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## M E M O R A N D U M

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**TO:** The California Air Resources Board

**FROM:** Modesto Irrigation District  
Redding Electric Utility  
Turlock Irrigation District

**SUBJECT:** Cost Containment Options in a California Cap-&-Trade Program

**DATE:** July 9, 2010

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### **Introduction**

Modesto Irrigation District (“MID”), Redding Electric Utility (“REU”), and Turlock Irrigation District (“TID”), collectively the “Utilities,” appreciate the opportunity to comment on the issues discussed during the June 22, 2010 workshop on “Cost Containment Options in a California Cap-&-Trade Program”. Cost containment measures are necessary to protect California’s businesses and consumers, who will ultimately bear the financial burden from the cap-and-trade program. The Utilities agree with the cost containment objectives presented by CARB on slide 4 of their presentation, and present the following additional goals as they relate to cost containment of the California cap-&-trade program:

- Cost Containment should provide assurance that the price of allowances will not exceed a defined threshold, nor fall below a certain threshold (i.e., a price collar);
- Any form of a strategic reserve should never be filled with allowances taken from under the cap as this in effect reduces the cap below the goals set forth in AB 32 thereby artificially and unnecessarily constricting the allowance market and raising allowance costs; and
- Increasing the amount of qualified, quality offsets allowed for compliance is the most efficient method to address cost containment.

The Utilities believe that offsets are the best method for reducing cost in the California cap-&

trade program. The Utilities are all members of the Offset Working Group<sup>1</sup>, and refer to comments submitted by the OWG which discuss the value of integrating additional offsets in the program. The Utilities are also participants in the Joint Utility Group<sup>2</sup>, and the issue of cost containment has been discussed in great detail within the Joint Utility Group. While consensus hasn't emerged on all issues related to cost containment within this group, all parties do agree that a method of price containment is necessary in the cap-&-trade program.

### **The Utilities**

MID, REU, and TID are local publicly owned electric utilities. MID and TID are irrigation districts located in the Central Valley, while REU is a municipal utility within the City of Redding. MID serves over 110,000 electric customers with a peak load around 620 Megawatts (MW). REU serves 42,000 customers with a peak load of 247 MW. TID serves about 100,000 electric customers with a peak load of approximately 600 MW. The Utilities maintain similar resource mixes, including hydroelectric, eligible renewable resources and fossil fuel sources.

### **Feedback Requested**

CARB specifically asked for feedback on the following issues:

#### **Choice of Cost Containment Mechanisms:**

CARB presented three mechanisms to increase the supply of compliance instruments when a soft price ceiling is reached. The design of the cap-and-trade program inherently leads to a shortage of allowances, which intentionally puts upward pressure on allowance costs with the goal of sending a "price signal" to consumers. The Utilities, however, believe that such price signal must be achieved with sensitivity toward the economic impact to the State and its consumers. A price ceiling is most direct and effective cost containment mechanism. In designing the price ceiling it is essential that flexibility be provided for covered entities to achieve compliance in a cost effective manner. A price ceiling would meet both the economic and environmental goals, providing the needed flexibility while furthering the global reduction of greenhouse gas emissions.

*Relax Quantitative Use Limit for Offsets.*

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<sup>1</sup> The members of the Offset Working Group are the Modesto Irrigation District, Sacramento Municipal Utilities District, Redding Electric Utility, Roseville Electric, and Turlock Irrigation District.

<sup>2</sup> The participants of the Joint Utility Group include SCE, PG&E, Sempra, NCPA, SCPPA, SMUD, LADWP, Pacificorp, and the Modesto/Redding/Turlock Utilities.

The Utilities support relaxing the quantitative use limit of offsets. This is the most direct and administratively simple approach to cost containment. Such a method avoids the complexities of other presented alternatives without disrupting the principles and objectives of the cap and trade program. The Utilities also encourage CARB to further assess the benefits of a supply increase based on various price triggers.

The Utilities urge CARB to link to thoroughly developed, vetted, existing offset protocols such as the Climate Action Reserve as soon as possible to send a clear signal to the offset market about future use and, more importantly, to encourage additional development of offset projects.

*Allow limited use of future vintage allowances from the next compliance period.*

The Utilities support allowing the limited use of future allowances from the next compliance period as a cost containment measure only if the allowances are borrowed from within a covered entity's own futures account and not from the entire market. This would simply be the concept of borrowing and allows each covered entity to individually determine the best uses and strategies for their own allowances.

*Use of an Allowance Reserve.*

The Utilities do not support the use of a reserve that is populated by allowances taken from under the cap – whether they are from current or future years. Such an approach would artificially constrict already limited markets for no additional environmental benefit. It would also create additional burden on compliance entities in the future, when allowances become scarcer, creating even more cost impacts and shortage of allowances during the most critical years of the program as the cap declines.

The Utilities could also support a reserve that is filled with offsets. However, the Utilities are concerned that filling a reserve with offsets would create unavoidable problems. For example, CARB has stated that they are not able to serve as both a market administrator and a market participant – the Utilities agree with this. A third party would need to act as a market participant to purchase the necessary offsets to fill the reserve. Who would this third party participant be, and what are the additional costs associated to the market and program administration with their participation? These are all questions that must be fully explored before this concept could be adopted. Further, the Utilities query how such a program (a reserve filled with offsets) is different from temporarily relaxing the offset limit? The Utilities believe these two options are virtually the same, and given the simplicity of relaxing the offset limit in comparison to the complexities of developing and administering a reserve, believe that relaxing of the offset limit is the most preferable cost containment method.

Preference for a trigger price mechanism versus a “window” sales approach:

As stated above, the only reserve the Utilities could support is one that is populated with offsets. Such a reserve would only be utilized when the price of allowances reaches the cap. If such a reserve is incorporated, the Utilities support having a window that is open at all times.

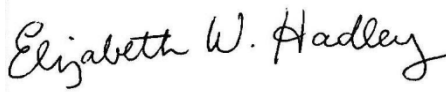
**Conclusion**

The Utilities believe that cost containment can be achieved through a well designed cap-&-trade trade program while still maintaining environmental integrity. Encouraging linkage to the Western Climate Program, offsets developed through existing CAR protocols are essential to stabilizing costs and ensuring environmental integrity.

Respectfully submitted,



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