BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	))))))	Rulemaking 06-04-009 (Filed April 13, 2006)

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In the Matter of: Order Instituting Informational Proceeding on a Greenhouse Gas Emissions Cap	))))))	Docket 07-OIIP-01

COMMENTS OF THE NORTHERN CALIFORNIA POWER AGENCY ON DRAFT "FINAL OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES"

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In accordance with Rules of Practice and Procedure of the California Public Utilities Commission (CPUC), and the instructions set forth in the CPUC's September 12, 2008 Cover Letter issuing the proposed *Final Opinion on Greenhouse Gas Regulatory Strategies* (Proposed Decision or PD), the Northern California Power Agency[1] (NCPA) submits these comments for the CPUC's consideration. These comments are also submitted to the California Energy Commission (CEC) in Docket 07-OIIP-01, in accordance with the practice established in this proceeding. The CPUC and CEC are collectively referred to as the "Joint Commissions" in these comments.

[1] NCPA is a Joint Powers Agency whose members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee-Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative, and the Placer County Water Agency.

I. INTRODUCTION

The Joint Commissions undertook a collaborative effort to develop and provide recommendations to the California Air Resources Board (CARB) on measures and strategies for reducing greenhouse gas (GHG) emissions in the electricity and natural gas sectors (PD, p. 3) for the implementation of Assembly Bill 32 (AB 32). Through that collaborative process, the Joint Commissions have provided recommendations to CARB on various issues impacting the electricity sector, including parameters for mandatory reporting and point of regulation.

NPCA supports the goals of AB 32 and has demonstrated its commitment to meeting emissions reductions through all feasible and cost-effective measures. NCPA supports the development of a comprehensive program that allows entities the flexibility to develop and adopt measures that meet established goals, reduce excessive cost impacts on electricity customers, ensure that NCPA's member retail providers are able to continue to provide safe and reliable electricity at a reasonable cost, and best serve the interests of their individual communities. NCPA appreciates the opportunity to provide these comments to the Joint Commissions and to participate in this important collaborative process.

The Joint Commissions' Proposed Decision is intended to provide more detailed recommendations to CARB on matters pertaining to allowance allocation and design of an emissions reduction program. To that end, the PD is a helpful *initial* tool to facilitate the development of a rulemaking at CARB. The PD, however, is too tentative to serve as a firm recommendation to CARB, and fails to address the full range of potential impacts on electricity sector stakeholders.

The process that led to the development of this Proposed Decision has been long and involved. Dozens of parties have participated in that process, attending workshops, filing comments, and expending considerable resources in providing requested input to the Joint Commissions in the interest of ensuring that the final recommendations to CARB reflect the best interests on the electricity sector and California's electricity consumers. Having participated in that process, NCPA appreciates the efforts of CPUC and CEC staff involved, and believes that there are several key issues that have been favorably determined in the PD:

- The PD correctly focuses on programmatic measures to attain the most immediate emissions reductions. Although specific points require fine tuning, it is appropriate to look to long-term, permanent reductions through non-market-based programs to achieve the greatest reductions.

- The PD rightly apportions any auction revenues to retail providers to be used to further the goals of AB 32.
- The PD properly discusses the use of offsets to meet compliance obligation and further facilitate the development of innovative GHG reduction opportunities.
- The PD recognizes that a multi-year compliance program is necessary to ensure the greatest flexibility and stability in developing the nascent emissions reduction program.

With that said, a number of significant issues still remain, especially those involving the concept of a market-based cap-and-trade program. Without question, the PD errs in several material respects. The Joint Commissions erred in placing their reliance on the development of a cap-and-trade program that is not substantiated by the record in this proceeding. Nor does the PD's recommendation for the allocation of allowances within the electricity sector properly reflect all of the mandates of AB 32.

The PD errs not only in proposing an unproven auction structure, but in advocating for a swift acceleration to full auction, rather than focusing on allocation of allowances to retail providers, and not just a portion of auction revenues.

The PD must be revised to include a more immediate recognition of emissions reductions measures accomplished through early actions and to ensure that all electricity customers are treated fairly and equitably, regardless of the resource portfolio of their energy service providers.

The PD must also be corrected to ensure that allowances are allocated based on retail sales, and that any transition to such an allocation methodology that relies on a generation-based allocation scheme recognizes <u>all</u> generation resources.

