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

BEFORE THE CALIFORNIA ENERGY COMMISSION

In the Matter of: AB-32 Implementation: Greenhouse Gases	Docket 07-OIIP-01

RESPONSE OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) TO THE APPLICATION FOR REHEARING OF THE LOS ANGELES DEPARTMENT OF WATER AND POWER

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I. INTRODUCTION AND BACKGROUND

Pursuant to Rule 16.1 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission"), San Diego Gas & Electric Company ("SDG&E") and Southern California Gas Company ("SoCalGas") (collectively referred to hereafter as the "Sempra Energy Utilities" or "SEU") herein provide their response to the *Request for Rehearing/Reconsideration of the Final Opinion on Greenhouse Gas Regulatory Strategies*[1] ("Application for Rehearing") submitted by the Los Angeles Department of Water and Power ("LADWP") on November 21, 2008 in the above-

[1] The Commission's Decision incorporating the recommendations to the California Air Resources Board was issued on October 22, 2008. The same recommendations were adopted by the California Energy Commission ("CEC") in Docket #07-0IIP-1 on October 28, 2008. Together, these decisions are herein referred to as the "Commission Decision" or "Final Opinion" in accord with the reference used in LADWP's Application for Rehearing.

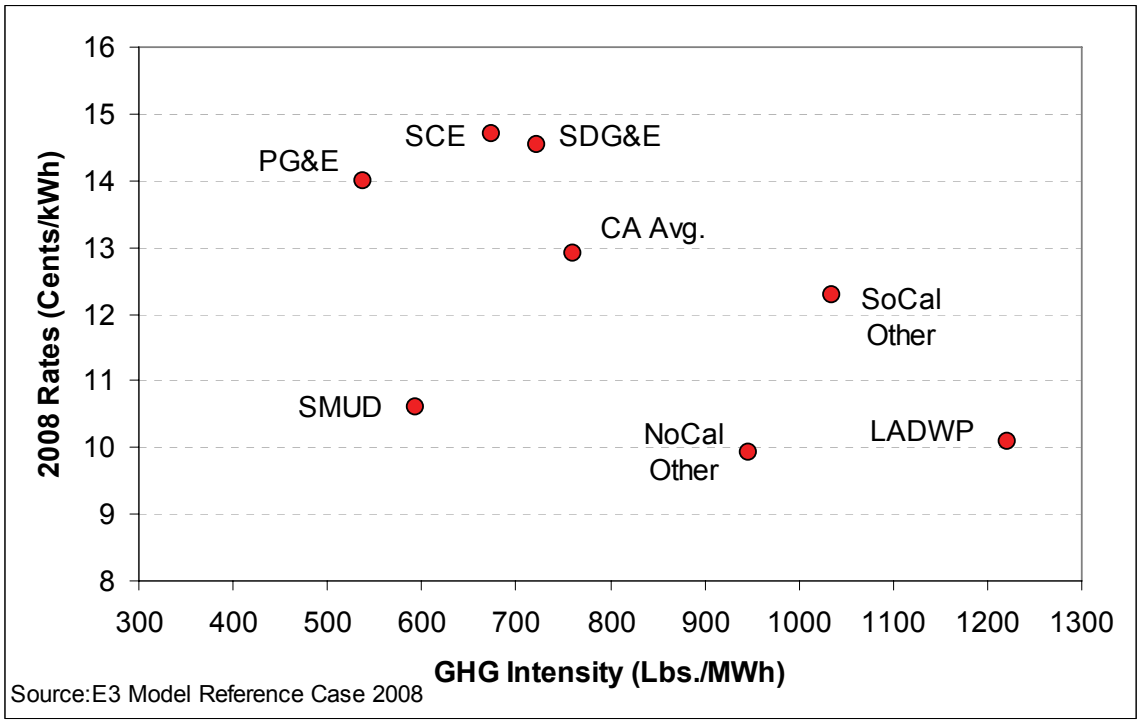
captioned proceedings. In short, LADWP's Application for Rehearing should be denied as it essentially rehashes the same arguments made earlier in the proceeding by LADWP -- all of which were previously considered and appropriately rejected by the Commission. Moreover, the bulk of the arguments raised by LADWP are materially flawed and unsupportable. As more fully discussed herein, LADWP's arguments do not merit rehearing or reconsideration on both substantive and procedural grounds and thus LADWP's request should be denied.

