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CALIFORNIA ENERGY COMMISSION
REPLY COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON PROPOSED DECISION ON GREENHOUSE GAS REGULATORY STRATEGIES

CHRISTOPHER J. WARNER

Pacific Gas and Electric Company
77 Beale Street
San Francisco, CA 94105
Telephone: (415) 973-6695
Facsimile: (415) 972-5220
E-Mail: CJW5@pge.com

Attorneys for
PACIFIC GAS AND ELECTRIC COMPANY

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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 (file April 13, 2006)

REPLY COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON PROPOSED DECISION ON GREENHOUSE GAS REGULATORY STRATEGIES

Pacific Gas and Electric Company (PG&E) provides its reply comments on the Proposed Decision (PD) on greenhouse gas (GHG) regulatory strategies under AB 32.

I. "BACKSTOP" CONSUMER PROTECTIONS SUCH AS PRICE COLLAR

The majority of parties addressing the issue of "backstop" consumer protections, including the CPUC's own Division of Ratepayer Advocates (DRA), support including a "price collar" or something similar in the design of a cap and trade program, in order to protect consumers from the risk of sustained high prices for GHG allowances in the event of market failure or market manipulation.[1]

In contrast to the support for these consumer protections, some parties[2] argue that the discretion of the Governor of California to suspend AB 32's overall deadlines under extraordinary circumstances is adequate cost containment protection and therefore a "price collar" or similar protection is unneeded.[3] PG&E and others vigorously disagree. The Governor's future discretion is not a practical or timely substitute for an effectively designed cap and trade program that includes "self-correcting" cost containment provisions. California recently experienced the consequences of relying on prospective political discretion to remedy a market failure – the result was that millions of California consumers and businesses experienced billions of dollars of higher electricity costs during the 2000- 2001 California energy crisis.

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[1] DRA, Opening Comments, pp. 6- 8; SCE, Opening Comments, pp. 17- 18; SDG&E/SoCal Gas, Opening Comments, pp. 8- 9; SCPPA, Opening Comments, pp. 21- 24.

[2] NRDC-UCS, Opening Comments, June 2, 2008, p. 21.

[3] *Ibid.,* citing Health and Safety Code section 38599.

Some parties also argue that a "price trigger" or "safety valve" would allow the overall carbon cap to be "broken," thus undermining the fundamental environmental integrity of the program.[4] However, in subsequent comments, two of the parties opposing "safety valves" and "price triggers" generally, NRDC-UCS, have distinguished PG&E's and DRA's similar "price collar" approaches—in which allowances would be made available at a pre-determined price from an "allowance reserve" from future years without changing the overall multi-year "carbon budget"—and concluded that such approaches would be "slightly better because it better maintains environmental integrity." Nonetheless, NRDC-UCS continue to oppose even this approach because in their view it creates "uncertainty in the market."[5]

Potential "market uncertainty" is not a compelling reason for denying California consumers and businesses with adequate and essential protections against a price "blow-out" or other system-wide failure in a cap and trade market. As DRA points out in their opening comments:

> "[T]he PD's recommendation against including a safety valve or price cap in a cap-and-trade system does nothing to remove or even limit uncertainty from the impact of unforeseen, extremely high allowance prices. Absent a price cap or safety valve, entities faced with skyrocketing allowance prices would have limited options: hope that the Governor intervenes to adjust compliance obligations12 and/or pay the as-yet undetermined penalty for failure to comply with the allowance requirements established by CARB.13 It is important to note that any cap-and-trade system that contains a penalty for noncompliance has an implicit price cap in place. That is, as reductions become more and more expensive, covered entities could choose to pay the noncompliance penalty in lieu of making additional reductions. Thus, instead of debating whether there should be a safety valve, California should instead consider at what price reductions are too costly."[6]

Thus, the PD should heed the recommendations of most parties as well as on-going discussion at the national level,[7] and be revised to recommend a "price collar" or a

[4] NRDC-UCS, Opening Comments, June 2, 2008, p. 21. CEERT opposes "borrowing" of allowances from future periods rather than "price triggers" or "safety valves" *per se,* but CEERT provides no explanation for its opposition. (CEERT Opening Comments, p. 11.)