II. DISCUSSION

A. THE PROPOSED DECISION PROPERLY EMPHASIZES THE IMPORTANCE OF PROGRAMMATIC MEASURES TO EFFECT GHG EMISSIONS REDUCTIONS.

Programmatic measures are the State's most effective means to achieve real and permanent GHG emissions reductions. (PD, p. 109) While both D.08-03-018 and the CARB

Draft Scoping Plan recommend that the electricity sector meet GHG emissions reductions goals through a combination of mandatory programs and market-based mechanisms, electricity sector stakeholders are not undivided on the issue of the efficacy of these two differing program types to meet the mandated GHG reductions. The key issue – as the PD properly notes – is "the interaction of GHG reductions through direct mandatory or regulatory control measures with voluntary reductions, including those claimed through the potential market-based cap-and trade program under consideration at ARB." (PD, p. 103)

The June 2008 CARB Draft Scoping Plan appears to place a greater emphasis on the broad programmatic approaches, including the important emissions reductions that can be achieved by encouraging the development of such things as additional energy efficiency programs, increased development of renewable resources, as well as the interactions between non-market-based emissions reductions measures and local government planning. (CARB Draft Scoping Plan, pp. 31-33) These kinds of existing and future programs should be the cornerstone of any recommendation to CARB regarding implementation of AB 32 for the electricity sector, with market-based mechanisms being used only as a back-up or stop-gap measure. The PD notes that some parties "view mandatory regulations and market mechanisms as two complementary policy instruments with added value when used in concert" and that "a combination of additional mandates and a cap-and-trade program should be used to achieve incremental reductions within the sector." (PD, p. 105) While NCPA, as well as others, have noted that the electricity sector is particularly vulnerable to the shortcomings of the market, it favors a program that will facilitate achieving the greatest reductions through the least total impact to electricity customers and the State's economy. If this can be achieved through a combination of programs, then those programs should be further developed. However, developing these programs concurrently with programmatic measures places the electricity sector in the unique – and untenable – position of being called upon to effect GHG reductions in excess of the sector's fair share. As it pertains to the electricity sector, it is imperative that any market-based program be utilized only to achieve those emissions reduction goals that could not be met through programmatic measures – both those currently employed and those being developed – and that in the event there is an auction, the ratcheted down cap not be seen as an *additional* reduction mandate on the electricity sector. NCPA notes that utilization of a "secondary" market to acquire additional emissions allowances in the event that all of the mandated reductions cannot be met through programmatic measures should not automatically trigger discussions of mandatory auctions.

In light of the conclusions in both D.08-03-018 and the PD that the Joint Commissions believe that “a cap-and-trade program will likely provide a relatively small incremental portion of the overall emissions reductions needed to meet the 2020 limit above emissions reductions achieved due to existing mandatory measures,” (PD, p. 109), the costs of launching and administering such a program – especially if a Western Climate Initiative (WCI) program is not fully operational – are likely to exceed any incremental benefits. Such an outcome would not only be a waste of resources, but the diversion of these resources into this secondary program at such a critical time will also thwart real GHG emissions that may have been otherwise achievable.

The PD properly addresses the significance of programmatic measures to effect GHG emissions; however, the PD should be revised to clarify that such programmatic measures are the basis of all emissions reductions mandated for the electricity sector, and that the utilization of market-based mechanisms will only be necessary on a voluntary basis should entities with a compliance obligation be unable to achieve the mandated reductions through these programs.

B. THE PROPOSED DECISION ERRS IN RECOMMENDING AN AUCTION AT THIS TIME.

Simply put, a mandatory allowance auction is not necessary to effect GHG reductions in the electricity sector. As noted above, the Joint Commissions have already acknowledged that the majority of the emissions reductions that are likely to be achieved by the electricity sector can be met by programmatic measures. (PD, p. 109) The PD also recognizes “that future success in reducing GHG emissions will involve increasing coordination at the regional and national levels.” (PD, p. 144) These conclusions, coupled with the tumultuous state of current economic markets, make it ill-advised for the launch of an untried, mandatory emissions allowance auction. If there is to be a discussion of auction coupled with a recommendation that such an auction be part of the WCI process, then that discussion must part of a regional forum. Furthermore, before finding that auctions are indeed the best market-based mechanism for achieving the desired result, the PD should address the potential utilization of non-mandatory market-based measures, such as the voluntary purchase and sale of emissions allowances between entities with a compliance obligation.

