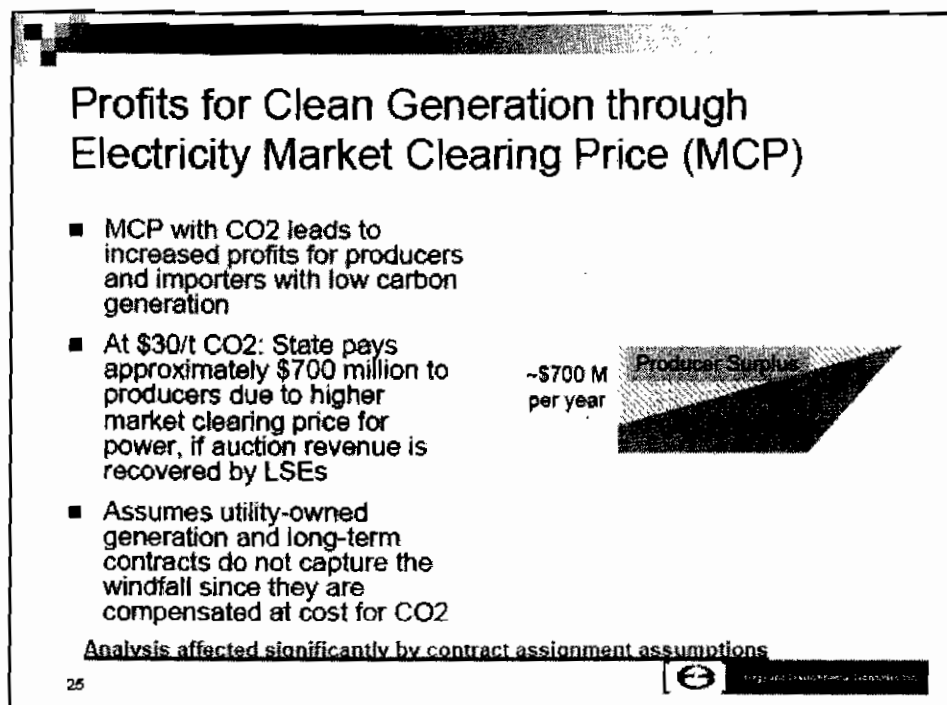
E3 Results, Slide 41. (Insofar as “SoCal Other” is roughly half SCPPA members other than LADWP and half energy service provider (“ESP”) direct access load, LADWP is the best indicator of the impact of meeting Reference Case goals on SCPPA members.)

Even though attaining E3 Reference Case objectives would impose the greatest burden on the ratepayers of SCPPA members, various members are already committed to goals that are higher than those assumed by E3 in its Reference Case. LADWP is committed to achieve a 35 percent RPS by 2020. Burbank and Riverside are committed to achieve a 33 percent RPS by 2020. The E3 analysis of the rate impact of a 33 percent RPS indicates that LADWP would incur a 46 percent increase in electricity rates (22 percent above the Reference Case increase of 24 percent that is shown above) between 2008 and 2020. Nevertheless, LADWP has set a goal of 35 percent for itself. A requirement that LADWP and the other similarly situated SCPPA members must purchase allowances would compound that already extreme rate impact.

The Commissions’ March 13, 2008 recommendation to include deliverers in a cap-and-trade program diverts attention from how to obtain concrete emission reductions through the programmatic measures that can be utilized to attain AB 32 goals. Given the lack of information from either E3 or the CARB about the level of allowance prices that could be expected under a single-cap multi-sector cap-and-trade program, it would be preferable for the Commissions to reassess their decision in the Interim Opinion to recommend that the electric sector be required to participate in a multi-sector cap-and-trade program and defer making any such recommendation until more information is available. In the meantime, the Commissions should focus on reducing barriers to renewable resources such as transmission, permitting, site control, and financing constraints.

E. A Cap-and-Trade Program Has the Potential to Result in Windfalls and Unnecessarily Increased Economic Rents that Would Exacerbate the Cost of the AB 32 Program.

In addition to deferring a decision about requiring the electric sector to participate in a cap-and-trade program due to lack of needed information, there are other reasons for deferring a decision about cap-and-trade. The E3 Results show that, in direct conflict with AB 32 requirement that AB 32 be “implemented in an efficient and *cost effective* manner,” a cap-and-trade program could result in some market participants realizing a windfall or increased economic rents that would raise AB 32 costs without realizing any emission reduction benefits. E3 calculated that assuming an allowance price at the relatively conservative level of \$30/tonCO₂, California could pay approximately \$700 million to producers of “clean generation” due to the higher market clearing price that they would realize for their product:



E3 Results, Slide 25. Other windfalls would result under various design options for cap-and-trade program. The Staff observed: “A pure emission-based allocation would almost certainly

result in considerable windfall profits for independent (non-utility) deliverers in competitive wholesale markets.” Staff Paper at 23.

Obviously, if deliverers were not required to participate in the California single-cap multi-sector cap-and-trade program, the potential for windfalls as envisioned in the E3 Results and in the Staff Paper would be obviated. It would be prudent for the Commissions to defer recommending inclusion of the electric sector in a single-cap multi-sector cap-and-trade program until more information is available about the potential effects of such a program on unnecessary windfalls becomes available.

F. Requiring Deliverers to Participate in a California Single-Cap Multi-Sector Cap-and-Trade Program Creates an Unnecessary Exposure to Potential Market Manipulation and Abuse.

Another reason for deferring a decision about including the electric sector in a California single-cap multi-sector cap-and-trade program is that the program would be exposed to the potential for illiquidity, volatility, market manipulation, and abuse. This is particularly true if the program is limited to California. A west-wide or national market would diminish the potential impact illiquidity, volatility, market manipulation, and abuse due to the substantially larger size of the market.

Deferring any recommendation that the electric sector should be required to participate in a cap-and-trade program would be consistent with awaiting development of a national cap-and-trade program. Both of the likely presidential candidates of the major national political parties advocate establishing a national GHG emissions reduction program. Without awaiting the election, Congress is actively considering legislation including S. 3036, America’s Climate Security Act. Legislation is expected to be passed next year, 2009. See U.S. Aims to Skirt Flaws in Europe’s Carbon Limits, Wall Street Journal, A4 (May 30, 2008).

G. Delaying Any Recommendation that the Electric Sector Be Required to Participate in a Cap-and-Trade Program Would Be Consistent with Avoiding the Cost of Melding a California Cap-and-Trade Program with a National Program.

If California were to proceed now with implementation of a cap-and-trade program on a single-state basis, not only would California run the risk of creating a market that would be exposed to illiquidity, volatility, market manipulation, and abuse. California would be required to endure the cost of modifying its program to mesh with the ultimately established federal program. AB 32 requires cost *minimization*. It would be consistent with AB 32 to avoid the potential for incurring the cost of melding a California program with the ultimately established federal program.

H. Instituting a Cap-and-Trade Program Conflicts with Retail Provider Attainment of Programmatic Objectives.

Requiring deliverers to participate in a California single-cap multi-sector cap-and-trade program could impede retail providers in attaining programmatic GHG emission reduction measures. Retail providers often tend to also be deliverers to the extent to which they own, operate, or control generation facilities. SCPPA members, in fact, tend to be fully resourced. As shown above, the customers of SCPPA members would have the highest burden of meeting E3 Reference Case objectives.

The SCPPA members' commitment to attaining expanded objectives is going to result in an even greater rate impact on the customers of SCPPA members. Requiring SCPPA members *both* to fund programs that would result in actual GHG emission reductions *and* to buy allowances through a cap-and-trade system would be likely to increase their cost of participation in California's GHG emission reduction effort. As a result, the requirement that retail providers that are also deliverers must purchase allowances could have the potential of diverting funds from efforts to attain concrete emission reductions. Any such diversions would impede rather

than enhance the ability of retail providers that are also deliverers to attain actual emission reductions.

I. The May 13, 2008 E3 Results Contradict the Summary Reasons Given by the Commissions in their March 13, 2008 Interim Opinion for Recommending Against Any Delay in Instituting a Cap-and-Trade Program.

In summary, the Commissions gave six reasons in D.08-03-018 for recommending “against any delay or a wait and see approach” to designing “a cap-and-trade program now.” D.08-03-018 at 5. The E3 Results that became available two months after the Commissions issued their Interim Opinion contradict each of the Commissions’ reasons for recommending against deferral:

- A cap-and-trade program is likely to produce additional real GHG emissions reductions beyond the mandatory program described above, from a wider variety of sources and at a lower cost than requiring reductions only from additional mandatory measures.

Response: The only “additional real GHG emissions reductions” identified by E3 that would result from requiring the electric sector to participate in a cap-and-trade program would occur at very high allowance prices. CARB has produced no data or analysis of the supply curve for emission reductions in other sectors that would indicate that the other sectors could produce emission reduction at a low cost so as to drive down allocation prices.

- It would achieve reductions in the least-cost manner by allowing for flexibility in achieving emissions targets through allowing obligated entities to rely on the least-cost abatement options across the entire economy.

Response: The only electric sector measures identified by E3 with costs below \$100/tCO₂ are already mandated by other provisions of law.

- It would encourage investment in research and innovation in technologies that lower GHG emissions by providing a larger market in which new technologies could be introduced.

Response: A cap-and-trade program may result in volatile allowance prices. Innovation and investment is encouraged by having a reasonably known price point that can be the target for the innovation or investment. Volatility discourages innovation and investment by depriving the innovators and investors of any assurance that their efforts will be rewarded.

- It would efficiently distribute the cost of GHG reductions across all capped entities, so that total costs of achieving emission targets are minimized.

Response: The CARB has not yet determined the responsibilities of different entities, so it is impossible to conclude at this time that a California cap-and-trade program “efficiently distributes” the cost of GHG reductions.

- AB 32 establishes an aggressive timetable for implementing reductions in California that persuades us to proceed now to design how the electricity sector could participate in a multi-sector cap-and-trade program, which ARB may choose to pursue if it finds that the tests outlined in Part 4 and Part 5 of the AB are met.

Response: The E3 Results demonstrate that current policies that are assumed in the E3 Reference Case will achieve the goal of 1990 emissions by 2020 for the electric sector.

II. GENERAL ISSUES

QUESTION 3 (5/13/08): 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.

SCPPA RESPONSE: There is a potentially severe conflict between requiring retail providers to participate in non-market-based GHG emission reduction programs while simultaneously requiring retail providers to participate in a cap-and-trade program. To the extent to which the retail providers are also “deliverers” of electricity as defined in the Interim Opinion, retail providers such as the SCPPA members are already bearing the cost of energy efficiency, RPS, and EPS programs as well as the cost of converting to lower GHG emission resources. The

cost of participating in the programs assumed in E3's Reference Case will tend to increase the rates of SCPA members between 20 and 25 percent, as shown by the data for LADWP on Slide 41 in the E3 Results.

Various SCPA members are already committed to emission reduction goals that are far higher than those assumed by E3 in its Reference Case. Burbank and Riverside are committed to an RPS of 33 percent by 2020, and LADWP is committed to an RPS of 35 percent by 2020. As a result, the Burbank, Riverside, and LADWP ratepayers are exposed to rate increases of approximately 46 percent by 2020. E3 Results, Slide 43.

If SCPA members were required to buy auctioned allowances to cover their GHG emissions in addition to financing their non-market-based GHG emission reduction programs, the resulting blow to their ratepayers could be unbearable. The cost of allowances could dwarf SCPA members' high expenditures on the programs that will result in actual reduction of emissions. The National Commission on Energy Policy ("NCEP") estimates that the cost of buying allowances through a cap-and-trade program could be *ten times* actual emission mitigation costs. Staff Paper, Appendix A at 4, 5 ("NCEP White Paper"). Resero Consulting estimates that if allowance prices were at \$100/tonCO₂, the California electric sector would be required to pay nearly \$100 billion to buy allowances during the period 2012 to 2020.

