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Pedro J. Pizarro
Senior Vice President

July 25, 2007

Ms. Mary D. Nichols
Chair, California Air Resources Board
California Environmental Protection Agency
1001 I Street
Sacramento CA, 95814

Re: Comments of Southern California Edison Company on the California Market Advisory Committee's *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California*

Dear Ms. Nichols:

Southern California Edison Company ("SCE") appreciates the opportunity to submit these comments regarding the *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California* ("Report") developed by the California Market Advisory Committee ("CMAC"). Adoption of the Report's specific recommendations on various important issues will allow SCE to continue its work with the California Air Resources Board ("CARB"), CMAC, other state agencies, and stakeholders to most efficiently achieve the greenhouse gas ("GHG") emission reductions goals set out in Assembly Bill ("AB") 32. For this reason, SCE commends the CMAC for its well-designed, thorough, and thoughtful recommendations and encourages the CARB to consider revisions to the Report as set out herein.

Scope of Regulation

The Report endorses a market-based approach to achieving AB 32 compliance. It recognizes the significant cost savings to be realized from the use of a comprehensive cap-and-trade approach as compared to command-and-control alternatives. SCE agrees with the Report's finding that a comprehensive market-based approach to implementation of AB 32 provides an opportunity for real, sustained emissions reductions at a lower cost to California's ratepayers and total economy than other approaches.

As noted in the Report, a First Seller structure will enable California to incorporate emissions from imported energy into the emissions cap along with emissions from in-state generation. A First Seller approach can also facilitate more transparent and straightforward reporting and measurement of emissions from in-state generation. Additionally, a First Seller approach can more easily be coordinated with the anticipated operation of California's electricity markets, whereas implementation of a load-based approach will complicate those markets.

8631 Rush St.
Rosemead, CA 91770
626-302-1497
Fax 626-569-2563
pedro.pizarro@sce.com

The First Seller paradigm recommended by the Report will also be compatible with the increasing level of investment in energy efficiency programs being supported by the California Public Utilities Commission and the California Energy Commission. As the Report correctly recognizes, load-serving entity ("LSE") incentives to pursue greater customer energy efficiency to reduce emissions are not fundamentally different under a First Seller approach than under a load-based cap-and-trade approach.

Similarly, the Report recognizes that the First Seller approach is not fundamentally different than a load-based approach when it comes to challenges faced by any attempt at AB 32 implementation. For example, the Report correctly finds that the potential for leakage is no different under a First Seller approach than it is under a load-based cap-and-trade structure. This finding corrects the common misperception that a load-based cap-and-trade program is a better way of addressing potential emission leakage issues in California.

For all of these reasons, the First Seller approach recommended by the Report is the most efficient and effective way of imposing a GHG program on California's ratepayers and economy. However, CARB must be mindful that the full benefits of such a regime require CARB to endorse a comprehensive approach to cap-and-trade *at the outset*. Any type of phased-in approach to a cap-and-trade system should be rejected in favor of a system that will include a wide variety of sectors that are free to trade allowances under an emissions cap. Including many sectors will present regulated entities with a wider range of choices for achieving compliance, resulting in a lower cost to California's consumers and economy. Accordingly, SCE encourages the CARB to further consider adoption of an approach that will include the transportation sector within a cap-and-trade regime by recognizing and considering credits that result from implementation of California's Low Carbon Fuel Standard.[1]

Offsets

The Report endorses the use of offsets without geographic or quantitative restrictions. However, as noted in the Report, there was not complete agreement among CMAC's members on this point. Offsets present California with an important tool for developing real, verifiable, and additional emission reductions at a lower cost than is available through rules or a cap-and-trade market. Therefore, for any given level of economic sacrifice, California will be able to accomplish larger reductions in GHG emissions if broad-based offsets are allowed.

To fully incorporate the effect of offsets in California, it is important that the CARB adopt the concept of geographic flexibility into any offsets program. Since California has a strong history of supporting renewable and environmentally-friendly energy sources, the State has become a leader in environmental protection. The effect of these efforts has been to move many of the most cost-effective projects for reducing emissions outside of California. Californians should have access to offsets from such sources in order to meet their AB 32 obligations.

Additionally, because offsets are such an environmentally valuable tool, any rule that would restrict the quantity of emission reductions that may be obtained via offsets will unnecessarily increase the cost of compliance with AB 32 and hinder the continued growth of California's economy.

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1 *See* Executive Order S-01-07.

Accordingly, SCE urges the CARB to adopt the Report's finding that high-quality offsets be eligible for use in achieving AB 32 compliance without any quantitative or geographic restrictions.

Localized Air Quality Impacts

The Report recognizes that with reduced GHG emissions levels come reductions in criteria pollutants. It also recognizes that existing environmental regulations and air quality standards will prevent development of any local hotspots. SCE fully supports both of these conclusions. Continued monitoring and enforcement of existing air quality regulations will provide important reassurance that adverse local impacts will not occur.