Strong programmatic measures have already been put in place by the Legislature and should be allowed to work before overlaying a complex, untested, and costly market mechanism on top of the State's GHG reduction program. However, if the Joint Commissions are inclined to recommend that the electricity sector participate in a mandatory auction, that recommendation must be accompanied by specific measures and design elements for the auction structure. Furthermore, in the event that an auction – one that is fully defined – is recommended, such an auction should not be mandatory for the electricity sector until such time as the State has had an opportunity to maximize all of the emissions reductions that can be achieved through the programmatic measures addressed in the PD. (PD, pp. 77-102) Expansion of such an auction should be slow and measured. Finally, all proceeds from a mandatory emissions auction for the electricity sector must be allocated directly back to retail electric providers for investments in programs and measures that can be used to meet the mandates of AB 32.

1. The Joint Commissions Must Address the Auction Structure Concurrently with an Auction Recommendation.

The Joint Commissions err in recommending an auction without also proposing specifics with regard to how that auction will be structured and administered. Although the PD addresses cap-and-trade market design in Section 7, the recommendation to move forward with an auction is too tenuously linked to "further considerations" to be sound. The PD states that "[w]hile it is critically important to design auctions in a way that prevents collusion and abuse of market power, we do not make detailed recommendations to ARB regarding auction design at this time." (PD, p. 130) This is simply the wrong approach. Failure to consider the design details of an auction prior to its recommendation is a serious misstep that has the potential to be followed by sobering financial consequences for the State's utilities and their customers. It is simply impossible to recommend an auction for the distribution of allowances throughout the electricity sector without first defining what that auction will look like; to do otherwise would be leaving a crucial issue to fate – or rather, the mercy of the markets, which is not only ill-advised, but has proven to be catastrophic for the electricity sector and California consumers in the past – both in terms of sky-rocketing energy prices and compromised reliability in electricity service.

Auction rules must be established up front as part of the development of the auction itself, and built into the final auction recommendation. As the PD notes, the "design of the cap-and-trade system, and its associated allowance allocation policy, can have a significant positive or negative impact on the costs borne by electricity consumers." (PD, p. 123) The risks associated with any "negative impacts" cannot – and should not – be summarily dismissed.

Auction design and governance cannot be secondary considerations. Rules matter, oversight is key, and these must be built into the new cap-and-trade market, especially an auction that will include the purchase and sale of allowances from all sectors of the economy. The Proposed Decision recommends that the electricity sector be a part of a multi-sector cap-and-trade program (PD, p. 107) that will have economy-wide impacts. As such, it is imperative that the market design issues – and not just the potential for manipulation – be addressed at the onset. The PD is devoid of any discussion regarding the actual interaction between the electricity sector and other sectors involved in a multi-sector/multi-jurisdictional cap-and-trade program.

Indeed, the PD acknowledges that "some <u>delays or other failures</u> may occur for some of the programs considered here, including both the regulatory mandates and the <u>cap-and-trade program.</u>" (PD, p. 111, emphasis added) The PD then asserts that overlapping programmatic measures with a cap-and-trade program would sufficiently mitigate any real consequences to achieving mandated reductions. However, in the event that there is a "failure" in the cap-and-trade system, such a dual system does nothing to protect the overall economic stability of the electricity sector, nor does it protect the individual entities caught in that failure.

Several key principles of a cap-and-trade program are so crucial to the continued viability of California's economy that they must be specifically set out in any recommendation to CARB in order to ensure that any subsequent proceeding to implement a cap-and-trade program is done with a clear sense of direction. For example, deferring the resolution of issues such as who may participate in the auction (PD, p. 256) leaves too many unanswered questions regarding the auction structure.

Despite the Joint Commissions' determination that the details of a market-based program will be worked out in a future CARB proceeding, the purpose of this joint proceeding is to advise CARB on matters pertaining to the electricity sector, and therefore, it is imperative that the Joint Commissions set forth the minimum requirements of such a program before recommending that such a program be implemented. Any market-based program for the allocation of valuable emissions allowances will create an opportunity for gaming, and it is essential that the Joint Commissions' recommendation to CARB not only identify this potential problem, but include a recommendation on the means by which it can be addressed. Although many details will be resolved in a subsequent CARB rulemaking, the Joint Commissions have termed this recommendation to CARB the *"Final Opinion on GHG Regulatory Strategies."* Therefore, at the nascent stages of market development, the Joint Commissions' recommendation to CARB must focus not only on crucial elements of market oversight, but mitigate the potential for abuse from the onset, as well as a means by which the rules of the market can be enforced.