The ratepayers of the SCPA members should not be required to bear the double burden of paying for programs that will result in actual GHG emission reductions and also bear a cost of auctioned allowances. The NCEP opined that the "most important" feature of auctioning allowances to entities that are required to participate in a cap-and-trade program was that "an auction can generate significant revenues that can then be directed to other public purposes: to reduce other taxes; cut the deficit; fund R&D programs; and/or compensate industries; workers,

and consumers who bear a disproportionate share of regulatory costs.” NCEP White Paper at 9. Any cap-and-trade program that would turn retail electricity providers into a cash cow to be bled as envisioned by the NCEP could cripple the retail providers’ efforts to finance energy efficiency, RPS, and related programs that would result in concrete emissions reductions.

QUESTION 10 (5/13/08): 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.

SCPPA RESPONSE: In the Staff Paper, the Staff interprets the Interim Opinion as directing “that allocation policy should ensure that GHG emissions reductions accomplished equitably and effectively, at the lowest cost to consumers.” Staff Paper at 1. Elsewhere, the Staff proposes four evaluation criteria: “consumer cost, equity among customers or retail providers, simplicity, and accommodation of new market entrants.” Staff Paper at 2.

SCPPA supports Staff’s criteria with cost effectiveness and equity being placed at the top of the list. AB 32 mandates a reduction in California’s GHG emissions to 1990 levels by 2020 with the reductions being “implemented in an *efficient and cost effective* manner.” Cal. H&S Code §38561(a) (emphasis added). Thus, the Legislature clearly and unequivocally expressed its intent in AB 32 that while the GHG reduction goal is to be met, the goal shall be met in such a way to minimize the cost to the consumer. As for equity, any regulatory program developed by California regulatory agencies should, as found by the Staff, provide for “equity among customers of retail providers.” Staff Paper at 2. The criterion of equity implies that there should not be wealth transfers from the consumers of some retail providers to the consumers of other retail providers.

Given the paramount criteria of cost minimization and equity, SCPPA recommended in earlier phases of this proceeding that regulated retail providers should be the point of regulation

in the electric sector with GHG emission allowances being allocated to the retail providers for the benefit of the retail providers' customers. SCPPA recommended that the allocation of allowances should be based upon recent pre-AB 32 actually experienced emissions, with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionately over time as necessary to achieve the AB 32 reduction goals as eventually established by the CARB for the electric sector and for each retail provider by 2020. SCPPA also proposed that the Commissions recommend to CARB flexible compliance mechanisms such as allowance trading as well as banking, borrowing, and offsets to contain program costs.

SCPPA's recommended program would be fair as well as effective in achieving AB 32 GHG reduction goals. Insofar as each retail provider would be required as a point of regulation to reduce emissions associated with its load-serving portfolio by the same percentage amount, each retail provider would be required to contribute to meeting the goal of reducing California's greenhouse emissions to the statewide 1990 level by 2020. On the other hand, retail providers such as the southern California publicly owned utilities that have a resource mix that is more carbon-intensive than the resource mix of other retail providers would need to do more than others to accomplish the same percentage reduction, and their customers would be required to bear proportionally higher costs.

SCPPA continues to support the recommendation that it made in the earlier phases of this proceeding. Although the Commissions elected to take a different course in the Interim Opinion by recommending on an interim basis that "deliverers" should be the electric sector point of regulation, SCPPA urges the Commissions to revisit the conclusions reached in the Interim Opinion and to reevaluate the merits of SCPPA's recommendation that retail providers be the

point of regulation. Revising the Interim Opinion conclusions is particularly appropriate given the E3 Results demonstrating the potentially adverse consequences of requiring California “deliverers” to participate in a single-cap multi-sector cap-and-trade program.

QUESTION 11 (5/13/08): Address any interactions among issues that you believe the Commissions should take into account in developing recommendations to ARB.

SCPPA RESPONSE: There is an interaction between the point-of-regulation issue and the allowance allocation issue. As SCPPA repeatedly stressed in earlier phases of this proceeding, if regulated retail providers were designated as the point of regulation for the electric sector, there could be an administrative allocation of allowances on the basis of historical emissions without a concern about the entities that are the points of regulation realizing a windfall by selling the administratively allocated allowances and keeping the profits to the detriment of consumers. The regulators that have jurisdiction over the regulated retail providers could ensure that the benefits of any administrative allocation of allowances would be passed through to the consumers.

Conversely, however, a decision to designate generators or “deliverers” of electricity as the points of regulation in the electric sector effectively precludes an allocation of allowances to the regulated entities on the basis of historical emissions. To the extent to which deliverers that are not also regulated retail providers were allocated allowances on the basis of their historical emissions, the deliverers that are allocated allowances could refrain from generating and then sell the allowances. Even if they generated, the deliverers that were not also regulated retail providers could raise their prices for electricity to cover the opportunity cost associated generating instead of selling the allowances. As a result, if deliverers were the electric sector

point of regulation, there could be large transfers of wealth from consumers to deliverers that were not regulated retail providers.

The Staff recognized this consequence of designating deliverers as the electric sector point of regulation rather than regulated retail providers: “A pure emission-based allocation would almost certainly result in considerable windfall profits for independent (non-utility) deliverers in competitive wholesale markets.” Staff Paper at 23. As a result, Staff was compelled to recommend against any emission-based administrative allocation of allowances except on the condition that only 50 percent of allowances would be allocated in 2012 on the basis of emission with a sharp decline to *no* allowances being allocated on the basis of emissions by 2017. *Ibid* at 23-24. If the Commissions had designated regulated retail providers as being the electric sector point of regulation in their Interim Opinion, the Staff would not have been driven to find against an emission-based administrative allocation of allowances as they were in the Staff Paper.

A second interaction among issues that the Commissions should take into account is between funding various programs and allowance allocation. Advisory Committees have proposed a myriad of ways to spend billions of dollars of auction revenues on GHG-related as well as non-GHG-related enterprises. *See Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California* at 56-58, Market Advisory Committee (“MAC”) (June 30, 2007) (use auction proceeds for low-GHG technologies and fuels, fund end-use efficiency, reductions in state taxes, tax rebates, worker transition assistance, etc.); *see also* Recommendation of Economic and Technology Advancement and Advisory Committee (“ETAAC”) (Feb. 14, 2008).

Allowance allocation should not be perceived as a funding tool. Instead, as made manifestly clear by the Legislature and understood by the Staff and the Staff Paper, AB 32 GHG emission reductions should be achieved while *minimizing* the impact on electricity consumers. The view of the NCEP that allowances should be allocated through an auction to “generate significant revenues that can then be directed to other public purposes” is flatly contrary to the intent of the California legislature and should be categorically rejected by the Commissions.

QUESTION 12 (5/13/08): 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?

SCPPA RESPONSE: SCPPA urges the Commissions to recommend that CARB adopt a GHG reduction program that is fully consistent with AB 32 and the underlying legislative intent. To that end, SCPPA joins the Staff in urging “that allocation policy should ensure that GHG emission reductions are accomplished equitably and effectively, at the lowest cost to consumers.” Staff Paper at 1. The Commissions and CARB should fashion a program that is true to those criteria and consistent with AB 32 instead of guessing what might be an ultimate national program and tailoring California policy to fit the conjecture.

If the Commissions want to be assured of avoiding the cost of transitioning to a federal program, the Commissions should recommend that CARB defer a California-only program until there is a federal program. Congress is currently considering S.3036, the Climate Security Act of 2008, and related legislation. Congress is expected to pass legislation next year, 2009. *See* U.S. Aims to Skirt Flaws in Europe’s Carbon Limits, Wall Street Journal, A4 (May 30, 2008).

The legislation that is being proposed at the federal level contains a mix of administrative allocation of allowances to various entities and auctioning to fund a variety of programs. Any California program, whatever it might be, is going to need to be substantially revised to fit within whatever national program emerges from the Congressional process.

QUESTION 13 (5/13/08): For each issue addressed in your comments, do you have any recommendations about the level of detail and specificity regarding the electricity and natural gas sectors that ARB should include in the scoping plan? Is there enough information in the record in this proceeding to support that level of detail and specificity? What additional information and/or analysis may be needed before ARB finalizes its scoping plan? What determinations regarding the electricity and natural gas sectors should ARB defer for further analysis after the scoping plan is issued? Please be as specific as possible about GHG-related policies for the electricity and natural gas sectors that you recommend be resolved this year, and policies that you believe should be deferred for further analysis after the scoping plan is issued.

SCPPA RESPONSE: At the May 19, 2008 California Senate Energy, Utilities and Communications Committee hearing, CARB Chairman Mary Nichols, told the Committee Chair, Senator Christine Kehoe, that a draft Scoping Plan will be issued on June 26, 2008 by CARB. Chairman Nichols said that the Scoping Plan will present programs that are calculated to achieve roughly 60 percent of the AB 32 GHG emission reduction goal. As for the remaining 40 percent, Chairman Nichols said that the draft Scoping Plan would present options, including direct regulation, a cap-and-trade program, and carbon fees. Absent the development of a substantial amount of additional information through modeling and otherwise, the Scoping Plan should not proceed much beyond the level of detail that Chairwoman Nichols outlined for the June 26, 2008 draft Scoping Plan.

If the electric sector point of regulation is to be deliverers as opposed to regulated retail providers, much more information than is currently available is needed to determine whether the

electricity sector should be in a cap-and-trade program. As shown by the E3 Results as discussed above, nearly no emission reductions would result from requiring deliverer participation in a cap-and-trade program until very high prices for allowances were reached. Consequently, requiring deliverers to participate in a single-cap multi-sector cap-and-trade program could have substantial cost consequences without commensurate offsetting benefits. Deliverers should not be required to acquire allowances unless substantial emissions reductions would be obtained at a reasonable cost.

For CARB to reach a reasoned decision about whether to require electric sector deliverers to participate in a single-cap multi-sector cap-and-trade program, CARB must determine which other sectors, if any, would be included in the single-cap multi-sector cap-and-trade program with the electric sector. Then, CARB must model the included sectors to project the likelihood of the sectors being able to accomplish emission reductions and to project both the likely cost of the reductions and likely allowance prices. The projection of likely allowance prices and the associated economic impact upon deliverers, electricity consumers, and the California economy would then provide a guide for CARB to project the cost of including the electric sector in a single-source multi-sector cap-and-trade program.

So far, CARB Staff has not produced projections of either potential allowance prices or the impact of projected allowance prices upon the California economy. Thus, as of now, CARB lacks information which could guide a reasoned decision about including the electric sector as well as other sectors in a single-cap multi-sector cap-and-trade program as opposed to achieving AB 32 goals through direct regulation and emission reduction programs.

In addition to developing projections of allowance prices under a single-cap multi-sector cap-and-trade program with deliverers as the electric sector point of regulation, CARB should

also model the potential effect of flexible compliance mechanisms including banking, borrowing, and offsets so as to determine the approximate level of allowance price mitigation that might result from such flexible compliance mechanisms. The completion of the modeling and analyses should be accomplished as a condition for reaching a finding in a finalized Scoping Plan about including sectors in a single-cap multi-sector cap-and-trade program. Absent such findings and analyses, any final Scoping Plan that is adopted later this year should contain sufficient flexibility to allow for modification as modeling and analyses are completed after the issuance of the Scoping Plan.