[5] NRDC-UCS Reply Comments, June 16, 2008, pp. 19- 20.

[6] DRA Opening Comments, October 2, 2008, p. 7.

[7] See "Cost Containment Discussion Paper," U.S. Climate Action Partnership, pp. 4- 5, March 20, 2008, http://www.us-cap.org/; S.2191, Lieberman-Warner Climate Security Act of 2008, Managers

similar consumer protection as an essential element in a cap and trade program. We urge the CPUC and Energy Commission to recommend to ARB that it continue to explore all tools, including a price collar, that can satisfy the dual objectives of protecting consumers against excessive price impacts while also maintaining the environmental integrity of a cap and trade program.

II. TRAJECTORY OF 2012- 2020 EMISSIONS CAPS

Numerous parties agreed with PG&E that the PD's "straight-line" trajectory for 2012- 2020 emissions caps should not be adopted, but instead a more gradual trajectory should be adopted that takes into account incentives for long term investment in new emissions reduction technologies and programs.[8] In particular, SMUD pointed out that the history of California's Renewable Portfolio Standard program should serve as a cautionary note in setting "straight line" deadlines for emissions reductions under AB 32: "[S]imply mandating a straight-line increase in procurement of renewable energy has not been successful."[9]

PG&E agrees with SMUD and other parties that the PD should carefully consider the impacts on investment, technology development and sustained emissions reductions before adopting a particular trajectory for the 2012- 2020 interim emissions caps.

III. ALLOWANCE ALLOCATION

Many parties addressed the cost and rate impacts of the PD's allowance allocation recommendations.[10] In particular, LADWP submitted 22 pages of new modeling results, including a 10-page spreadsheet appendix, that it argues support the

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Substitute Amendment, Section 431, establishing "Carbon Market Efficiency Board" with authority to increase amount of allowances that covered facilities may borrow from the future or expand the period from which allowances may be borrowed; see also, Murray, Newell, Pizer, "Balancing Cost and Emissions Certainty: An Allowance Reserve for Cap-and-Trade," Nicholas Institute for Environmental Policy Solutions, Duke University, August, 2008, http://www.nicholas.duke.edu/institute/carboncosts/ discussing automatic access to a limited reserve of emissions allowances as part of cost-containment provisions in national greenhouse cap and trade legislation.

[8] SCE Opening Comments, p. 16; Pacificorp Opening Comments, p. 7; SMUD Opening Comments, p. 4.

[9] SMUD Opening Comments, p. 13.

[10] E.g., NRDC-UCS Opening Comments, pp. 4- 13; LADWP Opening Comments, pp. 5- 14, Attachment 1; SCPPA Opening Comments, pp. 4- 20; SDG&E/SoCalGas Opening Comments, pp. 3- 5; SCE Opening Comments, pp. 14- 15; SMUD, pp. 5- 11; Independent Energy Producers Opening Comments, pp. 6- 10;

conclusion that the PD's recommended allowance distribution formula would create an inappropriate "wealth transfer" between ratepayers of different retail providers.[11] Likewise, SCPPA submitted 21 pages of comments disputing the PD's analysis of various alternatives for allocating GHG allowances.[12]

PG&E disputes the allegations of LADWP and SCPPA on rate and cost impacts of the PD's allocation recommendations. In fact, as NRDC-UCS argue, the PD's allocation recommendations will have the opposite effect—the PD will significantly and unfairly punish the customers of low-emitting utilities like PG&E, and instead reward higher emitting utilities and generators in the early years of the program, effectively postponing the deadlines for those utilities to make needed investments to reduce their GHG emissions.[13]

However, the concerns raised by all the parties on the cost and rate impacts of the PD's allowance recommendations have a common point on which ***all*** parties agree: ***The PD's fuel-differentiated, output-based allowance allocation is NOT supported by direct analyses of the rate and cost impacts on the customers of different retail electricity providers.*** As PG&E pointed out, based on our analysis, the fuel-differentiated allocation method, coupled with its distribution of "free" allowances to independent generators, will have significant adverse impacts on PG&E's customers that the PD has neither anticipated nor analyzed.[14] Parties also echo PG&E's concern that the untested allocation method proposed by the PD could result in windfall profits to independent generators even though there are other possible allocation methods that could prevent this outcome.[15]

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[11] LADWP Opening Comments, pp. 5- 14, Attachment 1.