If the State and WCI determine to move forward with an auction – no matter how small – it is imperative that all of the costs and market implications of an auction be fully addressed at the very start of any cap-and-trade program debate. Program costs should also be acknowledged and addressed. For example, auctions can be extremely costly to electricity consumers, and to date there has been no meaningful discussion regarding the administrative costs associated with establishing and running an auction. Electricity sector consumers will be called upon to bring about significant emissions reductions through non-market-based mechanisms (more than 40% of the State's total reduction target). There is no reason to believe that these costs will be insignificant or *de minimus*, and while the PD notes that the electricity sector should not necessarily bear all of the costs of the electricity sector programs or any or all of the additional costs associated with a cap-and-trade system (PD, 122), the Joint Commissions should go further in recommending that costs associated with establishing the program should be allocated across all sectors – not just to the electricity sector as the initial participant, and not solely to the capped sectors.

2. The Joint Commissions Should Scale Back the Initial Launch of an Auction, as well as the Acceleration to 100% Auction.

The recommendation for an auction "with a fairly brief transition period" (PD, p. 202) is another fault in the Proposed Decision. While the State cannot wait until today's volatile markets stabilize before it takes action on implementing the GHG emissions reduction measures mandated by AB 32, it is a fundamental error to rush into an untried carbon market – especially at this time. Clearly, this is not an ideal time to launch a brand-new market, especially one predicated on a mandatory auction. Even if today's economy could sustain an initial auction, the State – and electricity sector stakeholders with a compliance obligation – should be given sufficient time to work through the emerging auction period. If there is to be a full auction, the transition to 100% auction must flow at a very gradual pace; going from no GHG emissions allowance market to 100% auction by 2016 is simply too fast to ensure sufficient market protections are in place and working properly. The rush to full auction could be devastating to the State's electricity customers and economy.

A steep acceleration to 100% auction is also inconsistent with a regional approach. The PD properly recommends that California's cap-and-trade program should be linked with the WCI. Indeed, even the WCI scaled back its previously contemplated auction proposal in its cap-and-trade design recommendation released on September 23, 2008.[2] The careful and deliberative process that led to the release of the WCI Final Design Recommendations included a great deal of discussion regarding the relative merits of an auction as the primary means by which to distribute allowances throughout the WCI Partner jurisdictions. Initially, the WCI recommended that a large portion of allowances (25-75% beginning in 2012) be distributed through auctions (WCI Draft Design Recommendations, July 23, 2008). In its Final Design Recommendations, by comparison, the WCI proposes commencing with an auction with a minimum of 10% in 2012 and moving to 25% by 2020. (WCI Final Design Recommendations, Section 8.7.1) Although the WCI notes that the partner jurisdictions "aspire to higher auction percentage over time, possibly 100%" (Id.), the WCI's decision not to rush such a market structure recognizes that a hasty move into an allowance auction and steep glide path to 100% auction has greater potential harm than benefits.

Given the importance of linking a California auction with a regional program as acknowledged in the PD, the PD should be revised to allow for a much smaller initial auction, with a measured glide-path to full auction that takes into account the success and failures of the initial auction and the economic stability of those with a compliance obligation

[2] *Design Recommendations for the WCI Regional Cap-and-Trade Program*, dated September 23, 2008 (Final Design Recommendations).

participating in the auction. This would, as well, bring California more on track with the stated objective of being in step with regional efforts.

3. Allowances, and Not Merely a Portion of Auction Revenues, Should be Allocated to Retail Providers.

Allowances should be allocated directly to retail providers. Retail providers would then have the ability to utilize the value of the allowances to achieve emissions reductions in the most cost-effective manner for its individual and unique service area. As set forth in the PD, retail providers essentially receive a portion of auction revenues, the Joint Commissions recommend that "ARB distribute the allowances directly to the retail providers with a requirement that they in turn sell the allowances at auction." (PD, p. 174) Based on the uncertainties surrounding the structure and administration of an auction, returning auction revenues to retail providers will not compensate those providers for 100% of monies expended in participating in the auction. This is an unnecessary diminution in the total resources available to invest in emissions reduction strategies.

4. If There is an Auction, the Proposed Decision Properly Allocates Auction Proceeds to the Electricity Sector.

A primary weakness of an auction is the concern that market structure and potential manipulation will cause irrevocable harm to those required to participate. A secondary – and no less likely concern – is that the proceeds from the sale of allowances will be funneled away from the electricity sector and will not be available to reinvest in greater GHG reduction and consumer-protection programs. If there is to be an auction, the PD correctly acknowledges this concern, and makes recommendations to ensure that allowance values are not diverted away from the electricity sector. The PD recognizes the "greater good" in recommending that CARB "require that all allowance auction revenues be used for purposes related to AB 32, including the support of investments in renewables, energy efficiency, new energy technology, infrastructure, customer bill relief, and other similar programs." (PD, p. 14; Ordering Paragraph 12) This recommendation is also consistent with the WCI's directives regarding the use of allowance values. (Final Design Recommendations, Sections 8.2 and 8.3)