Chairman Nichols noted at the Energy, Utilities and Communications Committee hearing on May 19, 2008, that the actual institution of single-cap multi-sector cap-and-trade program would involve a lengthy rulemaking proceeding that would potentially last up to three years. Thus, a deferral of decisions in the absence of adequate modeling and analyses to the post-2008 rulemaking proceeding would be both possible and appropriate. Also, deferral would have the benefit of allowing time for the development of a federal program which may obviate the need to implement a California-only program.

QUESTION 1(a) (5/6/08): Discuss how your proposal would affect the environmental integrity of the cap, California's ability to link with other trading systems, and administrative complexity.

SCPPA RESPONSE: See Section IV.A below.

QUESTION 1(b) (5/6/08): Address how your various recommendations interact with one another and with the overall market and describe what kind of market you envision being created.

SCPPA RESPONSE: See Section IV.A below.

QUESTION 2 (5/6/08): With respect to flexible compliance mechanisms, what should California keep in mind in designing its system when considering the potential transition to regional and/or national cap-and-trade programs in the future? Are there mechanisms that California should avoid or embrace in order to maximize potential compatibility with other cap-and-trade systems?

SCPPA RESPONSE: As discussed above, California could pursue a cap-and-trade program with retail providers being the point of regulation as discussed above and consistently supported by SCPPA. Alternatively, California could pursue AB 32 goals programmatically while deferring any decision to implement a single-cap multi-sector cap-and-trade program for the potentially short time until the provisions of a federal program become clear. However, if California seeks to pursue a single-cap multi-sector cap-and-trade program with deliverers as the point of regulation now without awaiting further developments at the federal level, California should design its program including flexible compliance mechanisms so as to be consistent with the cost minimization criteria of AB 32 while being consistent with achieving the AB 32 goal of reducing GHG emissions to 1990 levels by 2020.

In order to be consistent with the cost minimization criteria of AB 32, the flexible compliance mechanisms of banking, borrowing, and safety valves should be considered and incorporated into a single-cap multi-sector cap-and-trade program. A broad offsets program should also be included, provided that the offsets result in additional and verifiable emissions reductions. Accomplishment of the objective of cost minimization should take precedence over maximizing compatibility of California flexible compliance mechanisms with other cap-and-trade systems unless, as in the case of offsets, maximizing compatibility with other cap-and-trade systems would expand the scope of potential offsets.

QUESTION 3 (5/6/08): What evaluation criteria should be used in assessing flexible compliance options?

SCPPA RESPONSE: In evaluating flexible compliance options such as banking and borrowing, the Commission should have cost minimization as a paramount criteria to the extent consistent with meeting the statutorily required goal of achieving 1990 emissions by 2020. In the case of offsets, any program should be as broad as possible in interest of cost minimization, provided that the allowed offsets result in additional and verifiable emission reductions as opposed to reductions that would occur anyway in the normal course of events.

III. ALLOWANCE ALLOCATION

A. Detailed Proposal.

QUESTION 1 (4/16/08): Please explain in detail your proposal for how GHG emission allowances should be allocated in the electricity sector.

SCPPA RESPONSE: Consistent with its position in earlier phases of this proceeding, SCPPA continues to support a GHG regulatory program for the electric sector in which *regulated retail providers* would be the point of regulation and GHG emission allowances would be allocated to the retail providers for the benefit of the retail providers' customers, with the allocation of allowances being based upon recent pre-AB 32 actually experienced emissions and with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionately over time as necessary to achieve the AB 32 reduction goals as eventually established by the CARB for the electric sector and for each retail provider by 2020.

Assuming, consistent with the Interim Opinion, that deliverers rather than regulated retail providers would be the point of regulation in the electric sector, the Staff examines three approaches to allocating allowances to deliverers: (1) an administrative allocation to deliverers

based on historical emissions, (2) an administrative allocation to deliverers based on output (electricity delivered), and (3) a “large percent” auction of allowances to deliverers with a subsequent distribution of auction revenues or “auction revenue rights” (“ARRs”) to retail providers on behalf of consumers. Staff Paper at 2. The Staff also presents three variations of the three basic allocation approaches: a “preferred emission-based approach” (Staff Paper at 23-24), a “preferred output-based approach” (Staff Paper at 31-33), and a “preferred auction approach” (Staff Paper at 39-40).

An Administrative Emission-Based Allocation of Allowances to Deliverers

An emission-based administrative allocation to “deliverers” rather than regulated retail providers suffers from a significant flaw: the administrative allocation to deliverers would result in “transfers of wealth from consumers to producers (or deliverers).” Staff Report at 10. “This occurs when producers are largely compensated for GHG costs through increased prices while also receiving allowances freely....” *Ibid* (citations omitted).

In order to compensate for this flaw, Staff presents a “preferred emission-based approach” to allocating allowances to deliverers. Staff’s preferred emission-based approach ameliorates the wealth transfer to unregulated deliverers by permitting no more than a 50 percent administrative allocation of allowances on the basis of emissions in 2012 with a rapid transition to a 100 percent allocation of allowances either on the basis of output or through an auction in 2017. Staff Paper at 24. As a result of Staff’s transition schedule, only 25 percent of allowances would be allocated to deliverers on the basis of historical emissions during the six years 2012 through 2017.

The rapid transition schedule that Staff recommends in its preferred emission-based approach would diminish the wealth transfer from consumers to unregulated deliverers that

would occur under a “pure” administrative allocation of allowances to deliverers, but it would not eliminate the wealth transfer. The likelihood that an administrative allocation of allowances on the basis of historical emissions to deliverers would result in a wealth transfer from consumers to unregulated deliverers disqualifies an emission-based administrative allocation of allowances to deliverers rather than retail providers as a viable allocation methodology regardless of the transition period that might be assumed.

Auctioning Allowances to Deliverers

The Staff discusses a “pure auction” of allowances to deliverers. Staff recognizes, however, that for retail providers that are also deliverers of electricity, auctioning without any return of revenues to the retail providers could result in a wealth transfer from the consumers of the retail providers that were also deliverers to whatever entities would be the recipients of the auction proceeds. The customers of fully resourced coal-dependent retail providers could be especially affected by a “substantial payout” if they had to buy auctioned allowances without any return of auction revenues: “If the retail provider were actually required to submit payment for the entire block of allowances purchased, this could constitute a substantial payout for retail providers that are fully resourced, particularly those still dependent on coal facilities.” Staff Paper at 34. This prompts the Staff to focus “on the disposition of auctioned revenues,” including proposals for a “recycling” of the revenues to retail providers. *Ibid* at 33.

The Staff analyzes various options for recycling auction revenues to retail providers. The Staff considers a sales-based allocation of auction revenue rights (“ARRs”) to retail providers, but the Staff correctly rejects that approach due to its tendency to result in wealth transfers from more carbon-intensive retail providers to less carbon-intensive retail providers: “A sales-based allocation of ARR in 2012 might lead to a large redistribution from coal-dependent retail

providers to less GHG-intensive retail providers. In fact, the effect is likely to be identical to a pure output-based allocation. Coal dependent retail providers might be saddled with rate increases due to GHG allowance costs in the first year of the cap.” *Ibid* at 38.

By contrast to a sales-based allocation of auction revenues to retail providers, assigning ARR on the basis of historical emissions of the total portfolios of retail providers would have little or no potential for creating wealth transfers among retail providers: “Assigning ARR on the basis of retail providers’ historical emissions would produce strikingly different results [than a sales-based allocation], with little potential for wealth transfer among customers of different retail providers.” *Ibid*. Accordingly, due to the “large distributional effects that might arise from allocating ARR on the sales basis,” the Staff proposes as its “preferred auction approach” that “ARR be assigned at the start of the program on an historical emission basis.” Staff Report at 39.

The allocation of ARR to retail providers would be based upon the retail providers’ entire portfolio: “When the 2012 allowances are auctioned, the revenues from the auction would be distributed to the retail providers in proportion to their emissions from their entire portfolio in a base period.” *Ibid* at 39. Thus, there would be no discrimination between retail providers that tend to be fully resourced and retail providers that tend to rely more on market purchases in order to serve their customers. Both would receive an allocation of allowances based on the emissions associated with their entire portfolio.

Staff proposes, however, a transition from allocating ARR 100 percent on the basis of emissions in 2012 to allocating ARR 50 percent on the basis of emissions and 50 percent on the basis of sales by 2020. *Ibid* at 40. A rapid transition from a 100 percent allocation of ARR on the basis of emissions to a 50/50 allocation on the basis of emissions is unnecessary,

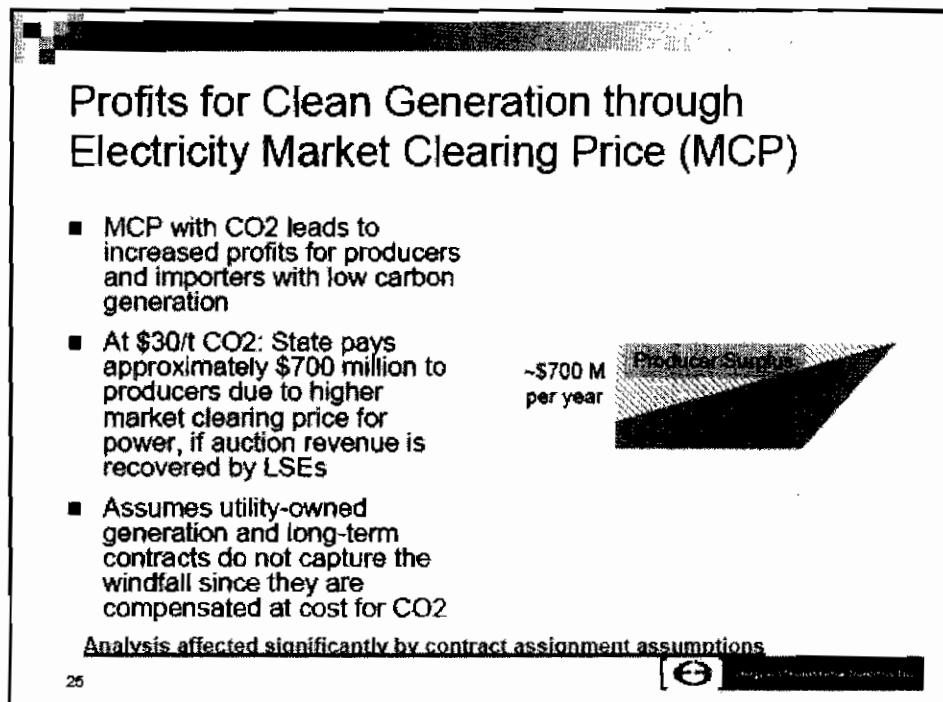
unjustifiable, and conflicts with the Staff's stated goals of achieving equity and minimizing wealth transfers. Although wealth transfers among the consumers of differently situated consumers would be mitigated at the beginning of the transition period in 2012 when 100 percent of ARRs would be allocated on an emissions basis, wealth transfers would start to occur immediately after the first year, 2012, and would become worse during succeeding years. Staff's proposed transition schedule ignores the fact that some retail providers have access to low-cost zero-GHG resources like hydroelectric generation that others do not have. It severely compromises the ability of Staff's "preferred auction approach" to prevent wealth transfers among the consumers of retail providers.

If Staff were proposing a transition from allocating ARRs 100 percent on emissions to allocating ARRs 50 percent on emissions and 50 percent on *net* load (gross retail provider load less load served by legacy hydroelectric and nuclear resources) the wealth transfer effect of Staff's proposed transition schedule would be somewhat mitigated. It could be further mitigated if ARRs were allocated on a fuel-differentiated basis so that there would be a proportionately higher allocation of ARRs to coal-served load than to gas-served load.