Fundamentally, LADWP's Application for Rehearing is premised upon an erroneous predicate in asserting that the proposed allocation methodology creates, "an unnecessary and inappropriate wealth transfer from publicly owned utilities, including LADWP, to investor owned utilities ("IOUs")."[2] In making its argument, LADWP essentially contends that imposition of the same standard on all industry participants creates an unlawful transfer of wealth unless all of the industry participants are identically situated with respect to that regulation before it is implemented. Of course that is never the case, and that is also not the case here. In fact, there are only two differences between LADWP and the California IOUs that are relevant to the issue:

1. LADWP has lower rates than most of the State's IOUs, which are partially caused by:
2. LADWP's heavy reliance on high greenhouse gas ("GHG") content coal and failure to incur costs to reduce its GHG emissions to levels close to those of the IOUs.

[2] LADWP Application for Rehearing, p. 2.

These differences are well illustrated by the following chart:



On page 3 of its Application for Rehearing, LADWP actually attempts to attribute its higher GHG emissions, in part, to geography -- even though LADWP is geographically situated between SDG&E and Southern California Edison, both of whom have very similar GHG emissions that are far below the levels of LADWP. If geography were the cause, one would expect LADWP, SDG&E and SCE to have similar emission levels, but this is clearly not the case.

Further, in arguing that regulations that treat all GHG emissions the same somehow create a transfer of wealth, LADWP pretends that certain emissions have a lower social cost to the environment when they come from high emitting sources. Clearly, this constitutes a fatally flawed underpinning to LADWP's arguments -- to the extent GHG emissions create environmental harm, the social cost associated with those emissions is the same for every ton of greenhouse gas that is emitted. Regulation that

recognizes this fact cannot lead to a transfer of wealth. Likewise, the Commission's Decision simply recognizes that GHG emissions come at a social cost, and that this social cost is the same for every ton of emissions that is created.

Indeed, regulation that inherently recognizes this basic principal and seeks to impose the same cost for every ton of GHG emissions does not create a transfer of wealth, but rather seeks to impose a price signal to the market that appropriately reflects the social cost of such GHG emissions. In addition, as the Commission's Decision recognizes, an allocation methodology that treats every ton of emissions by lower emitters and higher emitters the same maximizes incentives to reduce/minimize emissions and rewards early actions, all of which are consistent with the letter and intent of AB 32.

The only real transfer of wealth inherent in the Commission's Decision involves allocation proposals that are fuel based because these proposals would, if implemented, fail to impose the true social cost of GHG emissions on the source of those emissions. These aspects of the Commission's proposal treat the emissions of high emitters as if they create less harm to the environment than the emissions of lower emitters. Accordingly, and with this factual background in mind, SEU responds to the remainder of LADWP's legal arguments as follows.

II. NONE OF THE ARGUMENTS PROFFERED IN LADWP'S APPLICATION IDENTIFY ERRORS WHICH MERIT REHEARING.

According to its pleading, LADWP seeks rehearing of the Final Opinion based on "legal, factual and equitable grounds."[3] LADWP goes on to claim that: (1) the allowance recommendation creates a tax that violates Proposition 13; (2) the auction structure

[3] LADWP Application for Rehearing, p. 5.

violates home rule provisions; (3) the transfer of funds implicates other California Constitution provisions; and, that (4) there is insufficient record evidence to support the conclusions reached by the Commission and CEC with respect to their cap and trade recommendation.[4] However, all of these assertions are not only substantively flawed and unpersuasive but should also be rejected on procedural grounds. In that regard, the rules governing rehearing of Commission decisions allow rehearing solely on the basis of a clear legal error. Thus, under Sections 1731 and 1732 of the California Public Utilities Code[5] and the Commission's Rules of Practice and Procedure, the policy/equity and factual arguments raised by LADWP are inapposite to a rehearing determination and should be given little or no weight.[6] In order to successfully support such an application for rehearing under Rule 16.1 of the Commission's Rules of Practice and Procedure, LADWP must:

> set forth specifically the grounds on which applicant considers the order or decision of the Commission to be unlawful or erroneous, and must make specific references to the record or law. The purpose of an application for rehearing is to alert the Commission to a legal error, so that the Commission may correct it expeditiously.