The Proposed Decision goes even further in acknowledging this concern by properly recommending that "<u>all auction revenues</u> from allowances allocated to the <u>electricity sector</u> be used for the benefit of consumers in the electricity sector." (PD, p. 205; Ordering Paragraph 13, emphasis added) Furthermore, the PD properly recommends to CARB that the CPUC oversee the appropriate use of retail providers' auction revenues consistent with the purposes of AB 32 for investor-owned utilities, and that this function be undertaken by the governing boards for publicly-owned utilities for POU retail providers. (PD, p. 225; Ordering Paragraph 14)

Unfortunately, the PD, without any support in the record, goes on to recommend that CARB "require each publicly-owned utility to demonstrate annually to the Energy Commission that its use of auction revenues during the prior year was consistent with the purposes of AB 32." (PD, p. 225; Ordering Paragraph 15) Having already acknowledged that the governing bodies of local publicly owned utilities have oversight authority over these entities, the PD then determines, without any discussion or rationale for making such a recommendation, that there should be additional review of POU expenditures. The record is devoid of evidence to support a requirement that publicly owned utilities have their expenditures verified by a third party. The Proposed Decision errs in placing this secondary requirement on POUs, and should be revised to strike Ordering Paragraph 15.

C. ALLOWANCE ALLOCATION

Without an auction, or with a limited auction, the issue of distribution of allowances remains both pivotal and divisive. This matter is further complicated by the fact that not only must the Joint Commissions still analyze and determine what baselines should be utilized, but the overall allowance allocation scheme must be able to work in concert with a regional program. In undertaking at least a part of this challenge, the PD applies the proper evaluation criteria, yet errs in its final recommendations.

Based on input from stakeholders, the Proposed Decision sets forth key criteria and guidance to be used as guidance in evaluating the various possible allocation approaches (PD, p. 131):

- Minimize costs to consumers.
- Treat all market participants equitably and fairly.
- Support a well-functioning cap-and-trade market.
- Align incentives with the emission reduction goals of AB 32.
- Administrative simplicity.

1. Cost Impacts Cannot be Verified Using the E3 Modeling for All Retail Providers.

While NCPA recognizes the herculean efforts that have been expended in developing detailed models of the cost impacts of AB 32 implementation for the various retail providers in the electricity sector, the model results are not indicative for all retail providers. Indeed, in a section titled "Limitations of the Analysis and Scope of the Model," the PD acknowledges that "the GHG Calculator does not estimate the impacts of GHG policy choices on energy producers or entities other than the seven groupings of retail providers (and their customers) identified in the model." (PD, p. 28) The Joint Commissions must therefore use caution when relying on the modeling results to provide detailed information regarding the smaller retail providers. The E3 model sets out very specific information for the State's largest utilities – both investor-owned and publicly-owned. However, the level of detail for the State's remaining retail providers is not as detailed, and in fact is aggregated in large groups – *Northern California Other* and *Southern California Other*.[3] Conclusions and recommendations based on the perceived potential impacts to these "other" categories of retail providers are unreliable. NCPA urges the Joint Commissions to acknowledge this shortcoming in the modeling process.

2. The Proposed Allowance Allocation Methodology Does Not Minimize Costs to All Customers, nor Treat All Market Participants Fairly.

The PD does not treat all market participants fairly; it provides direct and immediate compensation to retail providers that have higher carbon portfolios. By ignoring the early actions of other retail providers, the PD forces consumers of entities with low-carbon portfolios to pay twice for emissions reductions. NCPA agrees that the Joint Commissions should aim to minimize consumer rate impacts, but the almost singular focus on protecting consumers served by high carbon-resourced providers comes at the expense of those consumers who have already seen rate increases as the result of early actions taken by their providers.

[3] On January 7, 2008, NCPA filed comments with the Joint Commissions raising these concerns regarding the E3 modeling.

The PD notes that treating all market participants fairly is a key criterion, and specifically speaks to recognition of historical investments and the importance of early actions. (PD, p. 141) However, the PD departs from pursuit of equal treatment by not recognizing that historical investments are not all high-emitting resources; some retail providers have historical investments in low-GHG resources that are completely ignored in the PD.[4] In fact, the PD specifically notes that its allowance allocation scheme is intended to protect only those customers of retail providers with higher GHG-portfolios by noting that the transition period contemplated in the PD "would ensure that any allowance rents would be short-term, and *would give existing high-emitting resources time to adjust their generation investments*." (PD, p. 282, emphasis added)

The PD mischaracterizes the impact of failure to adequately recognize and compensate for the costs associated with voluntary early action on consumers of retail providers that have taken such measures. This disregard is noted as both a part of the fuel-differentiated allocation for deliverers and historic emissions based allocation for retail providers.