There is a more fundamental problem with Staff's preferred auction approach beyond Staff's proposed transition schedule. Staff's proposal to use ARRs for distributing auction revenues to retail providers for the benefit of their consumers assumes that a secure mechanism can be established to assure that the auction revenues would not be siphoned off for other purposes before being distributed. SCPPA is deeply skeptical that a secure mechanism can be established, particularly in a state that has seen funds that are "guaranteed" for various purposes such as highway construction or education regularly being diverted to other purposes when the State confronts its frequent budget crises. Although Staff's proposal for delivering auctioned

revenues to retail providers may have a theoretical attraction, it is afflicted with the practical problem that may be extremely difficult to design a secure and dependable mechanism for returning auctioned revenues to retail providers. See SCPPA Response to Question 8 (4/16/08) below for an evaluation of one proposed solution.

A further concern about the Staff's preferred auction approach is that, according to the E3 Results, it would permit producers of "clean" electricity to reap additional economic rents of approximately \$700 million due to the higher market clearing price that would result from auctioning allowances to deliverers:



E3 Results, Slide 25. E3's estimate of a \$700 windfall to producers of "clean" energy is conservatively based on an allowance value of \$30/ton CO₂. Furthermore it assumes that utility-owned "clean generation" is committed under long-term contracts that do not capture any windfall. *Ibid.* Insofar as the owners of the "clean generation" would not be required to buy allowances through an auction, there would be no revenues from the "clean generation" to

recycle to retail providers through an ARR mechanism. Thus, the projected windfall to “clean generation” would be an uncompensated burden on the consumers of retail providers under the Staff’s preferred auction approach.

An Administrative Output-Based Allocation of Allowances to Deliverers

The Staff finds that an administrative allocation of allowances to deliverers that is based on output would have a major advantage over an administrative allocation of allowances to deliverers that is based on emissions. Unlike an administrative allocation to deliverers based on emissions, “an output-based allocation does not result in a large transfer of wealth from customers to deliverers.” *Ibid* at 26. The Staff reasons: “Under an output-based allocation, deliverers will find that they have an incentive to increase their delivery levels. Higher delivery levels ensure that deliverers will continue to receive valuable allowances in future years. In order to maintain sales, deliverers are likely to find they cannot pass on the entire value of their allowances.” *Ibid* at 26. The Staff cites a study finding that “an output-based allocation resulted in the lowest electricity prices when compared with historical emission-based allocation or auctioning (again, assuming no revenue recycling).” *Ibid* at 27. This leads the Staff to conclude that an “output-based allocation [to deliverers] results in low energy price increases relative to other emission-based or auction allocations.” *Ibid* (footnote omitted).

Although an output-based allocation “results in lower customer costs than emission-based allocation,” there is a flaw that leads Staff to reject a “pure” output-based allocation: “A pure output-based allocation will likely result in a large redistribution of money from customers of retail providers that depend on high-GHG sources of power to less GHG-intensive retail providers.” *Ibid* at 27. Staff explains how this wealth transfer would occur: “An ‘all-generation’ output-based allocation would provide a large amount of valuable allowances to deliverers of

power from existing nuclear, hydropower and other zero-GHG plants. Providing allowances to these entities would provide no clear program benefits that would generate large amounts of revenue for these entities when they sell allowances.” *Ibid* at 31. This leads Staff to recommend that the “pure” output-based approach modified so that the administrative allocation of allowances to deliverers would be “limited to fossil fuel generated electricity...” *Ibid*.

However, even if an output-based allocation of allowances to deliverers were limited to electricity generated with fossil fuel, gas deliverers would still be preferred over coal deliverers. This would lead to a wealth transfer from consumers that were more dependent on coal-fired generation to consumers that were more dependent on gas-fired generation. Staff explains:

The additional revenues that gas deliverers would receive from coal deliverers in the uniform allocation would allow gas deliverers to sell their output at a reduced cost. This would reduce consumer costs for customers of retail providers that are largely dependent on gas generation, but would raise consumer cost for customers dependent on coal-fired generation.”

Ibid at 31. To address this additional wealth transfer issue, Staff proposes that, in addition to limiting an administrative output-based allocation so that allowances are only provided to fossil-fuel generated electricity, there should be a fuel-specific allocation so that more allowances are given to coal-fired generation than to gas-fired generation. *Ibid* at 31. Staff finds that the “rating factor for coal-fired electricity is 2, based on the fact that coal plants emit approximately 1 metric ton of GHGs for every MWh produced and gas emit approximately 0.5 metric ton per MWh.” *Ibid* at 30. Accordingly, Staff proposes that allowances be allocated to coal-generated electricity and gas-fired electricity on a 2-1 basis. *Ibid* at 31.

As a third modification to the “pure” output-based approach, Staff proposes that there should be a transition from an output-based administrative to an auction. Staff proposes that 90 percent of allowances should be administratively allocated to deliverers on the basis of output in

2012 with 10 percent being allocated through an auction. Staff proposes that the administrative allocation of allowances should decline each year so that 100 percent of the allowances would be auctioned by 2018. Staff Report at 32.

An output-based administrative allocation of allowances to deliverers may have, as claimed by the Staff, a potentially significant advantage over an emission-based allocation to deliverers. The output-based allocation may substantially reduce the wealth transfers from consumers to deliverers that would occur under an emission-based allocation. However, this conclusion by the Staff appears to be based on theory and conjecture rather than analytical modeling results. Further modeling is needed to verify and refine the Staff's projection that under an output-based administrative allocation of allowances there would be little or no impact on the market clearing price ("MCP") of electricity. The Commission should not pursue the output-based allocation of allowances to deliverers without undertaking the requisite modeling to determine whether the claimed MCP mitigation would actually occur.

An administrative allocation of allowances on the basis of output to deliverers certainly has an advantage over Staff's "preferred auction approach" (auctioning with an assignment of ARRs to retail providers). It avoids the creation of a pool of auctioned revenues from which there could be substantial diversions of funds for purposes other than recycling of the revenues to retail providers.

A flaw in Staff's preferred output-based approach is Staff's suggested schedule for a transition from an output-based allocation to auctioning. The transition schedule should be substantially lengthened. Given that a primary virtue of an administrative allocation of allowances on the basis of output mitigates the impact of auctioning on market clearing prices, there is no merit to a sharp shift in five years from 90 percent of allowances being allocated on

output in 2012 to 100 percent being allocated on the basis of auction in 2018 as suggested by the Staff. Staff provides no explanation for why there should be a transition from a methodology that mitigates the impact on market clearing prices to one (auctioning) that has a profound impact on market clearing prices. If there is to be such a transition, the slope of the transition should be lengthened substantially.

Additionally, there should be clarification of how auction proceeds would be distributed if Staff's proposed transition schedule or something like it were to be adopted. Staff does not explain whether it is proposing that the auction proceeds be returned to retail providers under Staff's "preferred auction approach" or whether the proceeds would go elsewhere as could occur under "pure" auction approach.

SCPPA, as noted above, continues to support its original proposal for an administrative emission-based allocation of allowances to regulated retail providers as the electric sector point of regulation. However, if deliverers were to be the electric sector point of regulation, Staff's "preferred output-based approach" with no allocation to non-fossil output and with fuel differentiation in the allocation of allowances between coal and gas would merit further examination, provided that modeling demonstrates that the claimed MCP effect is real, and provided that Staff's proposed transition schedule were corrected. Likewise, if deliverers were to be the electric sector point of regulation, Staff's "preferred auction approach" would merit further examination if a secure means for recycling auction revenues to retail providers could be developed, the Staff's proposed transition schedule were corrected, and there were a mechanism for mitigating E3's projected windfall to "clean generation."

QUESTION 10 (4/16/08): 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.

SCPPA RESPONSE: See Response to Question 1 (4/16/08) above.

B. Response to Staff Paper on Allowance Allocation Options and Other Allocation Recommendations.

QUESTION 8 (4/16/08): 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.

SCPPA RESPONSE: The Staff description of “an option that would allocate emission allowances directly to retail providers to which Question 8 from the April 16, 2008 Ruling is apparently the following:

There is a variety of ways in which the auction revenues from the electricity sector could be preserved for the benefit of consumer purposes in the sector, either to aid in GHG reductions/mitigation or for consumer bill relief. One option would be to allocate allowances directly to retail providers of electricity, on behalf of their consumers, on some basis, but require those retail providers to offer up their allowances during the auction. In this way, retail providers would receive the proceeds from auctioning of their allowances directly, with the funds raised to be used to benefit their consumers. As with the free allocation methods described earlier in this paper, allowances could be granted to retail providers on a variety of bases, including historical emissions (based on their resource portfolio mix) or sales of electricity to consumers.

The advantage of this type of approach would be in the efficient distribution of auction revenues directly to retail providers on behalf of their consumers. This is the approach that most RGGI States are taking to distribution of allowance value. Note that staff is not proposing that retail providers conduct the auction; as stated above, we assume that the auction itself would be run by ARB or its agent. Retail providers would simply be required to offer up their allowances at auction in order to receive the revenues once the auctions conducted. Retail providers who are also deliverers

would also need to purchase allowances in the same auction to cover the emissions associated with their electricity deliveries.

Staff Paper at 33-34 (footnotes omitted). The Staff's envisioned procedure for allocating allowances to retail providers with the allowances then being surrendered for auctioning and a subsequent proportional allocation of auction proceeds to retail providers could help to address the primary shortcoming of Staff's "preferred auction approach" of assigning ARR's on the basis of emissions to retail providers: the lack of security that the revenues accumulated in an auction would be actually returned to retail providers instead of being siphoned off to other purposes. If there were an allocation of allowances to retail providers to create a *property right* in the allowances, subject to surrender of the allowances for monetization through an auction and a proportional return of proceeds, the return of auction proceeds would appear to be more secure than under the ARR approach.

However, there still are problems with an allocation of allowances to retail providers with subsequent monetization and return of proceeds. First, even if the grant of allowances to the retail providers were to create a property right in the allowances and a consequent right to a proportional return of proceeds after monetization, retail providers would have less security that they would realize the benefit of the allocated allowances than they would have if they were the electric sector point of regulation so that the monetization step could be avoided. Second, the process of monetization would add complexity to the program. Third, insofar as the monetization approach assumes that there will be an auction to deliverers, there will be windfall profits to "clean generation" as shown by Slide 25 in the E3 Results and as shown above.

More generally, there is a question about the lawfulness of an auction under AB 32. *See* SCPPA Opening Comment on Allowance Allocation Issues at 22 (October 31, 2007; LADWP Opening Comment on Allocation Issues at 21 (October 31, 2007; Energy Producers and Users

Coalition (“EPUC”) and Cogeneration Association of California (“CAC”) Opening Comment on Allocation Issues at 4-5 (October 31, 2007). Likewise, there are market power and manipulation concerns about the conduct of auctioning, and there are concerns about windfalls to “clean generation” as discussed in response to Question 1 above. *See* SCPPA Supplement to Opening Comment and Reply Comment on Allowance Allocation Issues at 11-12 (November 14, 2007).

QUESTION 9 (4/16/08): 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.

SCPPA RESPONSE: Economic efficiency was not listed as one of Staff’s primary desiderata in the Staff Paper, and properly so. Equity and cost minimization should take precedence over economic efficiency in evaluating allocation methodologies. As Burtraw, *et al.*, observe:

One should note that economic efficiency is only one measure of public policy. Equity and other concerns may override efficiency. An increase in electricity price may be viewed as enhancing efficiency, for example, because it provides a signal to encourage the purchase of energy-efficient appliances, but it also could cause hardship.