However, the purported grounds for rehearing alleged by LADWP do not support rehearing as the LADWP has failed to demonstrate that the Commission's Decision is

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4 *Id.* at 5.

5 After an order or decision has been issued by the Commission, any party to the proceeding may apply for rehearing with respect to any matters determined in the proceeding and specified in the application for rehearing (California Public Utilities Code ("Pub. Util. Code") §1731(b)). At its discretion, the Commission may grant and hold a rehearing on such matters if, in its judgment, there is sufficient reason therefore (*id*.). No party can challenge in court an order or decision of the Commission unless that party has filed a timely application with the Commission for rehearing (*id*.). An application for rehearing must identify specifically the ground or grounds on which the applicant considers the decision or order to be unlawful (Pub. Util. Code §1732). A party may not challenge in court a Commission decision on any ground not addressed previously in an application for rehearing (*id*.).

6 Indeed, the policy and factual issues raised by LADWP are also flawed and lack merit and should be rejected on a substantive basis as well.

unlawful or erroneous. Indeed, LADWP's claims should be rejected given that the Commission's Final Opinion/Decision represents *recommendations* offered by the Commission and CEC to the California Air Resources Board ("CARB") for its consideration. It remains within CARB's full discretion and authority as to whether or not (or to what extent) it ultimately adopts the joint Commission/CEC recommendations. Because such a determination has yet to be made, the recommendations contained within the Commission's Decision at issue are not binding and therefore LADWP's claims are not ripe for purposes of claiming that legal error has occurred under the relevant provisions of the California Public Utilities Code and the Commission's Rules of Practice and Procedure. Moreover, as discussed below, LADWP's arguments simply rehash the same litigation positions previously considered, addressed and rejected by the Commission in this proceeding. Accordingly, no changes to the Commission' Decision are required.

III. THE DECISION CONTAINS NO LEGAL ERRORS REGARDING TAXATION

LADWP claims the Commission's Decision is erroneous and will violate Proposition 13. LADWP is incorrect. Revenue funds will be considered a regulatory fee, and will only be eligible to be used for purposes closely related to the purpose of AB 32. They may not be diverted into the general fund, as a tax could be. Indeed, to the extent the use of auction revenues meets the legal standard established by the *Sinclair Paint* court decision, they legally constitute a fee and not a tax, as LADWP alleges.[7] Under *Sinclair Paint*, the fee must be reasonable and there must be a nexus between the purpose of the fee and the use of its revenues. In this case, the value of auction revenues will be

[7] *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 881 (citing *San Diego Gas &* Electric v. San Diego County Air Pollution Control District (1988) 203 Cal.App.3d 1132, 1146).

determined on the basis of actual market value – via principles of supply and demand. Clearly, a price level set on the basis of market value is reasonable.

In addition, there is a clear nexus between the proposed allocation methodology (particularly when allocation is entirely based on sales) and the purpose of the fee -- GHG emission reductions. There can be no doubt that, to the extent auction revenues are utilized to implement the command and control mandates adopted by CARB as well as other GHG-reducing activities, they constitute a fee, and not a tax.

Moreover, LADWP correctly points out that the "*Sinclair Paint* decision does not allow for unlimited application of fees, and makes clear that the agencies would have the burden to show that 'charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity' in order to constitute a fee."[8] However, what LADWP fails to acknowledge is that imposition of an allocation methodology that recognizes that the burdens on the environment of every ton of GHG emissions is the same, regardless of source, meets the *Sinclair Paint* standard. Rather than being designed to "to pay subsidies to ratepayers or to subsidize low GHG interests,"[9] auction revenues will (i) be based on the actual market value of GHG emissions; (ii) reflect accurately the environmental burdens that the regulations are being designed to prevent; and (iii) be used to implement GHG emission reducing activities. For these reasons, the proposed use of auction revenues does not violate Article XIIIA (Proposition 13).

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[8] LADWP Application for Rehearing, p. 8.

[9] LADWP Application for Rehearing, p. 7.