In dismissing the concerns of stakeholders that an emphasis on emissions-based allocation penalizes early investments, the PD states that "the extent to which historical emissions-based distributions to retail providers would recognize early actions that retail providers may have taken to reduce emissions would depend on the base period used." (PD, p. 168, see also p. 228) Yet the PD continues to distinguish between historic investments in clean, versus high-GHG emitting resources. This distinction is especially problematic for faster growing retail providers. In the case of service territories that are experiencing much needed economic development, in order to meet load-growth demands and continue to grow and expand the economy, retail providers are more likely to need to invest in additional generation, and based on reliability constraints, it is likely that this generation will not come from zero-emitting resources. Yet, under the allowance allocation mechanism contemplated in the PD, these same retail providers will be forced – until 2016 – to purchase allowances in the auction to meet their load growth despite their past investments in low emitting technologies.

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[4] For example, the North Fork Stanislaus River Hydroelectric Development Project, the state's most recently constructed large hydroelectric project, was built by NCPA at a much higher cost than it would have been to use other resources at that time.

While NCPA concurs that "there is no single measure of equity" (PD, p. 205), the balance struck in the proposed methodology that rewards those with higher-emitting portfolios is not reasonable. The Proposed Decision should be revised to compensate for past investments in both high- and zero-emitting generation resources.

3. The Proposed Decision Should Recognize All Generation Resources in Allocating Allowances.

At the end of the day, all retail providers are going to be called upon to make specified reductions, achieve minimum renewable portfolio standards and initiate new energy efficiency and demand response programs. These programs will require the expenditure of considerable resources, and will not cost retail providers with lower-GHG emitting generation resources any less to implement than those with higher-emitting resource portfolios. The PD errs by failing to acknowledge this fundamental principle in its allowance allocation proposals that start with a recognition of only historic emissions for retail providers and a fuel differentiated output-based approach for deliverers. For retail providers, allowances should be allocated based on retail sales. Allocation of allowances to deliverers (which include many vertically integrated retail providers) should be based on a methodology that recognizes all generation resources.

4. The Proposed Allocation Methodology is Not Administratively Simple.

The proposed allowance allocation methodology defies any notion of administrative simplicity. The PD notes that auctions can be complicated to implement and design (PD, p. 201), but without further evidence on how these complications will impact those with a compliance obligation, or how this implementation and design will draw resources away from actual emissions reductions programs, the PD continues to advocate for a swift transition to full auction.

The proposed auction would need to link with a WCI program, yet proposes an auction schedule that is much different from that set forth in the WCI's Final Design Recommendation. Furthermore, WCI recommends a "coordinated regional auction" that must be developed in the next year. (Final Design Recommendations, Section 8.8) This aggressive schedule will impose even greater resource demands on entities in the electricity sector, resources that are best expended on effecting emissions reductions through energy efficiency programs and other programmatic measures.

Linking a California emissions allowance auction to a regional program, while far more desirable than a California-only auction, creates further complexities. For example, the WCI recommends that each partner jurisdiction allocate allowances throughout its jurisdiction as it deems appropriate. (Final Design Recommendations, Section 8.4) However, the Final Design Recommendations also provide that based on analysis of competitive factors, it may be necessary for the Partners to mandate standardized allocation methodologies in the electricity sector. (Id., Section 8.5) These and similar considerations must be taken into account by the Joint Commissions in making a recommendation to CARB.

Finally, the PD should address the potential for duplicative and onerous reporting obligations on the electricity sector. Although not unique to any one implementation plan structure, the potential for multi-level, multi-forum reporting requirements is increased with the implementation of a mandatory, regional-based auction.

D. ACHIEVING REDUCTIONS SHOULD BE THE FOCUS OF ENERGY EFFICIENCY EXPENDITURES.

As noted above, energy efficiency programs are going to play a key role in the State's overall plan to meet the mandates set forth in AB 32. The PD correctly notes that energy efficiency is the "the cheapest and most effective energy resource," and that California will need to look to new and innovative ways to increase energy efficiency penetration and options throughout the state. (PD, p. 81) However, given the PD's acknowledgment that even E3's energy efficiency modeling is not conclusive on the cost-effectiveness of any given program, the focus on energy efficiency mandates must be on achieving results, and not on actual dollars expended. The PD provides, for example, that "although the Commissions and the ARB are considering energy efficiency goals up to 100% of economic potential for energy efficiency, which is slightly higher than the Itron "high" scenario, currently no data or analysis exists to estimate the costs of achieving that level of energy efficiency." (PD, p. 43) Accordingly, the focus should not be on expenditures of energy efficiency dollars, rather on the total energy savings that results from any one program in a particular area.