Staff Paper, Appendix B, Allocation of CO₂ Emissions Allowances and the Regional Greenhouse Gas Cap-and-Trade Program at 13, Resources for the Future Discussion Paper (June, 2005).

Burtraw, *et al.*, observe that “a historic or auction approach” to allocating allowances to sources of GHG emissions “is most efficient,” while the output approach (which Burtraw, *et al.*, call “updating”) “has about three times the social cost of the historic or the auction approach but has the political advantage of a lower electricity price....” Burtraw, *et al.*, at 30, Staff Paper, Appendix B. However, an allocation methodology should not be rejected on the basis that it

reduces economic efficiency by reducing the impact of a GHG emission reduction program on consumers. If economic efficiency were the paramount concern, arguably both Staff's preferred output-based approach and Staff's preferred auction approach with ARR's would be rejected because they minimize costs for electricity consumers in contrast, for example, to pure auctioning.

QUESTION 10 (4/16/08): 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.

SCPPA RESPONSE: If the Commission were to elect to adopt a methodology that involved returning auction revenues to retail providers, there are four issues that would need to be addressed: (1) the basis for allocating the return of revenues, (2) the transition schedule, if any, for moving from one basis to another, (3) the percentage of allowances to be auctioned with a return of revenues, and (4) the mechanism that would be used to ensure there would be a return of revenues to retail providers without revenues being diverted to other purposes.

Basis for allocating ARR's: The Staff correctly recognizes that "there could be large distributional effects that might arise from allocating ARR's on a sales basis." Staff Report at 39. Specifically, "this approach would constitute an unacceptable transfer from the customers of historically coal-dependent retail providers to other California customers." *Ibid.* The result would be a massive wealth transfer from the retail providers that currently have a more carbon-intensive resource mix to those that do not. SCPPA applauds the Staff's recognition of the effect that an allocation of ARR's on a sales basis could have on coal-dependent retail providers.

In recognition of the "large distributional effects that might arise from allocating ARR's on a sales basis," Staff proposes that ARR's be assigned at the start of the program on an

historical emission basis.” Staff Paper at 39. SCPPA agrees that if auctioning with a return of revenues to retail providers is to be considered, the return of revenue should be based on the emissions associated with each retail provider’s total portfolio.

Transition from emission-based ARR to sales-based ARR: Although Staff proposes that ARRs should be assigned among retail providers on an historical emission basis “at the start of the program,” Staff proposes a schedule for a transition from allocating ARRs on an emission basis to allocating ARRs on a sales basis. Staff Report at 40. ARRs would be allocated under the Staff proposal 100 percent on an emission basis in 2012, but the allocation on an emission basis would be ratcheted down so that 50 percent of the ARRs would be allocated on an emission basis and 50 percent would be allocated on a sales basis by 2019. *Ibid.*

The effect of a transition to a 50/50 allocation in only eight years would be that while wealth transfers from the retail providers that have a more carbon intensive resource mix to those that do not would be avoided in 2012, there would be substantial wealth transfers of increasing magnitude in subsequent years. The transition schedule proposed by Staff fails to recognize that various retail providers including the SCPPA members have existing contracts with out-of-state coal plants that will not expire until later years (for example, 2019 for the LADWP contract with Navajo and 2027 for various SCPPA members’ contracts with Intermountain Power Project.)

In order to mitigate the wealth transfer effect consistent with the reasoning of the Staff in the Staff Paper, there should be, at most, a minimal transition from an emission-based allocation of ARRs among retail providers to a sales-based allocation of ARRs during the AB 32 period 2012-2020 as discussed in response to Question 1 above. The wealth transfer effect could also be mitigated by allocating the sales-based ARRs only to sales served by fossil resources and on a

dual-fuel basis with a proportionately higher weighting of ARRs to coal-served load than to gas-served load.

The percentage of allowances to be auctioned with revenues being returned through ARRs: Under Staff's "preferred auction approach," 75 percent of allowances are to be auctioned with ARRs being allocated to retail providers. Staff provides no explanation for the selection of 75 percent as a percentage of allowances that would be subject to auctioning. If an ARR program were to be adopted (or an emission-based allocation of allowances to retail providers with a subsequent monetization and return of revenues to retail providers) to protect retail provider customers from the cost effect of the auction, it is unclear why something less than 100 percent of allowances would be auctioned with the revenues being returned to retail providers. E3 assumed 100 percent would be auctioned under the Staff's preferred approach. E3 Results, Slide 85.

Mechanism to assure that auctioned revenues go to retail providers: As discussed above in response to Questions 1 and 8 from the April 16, 2008 Ruling, a key problem with the Staff's "preferred auction approach" is assuring that auctioned revenues actually get to retail providers to be used for the benefit of consumers as opposed to being diverted to other purposes.

Allocating allowances to retail providers on the basis of emissions associated with the retail providers' total portfolios with the allowances then being aggregated and auctioned to deliverers with a proportional return of auctioned revenues to retail providers would be an improvement over auctioning with ARRs, particularly if the allocation of allowances to the retail providers would create a property right to the allowances.

The establishment of a property right to the allowances would better assure that the revenues that would result from the monetization of the allowances would be returned to retail

providers in proportion to the initial emission-based allocation of allowances among the retail providers. Legislation may be needed to create the property right. Absent some mechanism to assure the return of auctioned revenues to retail providers, SCPPA questions the merit of further considering the Staff's "preferred auction approach."

QUESTION 11 (4/16/08): 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?

SCPPA RESPONSE: This question appears to assume that some portion of allowances would be auctioned in order to raise money for a variety of public purposes including funding energy efficiency and renewable power projects. In NCEP's view, "an auction can generate significant revenues that can then be directed to other public purposes...." Staff Paper, Appendix A, NCEP White Paper at 9. If there were to be an auction for the sole purpose of raising revenues to be used for a variety of social purposes, the auction should be limited to five percent of allowances or less. As noted above, if allowances sold for \$100/tonCO₂, over \$10 billion would be raised from the electric sector alone if all allowances were auctioned. Auctioning just five percent of available allowances would, at the same allowance value, result in \$500 million per year.

QUESTION 12 (4/16/08): 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.

SCPPA RESPONSE: If auction revenues are returned to retail providers, the use of the revenue should be determined on a retail-provider-specific basis by the regulatory authority that has jurisdiction over the retail provider. The regulators of both investor-owned as well as publicly-owned utilities would undoubtedly require that the revenues be dedicated to the benefit of electricity consumers, but the allocation of the returned revenues among investment in new renewable projects, investment in energy efficiency, and mitigation of rate impacts should be individually determined for each utility by its regulator.

QUESTION 13 (4/16/08): If you prefer a combination of methods for returning auction revenues, describe your preferred combination in detail.

SCPPA RESPONSE: If the “methods for returning auction revenues” are (1) auctioning with ARRs to auction proceeds or (2) an administrative allocation of allowances to retail providers with subsequent monetization of the allowances through an auction and a return of revenues in proportion to the allocation of allowances, SCPPA recommends (2), consistent with SCPPA’s response to the April 16, 2008 Ruling Question 8 above. There should not be a combination of the two methods.

If, alternatively, by “combination of methods for returning auction revenues” the question asks whether there should be a transition from basing a return of auction revenues to retail providers on the basis of the retail providers’ portfolio emissions as opposed to sales, SCPPA supports an allocation on the basis of portfolio emissions with, at most, a very gradual transition to some portion of revenues being allocated on the basis of sales, as explained in SCPPA’s response to Question 10 above.

C. Legal Issues.

QUESTION 2 (4/16/08): Does any of the allowance allocation options discussed in the staff paper, or in the articles attached to the staff paper, or in your opening comments, raise concerns under the Dormant Commerce Clause? If so, please explain why that allocation option(s) may violate the Commerce Clause, including citations to specific relevant legal authorities. Also, explain if and, if so, how the allocation option(s) could be modified to avoid the Commerce Clause problem.

SCPPA RESPONSE: The allocation options discussed in the Staff Paper raise dormant Commerce Clause issues to the extent to which they reach out-of-state “deliverers” in addition to in-state sources of GHG emissions. A state enactment “will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the local benefits.” Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). The burden on out-of-state “deliverers” of electricity to California would be exposed to being found to be excessive in relation to the local benefits of California’s AB 32 GHG emission reduction program insofar as a California-only program will have no measurable impact on the worldwide phenomenon of climate change.

QUESTION 3 (4/16/08): Does any of the allowance allocation options discussed in the staff paper, or in the articles attached to the staff paper, or in your opening comments, raise legal concerns about whether they involve the levying of a tax and, therefore, would require approval by a two-thirds vote of the Legislature? If so, please explain why that allocation option(s) is taxation, including citations to specific relevant legal authorities. Also, explain if and, if so, how, the allocation option(s) could be modified to avoid such legal concerns.

SCPPA RESPONSE: An administrative allocation of allowances would not constitute a tax that would require two-thirds vote of the Legislation. However, an auction of allowances is functionally the equivalent of a tax on carbon emissions. As explained in comments submitted in the first phase of this proceeding, auctioning allowances is suspect, absent two-thirds vote of the

Legislature in accordance with Proposition 13. The obvious remedy is to obtain the Legislature's consent to auctioning with a two-thirds vote.

QUESTION 4 (4/16/08): Does any of the allowance allocation options discussed in the staff paper, or in the articles attached to the staff paper, or in your opening comments, raise any other legal concerns? If so, please explain in full with citations to specific relevant legal authorities. Also, explain if and, if so, how, the allocation option(s) could be modified to avoid such legal concerns.

SCPPA RESPONSE: Requiring out-of-state "deliverers" of electricity to California to acquire allowances as a condition for selling electricity into California is preempted by the Federal Power Act. See SCPPA Reply to Comments on Market Advisory Committee Report, 20-30 (August 15, 2007). Additionally, the delivery of power at the California-Oregon border or deliveries at other similar border locations raise an issue because they are not deliveries "in" California. Further, sales of power by federal power marketing agencies including the Western Area Power Administration ("WAPA") and the Bonneville Power Administration ("BPA") are beyond the reach of California law. Both WAPA and BPA deliver thermally-generated power to California, and neither has indicated a willingness to even identify the mix of the power that they are delivering.

QUESTION 5 (4/16/08): For reply comments: Do any of the allowance allocation options discussed in other parties' opening comments raise concerns under the Dormant Commerce Clause? If so, please explain why that option(s) may violate the Commerce Clause, including citations to specific relevant legal authorities. Also, explain if and, if so, how the allocation option(s) could be modified to avoid the Commerce Clause problem.

SCPPA RESPONSE: Reserved for Reply Comment.

QUESTION 6 (4/16/08): For reply comments: Do any of the options discussed in other parties' opening comments raise legal concerns about whether they

involve the levying of a tax and, therefore, would require approval by a two-thirds vote of the Legislature? If so, please explain why that allocation option(s) is taxation, including citations to specific relevant legal authorities. Also, explain if and, if so, how, the allocation option(s) could be modified to avoid such legal concerns.

SCPPA RESPONSE: Reserved for Reply Comment.

QUESTION 7 (4/16/08): For reply comments: Do any of the allowance allocation options discussed in other parties' opening comments raise any other legal concerns? If so, please explain in full with citations to specific relevant legal authorities. Also, explain if and, if so, how the allocation option could be modified to avoid such legal concerns.

SCPPA RESPONSE: Reserved for Reply Comment.

IV. FLEXIBLE COMPLIANCE.

A. Detailed Proposal.

QUESTION 1 (5/6/08): 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.