Allowance Allocation

SCE has recommended that emission allowances be allocated in a manner that mitigates economic displacement and harm to carbon-regulated companies. While SCE appreciates the Report's endorsement of allowance allocation as a way of mitigating the costs of AB 32 compliance to utility customers, it is notable that the Report did not endorse complete allowance allocation. Because emission allowances will be required for all capped GHG emissions, the cost of purchasing allowances could dwarf the cost of reducing emissions. This would unnecessarily increase the cost of compliance with AB 32 for California's consumers. It would also unnecessarily risk serious economic harm to California's economy. A cap-and-trade system with complete allowance allocation will establish a value for emission reductions and as such will motivate entities to reduce emissions. The allocation method itself will not affect the emission reduction decisions of carbon-regulated entities. However, the ability of a carbon-regulated entity to pass along its GHG mitigation costs to customers will vary across industries. As a result, it is important to allocate all allowances in a manner that will mitigate economic harm to all carbon-regulated entities and mitigate severe economic displacements.

AB 32 represents a substantial change in the regulatory incentives facing California's industries, including the electricity sector. SCE supports an allocation mechanism that recognizes the economic dislocation that will occur as a result of the changed regulatory incentives created by AB 32. To this end, it is critically important that the CARB recognize the substantial investments and long-term commitments executed by various stakeholders prior to the passage of AB 32. SCE suggests that CARB consider an approach to allowance allocation that involves establishing a baseline allocation of allowances that would mitigate the economic dislocation at the entity level beginning in 2012. From that point, allocations would then "ramp down" over the period 2012 to 2020 in a balanced, consistent, and fair manner so that by 2020 the number of allowances allocated precisely meets the emissions cap established in AB 32.

Benefits of Electrification

The electricity sector can be a valuable tool in California's efforts to reduce GHG emissions. SCE welcomes the opportunity to contribute to emission reductions via electrification of processes traditionally powered by fossil fuel combustion engines. However, with such initiatives, demand for electricity will increase and, as a result, emissions directly attributed to the electricity sector could increase. As such projects become operational the CARB will need to recognize the impact

on California electricity generation. LSE ratepayers should be protected from paying for the emission reductions more properly attributed to non-electric sectors.

Flexible Compliance

The Report does not endorse an allowance price cap, instead it concludes that because a price cap or "safety valve" could result in a regulated entity not meeting an emissions target for a compliance period, a price cap would be inconsistent with AB 32. SCE urges the CARB to reconsider the Report's exclusion of a "safety valve" for allowance pricing from any cap-and-trade approach. Having a "safety valve" not only provides cost certainty going forward, but also recognizes the unique obligations that regulated electric utilities have in serving their customers. Even with the best planning going forward, major changes in electric loads and resources can place a utility in a situation where it may not be able to serve its load without violating its GHG emission limit, consistent with AB 32's mandate.[2] Notably, AB 32 recognized this issue and provided for the Governor to take certain actions to adjust the compliance deadlines under extraordinary economic circumstances.[3] Consistent with this legislative philosophy and objective, there are forms of flexible compliance which can protect consumers from excess volatility without undermining the goals of AB 32. Thus, SCE recommends that the CARB reconsider this recommendation and explore compliance options that allow temporal flexibility.

Lastly, SCE notes that whenever the supply of a good is restricted, policy-makers must address the potential exercise of market power. SCE remains concerned about the possibility that innovative policy and electricity markets could adversely interact in unforeseen ways. California experienced such an event during the 2000-2001 electricity crisis, when the price of RECLAIM trading credits increased dramatically, forcing a temporary suspension of this program. A similar course of events in the emissions allowance market could erode public support for AB 32 and would needlessly risk the economic stability of the California energy market.

Thank you again for the opportunity to submit these comments. SCE looks forward to working with the CARB, other state agencies, and stakeholders to achieve the emission reduction goals established in AB 32.

Best Regards,

Pedro J. Pizarro
Senior Vice President
Power Procurement

PJP:LIG

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2 Cal. Health and Safety Code, §§38599 (a), (b).

3 *Id.*

cc: Mr. Winston Hickox
Chair, California Market Advisory Committee
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95814

Lawrence H. Goulder
Vice Chair, California Market Advisory Committee
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95814

Michael Scheible
Deputy Executive Officer
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Linda Adams
Secretary
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95814

Eileen Tutt
Deputy Secretary
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95814

Brian Prusnek
Deputy Cabinet Secretary
Governor's Office
State Capitol Building
Sacramento, CA 95814

Michael R. Peevey
President, CPUC
505 Van Ness Avenue
San Francisco, CA 94102