The Joint Commissions have recommended to CARB that the "State require equivalent investment in energy efficiency from both investor-owned and publicly-owned utilities." (PD, p. 82) This recommendation must be clarified to note that "equivalent investments" does not translate to "equal dollars." The focus should remain on output – that is, obtaining actual reductions in energy consumption – and not to mandate a specific investment. It does not make sense to "force" investments in programs that only aid in the development of "market transformation activities" for investor-owned utilities who are allowed to meet their mandated energy efficiency goals through such activities. Retail providers are unique, and so should be their energy efficiency programs. NCPA notes that the Legislature has also already recognized the value of diverse locally-tailored efficiency programs in AB 2021, by ensuring local flexibility toward that end.

The Proposed Decision properly notes that "we do not mean to suggest that the investor-owned and publicly-owned utilities must choose the same programs or approaches to energy efficiency investment; we simply encourage similarly aggressive levels of investment and delivered savings expectations from all retail providers." (PD, p. 81) The PD errs in concluding this discussion with an Ordering Paragraph that does not reflect the realities of energy efficiency discussed in the document itself, and Ordering Paragraph 1 should be revised to correctly reflect this discussion.

While NCPA supports the focus on attaining emission reductions through programmatic measures, it is crucial to the success of the entire program that any *mandated* measures properly reflect realistic results. The E3 modeling and CARB's Draft Scoping Plan both rely on aggressive proposed mandates that are contingent upon a host of variables. All mandated programs must be technologically feasible and cost-effective. These considerations must be part of the deliberative process and must be fully resolved before final recommendations regarding mandated programs can be made.

E. CALIFORNIA'S CAP-AND-TRADE PROGRAM SHOULD BE PART OF A REGIONAL PROGRAM.

The PD properly recommends to CARB that the State not "pursue a California-only program, but rather pursue bilateral linkage with other states in the Western Climate Initiative to help create a regional cap-and-trade market." (PD, p. 291, Conclusion of Law 19) NCPA agrees that the State should not attempt to launch a California-only cap-and-trade program. Linkage with other states in the WCI for the cap-and-trade system would remove or mitigate some of the challenges of a California-only approach, and should be pursued.

NCPA applauds the PD's proper recognition of the importance of a regional cap-and-trade program, one that will eventually transition to a federal program. Clearly, such a design was contemplated by the State legislature, as evidenced by Health and Safety Code § 38564, which specifically directs CARB to "consult with other states, and the federal government, and other nations to identify the most effective strategies and methods to reduce greenhouse gases, manage greenhouse gas control programs, and to facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs." NCPA fully supports integrating the State's GHG reduction measures with those of its neighboring jurisdictions, and has been actively involved in the ongoing efforts at WCI toward achieving such a goal.

However, at a minimum, the Joint Commissions' recommendation should include the fundamental requirements that must be incorporated into any cap-and-trade program applicable to the California markets, setting rational boundaries for subsequent rulemakings at CARB. While a regional program is strongly preferred over a California-only program, the Joint Commissions must make a recommendation to CARB that includes an outline of what a California-only cap-and-trade program will look like in the event that CARB determines to move forward with a State program should there be an unforeseen delay in the launch of the WCI's regional program. Despite the fact that the PD encourages CARB to implement a regional program, this contingency must be addressed.

As noted above, the contemplation of and recommendation for any market-based program must be undertaken concurrently with the recommendation to implement such a program.

F. ALLOCATION OF ALLOWANCES TO THE ELECTRICITY SECTOR.

The Proposed Decision is correct in its recommendation that CARB establish a cap for the electricity sector, and that the electricity sector not be called upon to make additional reductions simply because the "electricity sector is a sector in which techniques for reducing emissions are already known and generally fairly quantifiable and feasible." (PD, p. 119)

The PD addresses the importance of a fair and proportionate allocation of allowances to the electricity sector. While the PD falls short of recommending an actual number, it does recommend that the electricity sector reductions not be lower than the "approximately 79

MMT CO2e estimated in E3's Accelerated Policy Case." (PD, p. 124) This number can be used as a floor, but as the PD notes, comprehensive economic analysis has not been conducted for other sectors, and the fact that the electricity sector has already undertaken such an analysis should not be punitive. The PD should further clarify that the E3 Accelerated Policy Case does not necessarily include immediately attainable goals, and that some of the projected reductions, such as those that are estimated to be realized through expanded combined heat and power, have yet to be substantiated. Furthermore, it is anticipated that emission reductions will be achieved in other sectors through electrification efforts, such as those already being undertaken at the State's ports and through expanded high-speed rail efforts. While these efforts should be encouraged, the increase in the total need for electricity must be acknowledged in determining the total reduction obligation of the electricity sector.