SCPPA RESPONSE: SCPPA supports incorporating flexible compliance mechanisms into the California GHG emission reduction program. Banking, borrowing, and offsets are essential for meeting the AB 32 goal of minimizing the cost of the program. Furthermore, flexible compliance mechanisms can assist in meeting programmatic objectives beyond cost containment. For example, banking and borrowing can provide incentives for regulated entities to plan and invest in emission reduction measures for the longer term, and a liberal offsets program can provide incentives to innovation in achieving emission reductions. Safety valves would provide important protection against disequilibrium or illiquidity in allowance markets.

An independent market regulatory agency could also provide protection against market distortions. The Commissions and CARB should consider a full suite of measures including banking, borrowing, offsets, safety valves, and an independent board to accomplish cost containment as well as other important objectives.

Banking: Banking provides an important cost containment tool. Banking permits a regulated entity to accumulate allowances as a hedge against volatile allowance prices or unforeseen spikes in the entity's emissions. Additionally, banking may encourage long-term investment in emission reduction measures. For example, a regulated entity may be encouraged to size the installation of a technology to provide more emission reduction capability than the entity needs immediately if the entity is permitted to bank allowances for a future period.

Borrowing: Borrowing provides another important cost containment tool. Borrowing would permit a regulated entity to borrow allowances from the future if current allowance prices spike unexpectedly or if allowances are needed to cover an unanticipated spike in the entity's current emissions. Also, the ability to borrowing would permit a regulated entity to smooth the pattern of using allowances to cover emissions. The ability to smooth the pattern of using allowances could provide an incentive to invest in long-term emission reduction measures that could have long lead times. Regulated entities would be encouraged to undertake long-term capital investments that might not contribute to a reduction of emissions immediately but could result in a substantial step decrease in emissions in a later period. Borrowed allowances would be used to cover emissions in the current compliance period with repayment occurring during a subsequent compliance period. Any concerns about a default in repaying borrowed allowances could be easily addressed by imposing standard creditworthiness requirements on borrowers.

Offsets: A liberal offsets would put critical downward pressure on allowance prices while simultaneously providing an incentive for market participants to innovate so as to reduce emissions beyond what might be achieved using conventional measures. Although offsets should be additional and verifiable, unduly burdensome restrictions on offsets would reduce their effectiveness in containing costs and stimulating innovation to the detriment of both society and the environment.

Safety valves: There are a variety of mechanisms that could be used to combat unexpectedly high allowance prices that might result from illiquidity in the allowance market. A “price trigger” safety valve would release allowances into the market when allowance prices escalated to a preset level. A “circuit breaker” safety valve would not release additional allowances but would hold the cap on emissions constant under specified market conditions.

A “circuit breaker” would probably be less effective than a “price trigger” safety valve. A circuit breaker would prevent further reductions in the cap on multi-sector emissions but would neither roll back the cap nor release allowances into the market. Thus, if illiquidity were to occur when the cap on emissions reached a certain level, the illiquidity might persist without any affirmative ameliorative action being taken. Conversely, under the price trigger approach, affirmative action (release of additional allowances into the market) would occur to add liquidity to the allowance market. Thus, a “price trigger” type of safety valve would tend to be more effective than a “circuit breaker.”

Independent agency: As either an alternative to or supplement to having a safety valve to address market distortions, an independent agency could be established to intervene in the allowance market similar to how the Federal Reserve Board intervenes in credit markets. The independent agency could release allowances or take some other action to remedy market

disequilibrium. S. 2191, now S. 3036, the Climate Security Act of 2008 which is now being debated by Congress, provides for a Carbon Market Efficiency Board (“Board”). As envisioned in S. 3036, the Board would be empowered to carry out a variety of “cost relief measures to ensure functioning, stable, and efficient markets for emission allowances” including (1) increasing the quantity of emission allowances that covered entities may borrow from the future, (2) expanding the period of time allowed for repaying borrowed allowances, (3) increasing the quantity of allowances that covered entities may obtain from a foreign greenhouse gas emissions market, or (4) increasing the quantity of offsets that a covered entity would be allowed to use to meet its compliance obligation. S. 3036, §531.

An advantage of creating an independent agency to intervene in the allowance market to address market distortions is that the agency would be able to exercise informed discretion in tailoring market interventions to fit the situation at hand. A safety valve would operate more mechanically, although a safety valve would provide assurance to market participants that action would be taken upon the occurrence of prescribed events such as allowance prices hitting certain levels.

The Commissions and CARB should consider establishing *both* a safety valve and an independent agency. They are not mutually exclusive and can operate in tandem. For example, S. 3036 provides for both the creation of the Board and for “Cost-Containment Auctions” in which allowances would be auctioned from time to time at a statutorily prescribed range of prices. S. 3036, §§ 532, 533. The “Cost-Containment Auctions” would function similarly to a “price trigger” safety valve by assuring that additional allowances would flow into the market at certain price levels.

B. Scope of Market and Related Issues.

QUESTION 1(a) (5/6/08): Discuss how your proposal would affect the environmental integrity of the cap, California's ability to link with other trading systems, and administrative complexity.

SCPPA RESPONSE: Neither banking nor borrowing would affect the environmental integrity of the cap in the long run. Banking and borrowing only affect the timing of allowed emissions. They do not affect the total quantity of emissions over time, which is the driver of climate change.

To the extent to which an entity holds allowances as a result of acquiring offsets, the allowances associated with the offsets should count toward meeting the statewide cap for a compliance period. If the offsets are additional and verifiable, the environmental integrity of a cap would be maintained.

In contrast to banking, borrowing, and offsets, safety valves or independent agencies that intervene in the allowance market have the potential to affect whether a given cap on statewide emissions from multiple sectors would be met. However, the Legislature has determined that there should be at least one safety valve: "In the event of extraordinary circumstances, catastrophic events, or threat of significant economic harm, the Governor may adjust the applicable deadlines for individual regulations or for the state in the aggregate, to the earliest feasible date after that deadline." Cal H&S Code §38599(a). Other "safety valve" mechanisms or independent market intervention agencies as discussed in response to Question 1 above should be evaluated, as well, consistent with the apparent intent of the Legislature that the costs of AB 32 should be contained.

QUESTION 1(b) (5/6/08): Address how your various recommendations interact with one another and with the overall market and describe what kind of market you envision being created.

SCPPA RESPONSE: Banking, borrowing, and offsets are compatible. Likewise, as discussed in response to Question 1 above, safety valves are compatible with having an independent market intervention agency.

QUESTION 1(c) (5/6/08): 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.

SCPPA RESPONSE: It is especially important for the electricity market to have available cost containment mechanisms such as banking and borrowing. Weather is variable, and hydroelectric conditions are variable. Thus, the need for allowances in the electric sector is variable. The fact that weather is a substantial driver of electric sector emissions is a compelling reason to make banking and borrowing available to the electric sector.

Additionally, electricity consumers tend to view electricity as a necessity, not an optional luxury, and they are likely to be sensitive to changes in electricity prices. If a cap-and-trade program is established for California, there are likely to be attempts at market manipulation. A California market would be susceptible to manipulation insofar as it would be much smaller than a west-wide or national market, but a California-only market would nevertheless be potentially lucrative. Banking would permit electric sector regulated entities to bank allowances as insurance against market illiquidity, including illiquidity that might be caused by market manipulation and abuse. Borrowing would also allow electric sector regulated entities to counteract market illiquidity during any compliance period that may result in price spikes.

Further, banking and, particularly, borrowing may permit regulated entities in the electric sector to alter their “glide path” to reducing emissions by permitting more emissions in some years in return for sharply reduced emissions in later years. This ability to tailor individual “glide paths” to GHG emission reductions is especially important in a capital-intensive industry such as the electric industry. It may take substantial lead times to finance and install electric infrastructure that will result in substantial reductions in emissions in later years. Being able to borrow in early years in anticipation of repayment of borrowed allowances in later years would allow a regulated entity to adopt a glide path that would feature plateaus and cliffs in emission reductions.

QUESTION 1(d) (5/6/08): If your recommendations are based on assumptions about the type and scope of a cap-and-trade market that ARB 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.

SCPPA RESPONSE: CARB is currently modeling scenarios to develop a factual basis for determining, *inter alia*, which sectors that might be included in a single-cap multi-sector cap-and-trade market. Insofar as modeling has not been completed, it would be premature and speculative to attempt to identify the sectors that would be included in the market. Regardless of the ultimate size of the market, however, flexible compliance mechanisms should be considered to contain costs of the AB 32 program, including the cost that may result from market failures such as those that may occur as a result of attempts at market manipulation or abuse. Also, as discussed in response to Question 1 above, permitting banking and borrowing would facilitate and encourage long-term investment in emissions reduction measures, and allowing offsets could encourage innovation.

QUESTION 4 (5/6/08) To what extent should the recommendations to the ARB 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?

SCPPA RESPONSE: SCPPA urges the Commissions to recommend that CARB adopt flexible compliance mechanisms including banking, borrowing, and offsets and that the CARB consider both safety valves and independent market intervention boards in the event that the CARB elects to pursue a cap-and-trade program. Extremely detailed recommendations may not be inappropriate at this time, however, given that the CARB has not decided to pursue the cap-and-trade option. Details would be an appropriate subject for the multi-year rulemaking process that CARB apparently intends to undertake in the event that CARB decides to pursue the cap-and-trade option.

QUESTION 5 (5/6/08): 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?

SCPPA RESPONSE: Although limitations on participation in the allowance market by entities that do not have compliance obligations should be evaluated, the specific nature and scope of the limitations should be determined after more is known about the nature and scope of the cap-and-trade market that CARB may establish, if any. A benefit of permitting entities that do not have compliance obligations to participate in the market is that they may add liquidity to

the market. Conversely, however, participation by entities that do not have compliance obligations may raise a risk of market manipulation and abuse that would not otherwise arise.

C. Price Triggers and Other Safety Valves.

QUESTION 6 (5/6/08): 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.

SCPPA RESPONSE: As discussed in response to Question 1 about, California should consider incorporating both safety valves and an independent market intervention board into a California cap-and-trade program if CARB elects to pursue the cap-and-trade option. Section 38599(a) of AB 32 already provides for at least one safety valve: “In the event of extraordinary circumstances, catastrophic events, or threat of significant economic harm, the Governor may adjust the applicable deadlines for individual regulations, or for the state in the aggregate, to the earliest feasible date after that deadline.” Cal H&S Code § 38599(a). It would be appropriate for other safety valves such as price triggers or circuit breakers and for market intervention boards to be considered after the nature and scope of the market, if any, for GHG allowances is determined by the CARB. A safety valve including the one mandated by Cal. H&S Code §38599(a) or action by an independent market intervention board may affect attainment of the AB 32 cap on emissions by 2020 and may affect linkage with other systems.

QUESTION 7 (5/6/08): Should California create an independent oversight board for the GHG market?² 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?

SCPPA RESPONSE: As discussed above, if CARB determines to pursue the cap-and-trade option, the creation of an independent market intervention agency should be among the options that are evaluated to protect against market illiquidity, volatility, manipulation, and abuse. The creation of an independent market intervention board would not negate the need to permit banking, borrowing, and offsets liberally, and it would not be inconsistent with having a safety valve. If CARB determines to pursue the cap-and-trade option, CARB should consider establishing both an independent market intervention agency and a safety valve mechanism. S. 3036 would establish both. See S. 3036, §§ 531, 532.

D. Linkage.

QUESTION 8 (5/6/08): Should California accept all tradable units,³ 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.