IV. THE COMMISSION'S DECISION CONTAINS NO LEGAL ERRORS REGARDING "WEALTH TRANSFER"

LADWP also alleges that the Commission's Decision violates Article XI, Section 5(a) of the California Constitution. LADWP's argument is not compelling and should be rejected. Specifically, LADWP alleges a "permanent $3 billion wealth transfer by 2020 and $1.1 billion per year thereafter that is entirely exclusive of investments in direct emission reductions and solely the result of a flawed cap-and-trade design."[10] LADWP's sole support for this claim is a citation to its own comments to the Proposed Decision ("PD"). In that regard, LADWP's comments on the PD submitted 22 pages of new modeling results, including a 10-page spreadsheet appendix, that it argued to support the conclusion that the PD's recommended allowance distribution formula would create an inappropriate "wealth transfer" between ratepayers of different retail providers. However, such purported "data" constitutes untested modeling and is not record evidence, and thus cannot be relied upon (or any conclusions can be drawn therefrom) as a basis for granting rehearing.

Additionally, in support of its "wealth transfer" argument, LADWP claims that:

> "The Constitution recognizes the State's right to regulate matters of "statewide concern," [footnote omitted] subject to federal preemption on matters within federal jurisdiction. But when the State does so, its actions must be "both (i) reasonably related to the resolution of that concern, and (ii) 'narrowly tailored' to limit incursion into legitimate municipal interests." [Footnote omitted.] . . . An auction structure that produces wealth transfers will not satisfy either test."[11]

As discussed above, the fundamental problem with LADWP's argument is that it fails to recognize that regulation that assumes that every ton of emissions creates the same

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[10] *Id.* at 3.

[11] LADWP Application for Rehearing, p. 8.

burden on the environment does not produce wealth transfers -- it imposes the same cost on every emitter for every ton of emissions it creates (or for which it is responsible). Regulation of GHG emissions is a clear matter of statewide concern, as is reflected in the provisions of AB 32.[12] Thus, regulations that recognize that the social cost of emissions from high emitters is the same as the social cost of emissions from low emitters are reasonably related, and narrowly tailored, to meet the statewide concern of reducing GHG emissions. Moreover, the Commission already considered LADWP's claim that an auction structure would financially undermine its renewable program and determined that LADWP had failed to substantiate its claim that a genuine conflict exists or is otherwise un-resolvable[13] pursuant to relevant legal precedent.[14]

V. THE DECISION CONTAINS NO LEGAL ERRORS REGARDING USE OF PUBLIC FUNDS

Again, LADWP attempts to relitigate a previously considered issue because it disagrees with the Decision's recommendation. Here, LADWP's claim that the auction process violates Article XVI, Section 6, was rejected by the Commission after a full vetting of this issue.[15] Raising essentially the same arguments in its rehearing request does not establish that the Commission's Decision committed legal error on the issue.

LADWP expresses concern that the Decision will result in an unfair transfer of wealth and that this would constitute an improper use of public funds.[16] SDG&E

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[12] *Bishop v. San Jose,* 1 Cal. 3d 56 (1969), As to matters which are of statewide concern, however, home rule charter cities remain subject to and controlled by applicable general state laws regardless of the provisions of their charters, if it is the intent and purpose of such general laws to occupy the field to the exclusion of municipal regulation (the preemption doctrine).

[13] D.08-03-018, n. 32.

[14] *California Fed. Sav. & Loan Assn. v. City of Los Angeles* (1991), 54 Cal. 3d 1, 16-17.

[15] D.08-10-037, pp. 236-237.

[16] LADWP Application for Rehearing, p. 12.

disagrees that this argument has any basis in law. The provision cited by LADWP (Cal. Const. Art. XVI § 6) prevents the California Legislature from making gifts of public money. The Commission's Decision is not an act of the Legislature nor does it make gifts of public money. If LADWP truly believes AB 32 is unconstitutional, its recourse is not through rehearing of a Commission decision that simply offers recommendations to another state agency, but rather through the courts.

Moreover, for the reasons explained above, the proposed allocation methodology insofar as it treats all emissions the same without regard to source or fuel input, would not constitute a transfer of wealth, gift, or otherwise violate Article XVI, Section 6 (No Gifts of Public Funds). Such an allocation methodology simply recognizes that the social cost of every ton of GHG emissions is the same, without regard to source. It does not require a transfer of money, or require a gift to be made from high emitters to low emitters. It merely requires all emitters to pay the same market price for every ton of GHG emissions for which they are responsible, creating a situation in which they bear the actual cost of their emissions.