Accordingly, it is crucial that the Joint Commissions' recommendation to CARB on a total electricity sector cap not exceed the sector's realistic, fair share of the total statewide emissions reductions.

G. FLEXIBLE COMPLIANCE OPTIONS

The Commissions acknowledge that "a cap-and-trade program would add a GHG emissions cost to electricity generation" (PD, p. 17) and further recognize the "uneven nature of the emissions in the electricity sector due to weather-driven variations in energy consumption and the supply of zero-emitting hydropower." (PD, p. 266) Evaluation of a proper and equitable allocation distribution methodology is a complicated and somewhat speculative undertaking, and throughout the Proposed Decision, the Joint Commissions recognize that key goals of AB 32 implementation include minimizing the costs to ratepayers and incentivizing investment in GHG reduction technologies.

1. Allowing the Use of Offsets Will Provide Needed Flexibility in the Early Stages of Program Implementation.

The Proposed Decision properly recognizes the benefits of offsets to meet compliance obligations and further facilitate the development of innovative and inventive GHG reduction opportunities. Keeping in mind the Joint Commissions' five evaluation criteria, NCPA views offsets as a necessary means to temper the financial impact of AB 32 implementation on California's electricity consumers, particularly in the early years of the compliance program, and fully supports the Joint Commissions' recommendation for geographically unlimited offsets to ease costs and “reduce the impact of abnormal hydropower years or other anomalies.” (PD, p. 145)

The Proposed Decision also acknowledges that the benefits of offsets also reach beyond the immediate goal of reducing consumers’ electricity bills by encouraging investment in emissions reduction technologies and easing the transition to a regional program, thus creating the potential for out-of-state markets to invest in clean technology products manufactured in California. (PD, p. 271)

Finally, the Joint Commissions’ proposed recommendation on the use of offsets is consistent with the expansive definition and support of offsets set forth in Section 9 of the WCI Final Design Recommendations.

2. A Multi-Year Compliance Program Ensures Flexibility and Stability in Early Program Implementation.

The Proposed Decision also properly recognizes that the interests of program flexibility and stability are also served by a multi-year compliance period. As was the case with offsets, the Joint Commissions recognize that a multi-year compliance period “would help ease potential allowance demand spikes” and would help counter the effects of variations in weather that impact energy consumption and availability of hydropower resources. (PD, p. 145) Since the WCI also recommends a multi-year compliance period, commencing in 2012, (Final Design Recommendations, Section 8.15) the PD correctly allows for a seamless evolution to the proposed regional program.

III. CONCLUSION

NCPA commends the efforts of the CPUC and the CEC to develop a comprehensive recommendation to CARB on regulation of the electricity sector as part of the statewide implementation of AB 32. Despite all of the efforts and resources expended to date, it is clear that development of comprehensive rules for implementation and administration of AB 32’s laudable and aggressive objectives is not going to be accomplished overnight. The interaction between so many diverse sectors – and indeed, jurisdictions – makes the tasks ahead challenging ones. Yet, as a sector that represents a vital and essential part of the State’s economic well being, it is imperative that everything possible be done to protect the State’s electricity consumers from undue and unnecessary economic hardship occasioned by the implementation of AB 32. To that end, any recommendation must reflect awareness of the hard lessons stemming from the California electricity crisis. NCPA appreciates the opportunity to provide these comments to the Joint Commissions in furtherance of developing recommendations to CARB, and looks forward to working with the Joint Commissions in this ongoing effort.

October 2, 2008 Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rule of Practice and Procedure, I have this day served a true copy of the **COMMENTS OF THE NORTHERN CALIFORNIA POWER AGENCY ON DRAFT "FINAL OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES"** on all parties on the Service Lists for R.06-04-009, as last revised on the Commission's website on October 1, 2008, by electronic mail, and by U.S. mail with first class postage prepaid on those Appearances that did not provide an electronic mail address.

Executed at San Jose, California this 2nd day of October, 2008.

Katie McCarthy