[12] SCPPA Opening Comments, pp. 1- 21.

[13] NRDC-UCS Opening Comments, pp. 9- 13, including pointing out at p.12, fn.20, that LADWP has been on notice since at least 1990 of the need for emissions reductions and made a voluntary pledge in 1990 to do so. PG&E also notes that LADWP forecasts that it will only reduce its carbon intensity to 961 lbs/MWh by 2020, more than double PG&E's 2020 carbon intensity, and more than 50% higher than PG&E's carbon intensity *in 2008*. (LADWP Opening Comments, p. 6, Table 2.)

[14] PG&E Opening Comments, pp. 11- 14. Additionally, PG&E agrees with the points raised by Morgan Stanley on the need to consider treating out-of-state deliverers on a non-discriminatory basis similar to in-state emitting deliverers.

[15] NRDC Opening Comments, pp. 7- 9.

For this reason alone, the PD should be revised to require more thorough and specific analyses of the rate and cost impacts of the "fuel-differentiated, output-based" allocation proposal, along with full opportunity for all parties to comment on the analyses, ***before*** any allocation proposal is recommended to the ARB.

IV. 33% RENEWABLES EMISSION REDUCTION MEASURE

Several of the parties commenting on the PD's 33% renewable measure supported PG&E's request that additional cost-effectiveness and feasibility analysis be performed before reliance on the 33% goal as an AB 32 emissions reduction measure.[16] PG&E supports these comments.

EPUC/CAC's comments on Combined Heat and Power (CHP) highlight the complexity of dividing CHP operations into different streams.[17] PG&E agrees with EPUC/CAC that all on-site CHP should be treated similarly, but the better, more simple solution is to address delivered kWh in the electric sector and all other CHP output—both on-site thermal and on-site electric, in the industrial/commercial sector.

V. OFFSETS

Some parties recommend that the PD be revised to recommend that the ARB limit offsets to 10% of the cap as proposed in the ARB Draft Scoping Plan.[18] PG&E disagrees; artificial quantitative limits on offsets that are otherwise permanent, additional and verifiable may substantially increase costs to California consumers and businesses and preclude investments and development of environmentally sound emissions reduction projects. This proposed limitation should be rejected.

VI. CONCLUSION

PG&E recommends that the PD be revised consistent with its opening and reply comments.

Respectfully Submitted,

/s/

Dated: October 7, 2008 CHRISTOPHER J. WARNER for Pacific Gas and Electric Co.

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[16] SCE, pp. 5- 7; SDG&E/SoCal Gas, pp. 5- 6; EPUC/CAC, pp. 21-22; Modesto ID, pp. 4, 8-9.

[17] EPUC/CAC Opening Comments at pp. 12- 13.

[18] NRDC-UCS Opening Comments, p. 16. NRDC-UCS incorrectly interpret the ARB proposal as being 10% of the emission reductions in the cap and trade program. Rather, the ARB Draft Scoping Plan proposes to limit offsets to "10% percent of the compliance obligation for an individual firm," which equates to 10% of the entire cap in the market. (ARB Draft Scoping Plan, p. 19.)

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **REPLY COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U39 E) ON PROPOSED DECISION ON GREENHOUSE GAS REGULATORY STRATEGIES** on all known parties to R. 06-04-009 by

- transmitting an e-mail message with the document attached to each party on the official service list providing an email address; or
- by first-class mail, postage prepaid, to each party on the official service list not providing an email address.

Executed on October 7, 2008, at San Francisco, California.

/s/
Martie Way