It would also appear that LADWP has attempted to over-state the potential financial impact of the proposed allocation methodology. Without even analyzing how they have calculated the total market value of the emissions they create (described as a "transfer of wealth"), it is clear that LADWP has assumed a market value of allowances that is on the very high end of plausible values. In this regard, LADWP's calculations assume a market value of $100/ton. However, based on a survey of price forecasts, LADWP's assumption is outside current estimates:

- The Synapse study places the likely costs of a California market at no more than $30/metric ton[17];
- CARB has opined the price will be around $10/MT (due to complementary 33% RPS and high EE policies and limited use of offsets)[18];
- WCI consultants place the allowance price of a west-wide cap-and-trade starting at $5 per Metric Ton in 2012 and increasing to $24/MT for a broad program (including transportation sector and small gas customers as well as electric and industrial) with limited offsets, $63/MT for a broad program with no offsets, and $71/MT for a narrow program (industrial and electric cap-and-trade) with limited offsets in 2020; with all scenarios assuming EE comparable to CA and adopted RPS for each WCI state (e.g., 20% for CA)[19];
- McKinsey study puts the cost at no more than $50/MT for a U.S. market[20]; and,
- The EPA modeled allowance prices for 2020 with most scenarios in the $30-$50/MT range.[21]

Spurious claims, supported by high numbers, relative to current forecasts, are not an

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[17] David Schlissel, Synapse Energy Economics, "Greenhouse Gas Adder for Use in Determining the 2008 Market Price Referent (MPR)," March 27, 2008 presentation, available at http://www.synapse-energy.com.

[18] California Air Resources Board, "Climate Change Proposed Scoping Plan," October, 2008, p. 75.

[19] Western Climate Initiative, CI's "Design Recommendations for the WCI Regional Cap-and-Trade Program," September 23, 2008, Appendix B, Table B-12, p. 20, and WCI, Economic Modeling Team Workshop presentation, December 3, 2008, p. 7.

[20] McKinsey and Company, "Reducing U.S. Greenhouse Gas Emissions: How Much and At What Cost?" prepared for the Conference Board, December, 2007.

[21] U.S. Environmental Protection Agency, Office of Atmospheric Programs, "EPA Analysis of the Lieberman-Warner Climate Security Act of 2008," March 14, 2008 presentation, p. 27.

appropriate basis for reconsideration or rehearing of a Commission decision.

In addition, LADWP states that "the E3 modeling, in its current stage of development, does not allow for the analysis of a fuel-differentiated allocation with a weighted factor (2 for coal, 1 for natural gas)." SDG&E agrees that the Decision's fuel-differentiated, output-based allowance allocation is not supported by direct analysis of the rate and cost impacts on the customers of different retail electricity providers. The direct allocation method clearly does not align incentives with emission reduction goals of AB 32 because it encourages the continued use of high emitting coal generation instead of lower emitting gas generation. (This, of course, benefits market participants like LADWP that rely heavily on low cost, high emitting coal.)

In that regard, SDG&E suggests that the recommendation in the Final Opinion regarding the fuel-differentiated allocation should be revised so as to be conditioned on a thorough and specific analysis of the rate and cost impacts of the fuel-differentiated, output-based allocation proposal before it is recommended to the CARB. However, the potentially deficient analysis of the fuel-differentiated, output-based allocation method does not impact the analysis of 2016 and beyond, since the method is phased out by 2016. Furthermore, it does not impact the analyses conducted using historical emission and sales based allocations of allowances and subsequent auction of the allowances to first deliverers. The lack of analysis of one part of the proposal does not negate the sufficiency of the analysis of the rest of the proposal.

VI. CONCLUSION

While LADWP may differ with the majority of the Commission regarding the conclusions to be drawn after weighing all the record evidence, such disagreement merely represents a difference of opinion and does not constitute legal error compelling

rehearing of the Commission's Decision. Indeed, there is nothing unprecedented, unlawful or erroneous in drawing different conclusions from the same record. Given that LADWP's Application for Rehearing fails to show that the Commission's Decision constitutes legal error, LADWP's request should be denied.

Respectfully submitted,

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