SCPPA RESPONSE: The acceptance of GHG allowances from other carbon trading programs would have to be determined after full evaluation of the circumstances surrounding the

² In its Final Report adopted February 11, 2008, the Economic and Technology Advancement Advisory Committee recommends that ARB create a California Carbon Trust that could, among other functions, manage the carbon market in California similar to the way that the Federal Reserve Bank manages interest rates by adjusting the supply of emission allowances and credits through sales and purchases. That report is available at <http://www.arb.ca.gov/cc/etaac/etaac.htm>.

³ Tradable units refer to (1) GHG emission allowances that permit emission of a ton of carbon equivalent (CO₂E) and (2) offsets that reflect a reduction in GHG emissions of a ton of CO₂E, as addressed in Section 2.8 of this ruling. A credit is a broad term used in this ruling to refer to any tradable unit other than a GHG emission allowance issued by California.

allowances. For example, consideration should be given to features in the other trading programs such as price triggers that would adjust to the quantity of allowances from time to time and, hence, adjust the value of allowances.

QUESTION 9 (5/6/08): 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?

SCPPA RESPONSE: Linkage with other GHG emission reduction programs should be considered on a case-by-case basis. That is apparently happening. At CARB's May 28, 2008 informational hearing on cap-and-trade mechanisms, CARB Chairman Mary Nichols announced that California EPA officials are currently in Brussels discussing linkage with the EU ETS.

Deferral of implementation of a California program until implementation of a federal program would obviate difficulties that would arise if attempts were made to link the California program with other programs in the United States.

QUESTION 10 (5/6/08): 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)?

SCPPA RESPONSE: A decision about unilateral or bilateral linkage would be appropriate only upon completing a case-by-case evaluation of a program with which the

California program would be linked. Linkage with other programs in the United States would not be an issue if California awaited implementation of a federal program.

QUESTION 11 (5/6/08): 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?

SCPPA RESPONSE: Whether allowances or other credits from other carbon treating programs should be treated as offsets would depend upon a case-by-case analysis of terms and conditions that underlie the creation of allowances from other carbon treating programs.

E. Compliance Periods

QUESTION 12 (5/6/08): 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?

SCPPA RESPONSE: SCPPA has consistently supported longer compliance periods such as three years rather than one year. A longer compliance period is especially important for regulated entities in the electric sector. The demand for electricity can vary substantially due to year-to-year changes in weather conditions. Longer compliance periods can smooth the effect of changes in weather conditions. Also, like borrowing, longer compliance periods can permit a regulated entity to smooth the impact of a capital intensive infrastructure improvement that might result in a significant step decrease in the entity's emissions.

QUESTION 13 (5/6/08): Should compliance extensions be granted? If so, under what circumstances?

SCPPA RESPONSE: Compliance extensions for individual regulated entities should be considered as an additional flexible compliance mechanism. The benefit of compliance extensions would be similar to the benefits that could be derived from permitting borrowing and longer compliance periods.

F. Banking and Borrowing.

QUESTION 14 (5/6/08): 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?

SCPPA RESPONSE: In general, entities with California compliance obligations should be allowed to bank allowances, offsets, or credits from another carbon trading program, provided that the conditions surrounding the creation of allowances, offsets, or credits by the other program are compatible with the California program. Borrowing tradable units from other programs should be considered, as well. The cost containment benefits of banking or borrowing tradable units from another program are similar to the benefits that can be derived from banking and borrowing within the California program. The benefit of encouraging long-term investment as discussed above is similar, as well.

Whether entities that do not have compliance obligations should be permitted to bank tradable units should be determined after the CARB determines the scope of a California cap-and-trade program, if any. Entities that do not have compliance obligations have the potential to provide additional liquidity to an allowance market. Their potential to add liquidity would be

arguably enhanced if they were permitted to bank tradable units. On the other hand, entities that do not have compliance obligations would tend to trade allowances solely on the basis of potential gain and would lack any operation-driven motivation for trading. That raises a question about whether permitting entities that do not have compliance obligations to bank tradable units would actually decrease liquidity by creating an opportunity for withholding. It would be helpful for the Commissions to have more information about the size and scope of the market before making any determination about whether entities that do not have compliance obligations should be permitted to bank tradable units.

QUESTION 15 (5/6/08): Should limitations be placed on banking aimed at preventing or limiting market participants' ability to "hoard" allowances and offsets or distort market prices?

SCPPA RESPONSE: Limitations on banking depend, in part, on whether market participants that do not have compliance obligations are permitted to bank allowances. Banking is a cost containment mechanism. Consideration should be given to placing conditions upon banking so that banking would be not converted into being a market manipulation and abuse mechanism. However, care should be given to preventing such conditions from unduly impeding the legitimate use of banking.

QUESTION 16 (5/6/08): 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.

SCPPA RESPONSE: Regulated entities should be permitted to borrow to permit cost containment and to permit market participants to tailor their “glide path” to emissions reductions through successive compliance periods. This is particularly important for regulated entities that are in the capital intensive electric sector. It may take long lead times to construct facilities that may result in a sharp drop in emissions after the facilities become operational. Borrowing would permit a regulated entity to meet its compliance obligation during the period of construction in anticipation of the reduced need for allowances after a new facility becomes operational.

Repayment periods may depend upon the purpose for the borrowing. The repayment period for allowances that were borrowed to cover an unanticipated spike in either emissions or allowance prices would be likely to be shorter than the repayment period for allowances that were borrowed to cover emissions while a new low-GHG facility is being permitted and constructed.

It is unclear that “interest payments” are appropriate. If interest payments were required for allowances that were borrowed to cover emissions while a new low-GHG facility is being constructed, the cost of the interest would add to the cost of the facility and may provide a perverse incentive to avoid installing the facility. In any event, any imposition of interest payments for borrowing allowances should not be so onerous as to impede the effective use of the borrowing mechanism for cost containment or for tailoring “glide paths” to compliance.

G. Penalties and Alternative Compliance Payments.

QUESTION 17 (5/6/08): Should there be penalties for entities that fail to meet their compliance obligations? If so, how should the penalties be set? If not, what should be the recourse for non-compliance?

SCPPA RESPONSE: As the CPUC observed in D.06-02-032, “some form of penalty structure is necessary or else the program will only be a voluntary one.” One possibility would be to structure penalties as alternative compliance payments (“ACPs”) so that, as the CPUC observed, “the funds may be used for future GHG reduction efforts.” D.06-02-032 at 46-47. If penalties or ACPs are collected from the electric sector, the money should be returned to the electric sector.

At this point, prior to a determination of the nature and scope of a cap-and-trade market by the CARB, it would be premature to determine the level of penalties or the exact nature of an appropriate penalty mechanism.

QUESTION 18 (5/6/08): Instead of penalties, should there be alternative compliance payments? What would be the distinguishing attributes of alternative compliance payments versus penalties? How would the availability of alternative compliance payments affect the environmental integrity of the cap?

SCPPA RESPONSE: See the Response to Question 17 above.

QUESTION 19 (5/6/08): Would penalties and/or alternative compliance payments allow obligated entities to opt out of the market? Would this add too much uncertainty for other market participants?

SCPPA RESPONSE: Whether penalties or ACPs would, effectively, permit obligated entities to opt out of the cap-and-trade market would depend upon the level established for the penalty or alternative compliance payments. Presumably, the penalties or ACPs would be set at a level that would be high enough to compel covered entities to acquire allowances that were sufficient to cover their emissions.

QUESTION 20 (5/6/08): How should California use the money that would be generated by penalties and/or alternative compliance payments?

SCPPA RESPONSE: To the extent to which a fund is accumulated through assessment of penalties or alternative compliance payments on electric sector entities, it would be most appropriate to use the resulting funds for GHG reduction efforts within the sector from which the funds were derived. Such a use of the proceeds from penalties or alternative compliance payments would, to some degree, “compensate the industry for their cost of complying with carbon emission regulations.” Staff Paper at 21.

H. Offsets.

QUESTION 21 (5/6/08): Should California allow offsets for AB 32 compliance purposes?

SCPPA RESPONSE: Yes.

QUESTION 22 (5/6/08): 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?

SCPPA RESPONSE: Consistent with the AB 32 directive that California’s GHG emission reduction program should minimize the cost to consumers, offsets should be permitted liberally to maximize the cost containment benefit of offsets, provided that the offsets should be additional and verifiable so as to avoid undermining the AB 32 cap. Also, offsets should be permitted liberally to maximize the use of offsets to stimulate innovation in emissions reduction. Geographic restrictions would tend to impede realization of the benefits of having an offsets program.

QUESTION 23 (5/6/08): 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?

SCPPA RESPONSE: This question is inapposite to the extent it addresses specifically the natural gas sector. The Interim Opinion notwithstanding, SCPPA is confident that if CARB elects to adopt a single-cap multi-sector cap-and-trade program, the natural gas sector will be included in the program. Inclusion of the natural gas sector in a cap-and-trade program is contemplated by the Western Climate Initiative. *See* WCI Draft Design Recommendations on Elements of the Cap-and-Trade Program at 8-9 (May 16, 2008).

If the electric sector is to be included in a single-cap multi-sector cap-and-trade program, the natural gas sector should be included in the cap-and-trade program. Many consumer end-uses such as space heating and water heating are fungible between the electric and gas sectors. If emission reductions are to be accomplished “in an efficient and cost effective manner” as required by AB 32, the form of regulation for the two sectors should be identical. Otherwise, lower-carbon electricity options such as high-efficiency heat pumps would not be permitted to compete equitably with higher-carbon natural gas options such as direct-combustion furnaces and water heaters.

If, unlike the natural gas sector under the Interim Opinion, a sector is correctly excluded from the cap-and-trade program for legitimate reasons and an emission reduction project is developed voluntarily in the sector rather than to comply with a governmental mandate, it would be consistent with the policy of permitting offsets liberally to allow the project to be a source of offsets.

QUESTION 24 (5/6/08): Should there be limits to the quantity of offsets? If so, how should the limits be determined?

SCPPA RESPONSE: Offsets that are additional and verifiable should be permitted liberally to attain the cost minimization and incentive objectives of the offset program. It is unclear that there would be a valid rationale for placing limits on offsets that are additional and verifiable. Offsets that are not additional and verifiable should not be permitted at all.

QUESTION 25 (5/6/08): 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?

SCPPA RESPONSE: Details about the administration of an offsets program should be addressed after a decision is made about whether California should have a cap-and-trade program and, if so, whether offsets shall be permitted.

QUESTION 26 (5/6/08): Should California discount credits (i.e. make the credits worth less than a ton of CO₂ e) 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?

SCPPA RESPONSE: See Response to Question 25 from the May 6, 2008 Ruling.

I. Legal Issues.

QUESTION 27 (5/6/08): 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, 38550, and 38562(a) added by AB 32.

SCPPA RESPONSE: AB 32 permits “alternative compliance mechanisms” including “an action undertaken by a greenhouse gas emission source that achieves the equivalent reduction of greenhouse gas emissions over the same time period as the direct emission reduction, and that is approved by the State Board.” Cal. Pub. H&S Code §38505(b). That definition appears to encompass offsets broadly.

QUESTION 28 (5/6/08): Do any of the flexible compliance options identified in these questions or discussed in the attachments to this ruling or in your opening comments raise concerns under the dormant Commerce Clause? If so, please explain why that flexible compliance option(s) may violate the Commerce Clause, including citations to specific relevant legal authorities. Also, explain if and, if so, how the flexible compliance option(s) could be modified to avoid the Commerce Clause problem. Address, in particular, whether a policy that limits offsets to only emission reduction projects located in California would raise dormant Commerce Clause concerns.

SCPPA RESPONSE: Subject to more details about the intended flexible compliance mechanisms becoming known and subject to review of the comments of other parties, SCPPA does not perceive banking, borrowing, offsets, safety valves, or independent market intervention agencies as raising concerns under the dormant Commerce Clause.

QUESTION 29 (5/6/08): Do any of the linkage options identified in these questions or discussed in the attachments to this ruling or in your opening comments raise concerns under either the Compact Clause or the Treaty Clause of the United States Constitution? If so, please explain why that linkage option(s) may violate one or both of these Clauses, including citations to specific relevant legal authorities. Also, explain if and, if so, how the linkage option(s) could be modified to avoid the Compact Clause and/or Treaty Clause problem.

SCPPA RESPONSE: Absent any details about the nature of the linkage that appears to be contemplated by this question, SCPPA is unable to assess whether there would be any concerns under either the Compact Clause of the Treaty Clause of the United States Constitution.

QUESTION 30 (5/6/08): Do any of the flexible compliance options identified in these questions or discussed in the attachments to this ruling or in your opening comments, raise any other legal concerns? If so, please explain the legal concern(s), including citations to specific relevant legal authorities. Also, explain if and, if so, how the flexible compliance option(s) could be modified to avoid the legal concern(s).

SCPPA RESPONSE: None at this time, subject to the review of the comments of other parties.

QUESTION 31 (5/6/08): For reply comments: do any of the flexible compliance options identified by other parties in their comments raise legal concerns? If so, please explain the legal concern(s), including citations to specific relevant legal authorities. Also, explain if and, if so, how the flexible compliance option(s) could be modified to avoid the legal concern(s).

SCPPA RESPONSE: Reserved for reply comments.

V. TREATMENT OF CHP

“Combined Heat and Power (“CHP”), i.e., co-generation facilities, should not be permitted to receive an administrative allocation of allowances beyond those required to cover their emissions or output, depending upon the basis for the administrative allocation of allowances. If a program is constructed under which CHP facilities would be points of regulation in a single-cap multi-sector cap-and-trade program with allowances being made available through a market mechanism such as an auction, CHP facilities should be subject to a requirement that they obtain allowances to cover their emissions to the same extent as that

requirement would apply to non-CHP covered entities. The GHG emission reduction program under AB 32 should not be transformed into a CHP subsidization program with more allowances being allocated to CHP facilities than other facilities with comparable emissions.

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

A. Electricity Emission Reduction Measures.

QUESTION 1 (5/13/08): 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 ARB's Assembly Bill (AB) 32 scoping plan?

SCPPA RESPONSE: SCPPA members are, at their own initiative, undertaking direct programmatic emission reduction measures beyond the current mandates in the areas of energy efficiency and renewable projects, as exemplified by the adoption of RPS goals that exceed 20 percent. SCPPA does not have a recommendation at this time regarding programmatic or regulatory emission reduction measures beyond current mandates that would be imposed on other potentially regulated entities within the electric sector.

QUESTION 2 (5/13/08): Are there additional regulations that ARB 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?

SCPPA RESPONSE: See Response to Question 1 above.

QUESTION 5 (5/13/08): 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? What criteria should be used to determine the portion from each approach? By what approach and in what timeframe should this question be resolved?

SCPPA RESPONSE: The E3 Results demonstrate that “market based measures or mechanisms” fail to result in any significant electric sector GHG emission reductions by causing a change in dispatching until very high allowance prices are reached. *See* E3 Results, Slides 21-22 (May 13, 2008). Further, the E3 Results demonstrate that if no programmatic measures beyond the measures assumed in the E3 Reference Case were pursued, by 2020 the electric sector emissions would be 108.2 MMtCO₂ e. E3 Results, Slide 14 (May 13, 2008). That is *below* the electric sector emissions of 110.6 MMtCO₂ e in 1990. Staff Report, California 1990 Greenhouse Gas Emissions Level and 2020 Emissions Limit, at 6 (November 16, 2007). SCPPA recommends that the Commissions and CARB more fully evaluate the use of programmatic and direct regulatory measures to attain AB 32 goals in all sectors before taking the step of requiring the electric sector to participate in a single-cap multi-sector cap-and-trade program.

To the extent to which direct regulatory measures are pursued, the regulatory measures should be similar to traditional Clean Air Act regulation. Specifically, regulated retail providers rather than deliverers should be the point of regulation with caps being set for the retail providers on an entity-specific basis on the basis of recent pre-AB 32 actual experienced emissions and with the cap being reduced proportionately over time as necessary to achieve the AB 32 reduction goal as eventually established for each retail provider by 2020.

As noted in SCPPA’s February 28, 2008 comment on the Commissions’ February 8, 2008 proposed Interim Opinion, if the Commissions continue to propose inclusion of the electric sector in a single-cap multi-sector cap-and-trade program, the Commission should permit a direct regulatory option for retail providers that are also deliverers of electricity. Specifically, retail providers that are also deliverers should be permitted to elect to be regulated under an alternative compliance mechanism. To mitigate the double burden of paying for energy efficiency,

renewable portfolio projects, and other measure to reduce GHG emissions while also paying for allowances to cover emissions associated with deliveries to serve native load, retail providers that are also deliverers should be permitted to elect to be subject to entity-specific caps and to be relieved of the obligation to acquire allowances to cover emissions associated with deliveries to serve native load up to the level of their caps. *See* SCPPA Comment on Proposed Decision at 12-13 (February 28, 2008).

B. Natural Gas Emission Reduction Measures.

QUESTION 1 (5/13/08): 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 ARB's Assembly Bill (AB) 32 scoping plan?

SCPPA RESPONSE: *See* the Responses to Questions 2 and 5 from the May 13, 2008

Ruling above.

QUESTION 2 (5/13/08): Are there additional regulations that ARB 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?

SCPPA RESPONSE: *See* the Responses to Questions 2 and 5 from the May 13, 2008

Ruling above.

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

QUESTION 4 (5/13/08): The scope of this proceeding includes making recommendations to ARB 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 ARB for inclusion in its scoping plan?

SCPPA RESPONSE: The Commissions proposed in their March 13, 2008 Interim Opinion that the electric sector should be included in a single-cap multi-sector cap-and-trade program. If that recommendation were adopted by the CARB, there would be no sector-specific cap for the electric sector. There would only be a single cap that would apply to the aggregate emissions from all of the sectors that would be included in the California cap-and-trade program.

The Commissions also proposed in their March 13, 2008 Interim Opinion that the natural gas sector should not be subject to a cap-and-trade program. If that recommendation were adopted by the CARB, neither a sector-specific cap nor a single multi-sector cap would apply to emissions from the natural gas sector. That would create uneconomic and perverse results if the electric sector were included in a cap-and-trade program. High-emission gas uses would have an economic advantage over low-emission electric end-use due the difference in GHG regulation for the two sectors.

SCPPA recommends that the Commissions revisit their March 13, 2008 Interim Opinion to reconsider the appropriateness of including the electric sector in a single-cap multi-sector cap-and-trade program. The E3 Results demonstrate the ineffectiveness of including the electric sector in such a program except upon reaching very high allowance prices. If the Commissions decline to reconsider and defer a recommendation to include the electric sector in a single-cap multi-sector cap-and-trade program, SCPPA urges the Commissions to consider providing for an alternative compliance mechanism as recommended by SCPPA in its February 28, 2008 Comment on Proposed Decision in this proceeding.

D. Legal Issues.

QUESTION 6 (5/13/08): Do any of the non-market-based emission reduction measures discussed in your opening comments raise any legal or regulatory concern(s) or barrier(s)? If so, please explain the legal or regulatory concern(s) or barrier(s), including citations to specific relevant legal authorities. Would additional legislation be necessary to overcome any identified legal barrier(s)? Also, explain if and, if so, how the emission reduction measure(s) could be modified to avoid the legal or regulatory concern(s) or barrier(s).

SCPPA RESPONSE: The currently established non-market-based emission reduction measures do not raise legal concerns. Further measures should be evaluated for legality on a case-by-case basis.

QUESTION 7 (5/13/08): For reply comments: do any of the emission reduction measures identified by other parties in their comments raise legal concerns? If so, please explain the legal concern(s), including citations to specific relevant legal authorities. Also, explain if and, if so, how the emission reduction measure(s) could be modified to avoid the legal concern(s).

SCPPA RESPONSE: Reserved for reply comments.

VII. MODELING ISSUES.

A. Methodology.

QUESTION 8 (5/13/08): Address the performance and usefulness of the E3 model. Is it sufficiently reliable to be useful as the Commissions develop recommendations to ARB? How could it be improved?

SCPPA RESPONSE: SCPPA recommends several changes to E3's modeling. First, SCPPA recommends that the E3 Calculator be redesigned to permit modeling of regulatory scenarios with fuel differentiation being taken into account.

Second, if the impact of various allowance allocation proposals on the consumers of each California retail provider is to be compared to the impact on other retail providers, SCPPA

recommends that the metric that should be used to make the comparison is percentage change in annual costs (“PCAC”) for each retail provider. E3 uses the change in net cost for each utility. E3 Results, Slide 53, *et seq.* That is an unfair metric. A \$10 million change in net cost for LADWP or Sacramento Municipal Utility District (“SMUD”) is more consequential than it is for Southern California Edison Company (SCE”) or Pacific Gas and Electric Company (PG&E”) insofar as LADWP or SMUD are much smaller than SCE or PG&E. E3 also uses the change in rates for each utility. E3 Results, Slide 55, *et seq.* That is an inaccurate metric insofar as rates are affected by changes in load as well as changes in cost.

Third, the “SoCal Other” and “NorCal Other” groups of utilities should be disaggregated. SPPA is informed that about half of the “SoCal Other” load is associated with direct access customers. That greatly diminishes the usefulness of the “SoCal Other” data for southern California publicly-owned utilities other than LADWP (which is treated separately). Similarly, including utilities like Pacific Power and Light Company and Sierra Pacific Power in the “NorCal Other” group negates the usefulness of the “NorCal Other” data for northern California publicly-owned utilities other than SMUD (which, like LADWP, is treated separately).

B. Inputs.

QUESTION 9 (5/13/08): Address the validity of the input assumptions in E3’s reference case and the other cases for which E3 has presented model results. If you disagree with the input assumptions used by E3, provide your recommended input assumptions.

SCPPA RESPONSE: Reserved.

C. Results Reported by E3.

The results reported by E3 on May 13, 2008 demonstrate that the Commission should reassess their March 13, 2008 recommendation that electric sector deliverers should be included

in a single-cap multi-sector cap-and-trade program. The E3 Results demonstrate that including electric sector “deliverers” in such a program would raise costs without achieving emission reductions unless extremely high allowance prices are reached.

D. Additional Modeling and Scenarios to Support Parties’ Comments.

SCPPA does not have additional modeling or scenarios to present at this time.

VIII. CONCLUSION.

SCPPA recommends that the Commissions reconsider their March 13, 2008 Interim Opinion and issue a final decision in this proceeding with recommendations being made to the CARB that are consistent with the comments set forth above.

Respectfully submitted,

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Attorney for the **SOUTHERN CALIFORNIA
PUBLIC POWER AUTHORITY**

Dated: June 2, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMPREHENSIVE COMMENTS** on the service list for CPUC Docket No. R.06-04-009 and CEC Docket No. 07-OIIP-01 by serving a copy to each party by electronic mail and/or by mailing a properly addressed copy by first-class mail with postage prepaid.

Executed on June 2, 2008, at Los Angeles, California.

/s/ Sylvia Cantos

Sylvia Cantos

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