American Gas Association

Comments of the American Gas Association on the California Air Resources Board's June 2008 Discussion Draft Scoping Plan Prepared Pursuant to AB 32, The Global Warming Solutions Act of 2006

August 1, 2008

The American Gas Association (AGA) appreciates the opportunity to comment on the California Air Resources Board (ARB) Climate Change Draft Scoping Plan.

The American Gas Association, founded in 1918, represents 202 local energy companies that deliver natural gas throughout the United States. There are nearly 70 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 64 million customers — receive their gas from AGA members. Today, natural gas meets almost one-fourth of the United States' energy needs. For more information, please visit www.aga.org.

We commend California's leadership in developing programs to improve energy efficiency and to reduce greenhouse gas emissions cost effectively. Thanks in large part to programs developed in California and adopted across the country, natural gas residential and commercial customers have dramatically improved their energy efficiency and reduced their per capita greenhouse gas emissions. California has proven that enhanced energy efficiency and building code programs are the best way to reduce the "carbon footprint" of these small natural gas customers.

The ARB Draft Scoping Plan offers a thoughtful first step toward developing the programs that will be needed to achieve the goals set out in the California Global Warming Solutions Act (AB 32). We agree that implementing AB 32 will require a coordinated set of solutions and a wide mix of strategies, including both market mechanisms and other programs. We also agree that the cap-and-trade program should be as broad as possible to improve the functioning of the market and reduce leakage. Linking with the Western Climate Initiative (WCI) will be helpful in this regard. Ultimately, we favor a national climate program to avoid the problems inherent in potentially different and conflicting regional and state programs. The California and WCI programs will create a precedent that will

help shape the national climate program. For this reason, AGA believes it is crucially important for California and WCI to develop the most effective and cost-effective methods for reducing greenhouse gas emissions from different sectors of the economy.

Energy Efficiency Works for Natural Gas Consumers – A Cap Would Not

AGA shares the concerns raised in comments by our members Pacific Gas & Electric Company, Southern California Gas Company, San Diego Gas & Electric Company and Southwest Gas Corporation regarding the role that residential and commercial natural gas customers should play in achieving greenhouse gas reductions. It is not clear to us whether or when the Draft Scoping Plan recommends placing natural gas residential and commercial customers under the cap-and-trade program before 2020. On page 17, the Draft Scoping Plan says that "[c]apped sectors would include electricity, transportation fuels, natural gas, and large industrial sources." Table 4 on the same page lists the "Commercial and Residential" sector as contributing toward "Projected 2020 Emissions After Implementation of Other Recommended Measures." However, Table 4 also seems to suggest that natural gas consumers may be expected to contribute additional reductions through the cap-and-trade system.

We urge you to clarify that residential and commercial customers would *not* be under the cap at least before 2020. In 2020, ARB could evaluate whether enhanced energy efficiency programs and building standards are continuing to produce sufficient greenhouse gas reductions from this sector. If so, ARB could continue that approach. If not, ARB could include this sector under the cap.

AGA believes that natural gas utilities and their customers should play a role in reducing greenhouse gas emissions. However, there is a more effective way to reduce these emissions than placing them under a cap. Over the past three decades, we have had enormous success in reducing greenhouse gas emissions from natural gas customers by improving energy efficiency. Nationwide emissions from residential use of natural gas have not increased above 1970s levels, even though we have nearly doubled the number of customers over the last three decades. The average residential natural gas customer uses nearly one-third less natural gas today than in 1980. Natural gas provides nearly half of all energy consumed in the residential and commercial sectors but accounts for less than 6 percent of total U.S. greenhouse gas emissions. It is the most efficient and lowest carbon-emitting fossil fuel.

The stated goal of the California Global Warming Solutions Act of 2006 is to reduce greenhouse gas emissions to 1990 levels by 2020. In contrast to other emission sources, natural gas consumption and related greenhouse gas emissions for non-electricity applications have shown very little growth or even

declined since 1990. In other words, natural gas consumers in California have already achieved the goal of AB 32 – at least in this sector - to reduce greenhouse gas emissions to 1990 levels by 2020.

To ensure that residential and commercial natural gas customers continue to conserve and use natural gas efficiently, as well as to lessen the potential economic impact on these customers, they should be covered through the aggressive promotion and implementation of state- or utility-sponsored conservation and efficiency programs, tightened building codes and standards, and higher appliance efficiency standards – rather than by an emissions cap, at least at this time.

We are not alone in this view.

CPUC Recommended that ARB Cover But Not Cap Natural Gas Customers: In March 2008, the California Public Utility Commission (CPUC) recommended to ARB that the California cap should not include natural gas residential and commercial customers at least initially, but instead should obtain emission reductions from this sector through enhanced energy efficiency programs and building codes and standards. Specifically, the CPUC said:

> *"We recommend that the natural gas sector not be included in a cap-and-trade system at this time. There are several reasons for this recommendation. Key differences between the electricity and natural gas sectors persuade us that it would be premature to include the natural gas sector in a cap-and-trade system:*
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> - *Significantly fewer options exist to reduce GHG emissions in the natural gas sector compared to the electricity sector.*
> - *There is currently very limited availability of low-carbon alternative sources of natural gas.*
> - *Energy efficiency and other natural gas demand reduction programs are the best options for reducing GHG emissions in the natural gas sector.*
> - *The incremental benefits from including the natural gas sector in a multi-sector cap-and-trade program are likely to be smaller than those for the electricity sector.*
> - *Reporting protocols for GHG emissions are still under development.*

- *Relying on programmatic measures to achieve emission allows additional time to develop reporting protocols."*

See the CPUC Decision issued March 2008 and filed April 13, 2008, section 1.2 Natural Gas Sector, pages 11-12:
http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/80150.pdf

Pew Center Recommended to Cover But Not Cap Natural Gas At This Time:
Similarly, in a May 30, 2008 letter to the U.S. Senate, the Pew Center on Global Climate Change recommended that the Senate climate bill S.2036 should cover emissions from large industrial combustors of natural gas at the point of combustion, but should *not* cap emissions from residential and commercial customers at least initially. Instead, the Pew Center recommended that to "reduce natural gas-related emissions from homes and small businesses, the bill should [at this time] rely on its energy efficiency incentives, appliance standards, and building code improvement incentives…." Pew Center May 30, 2008 Letter to U.S. Senate at page 2. See: http://www.pewclimate.org/docUploads/LetterToSenators-05.30.08.pdf

WCI Recommended to Cover But Not Cap Natural Gas At This Time:
Most recently, the WCI revised its Draft Design Recommendations on July 23, 2008 to postpone application of the regional cap to natural gas residential and commercial customers until the second compliance phase begins in 2015. See http://www.westernclimateinitiative.org . See section 6.3. In order to coordinate with the regional program, as ARB staff has recommended, we encourage ARB to postpone application of the California cap on this sector and to clarify that natural gas residential and commercial customers will reduce their carbon footprint through energy efficiency programs and will not be under the California cap, at least until a later date.

A Cap Would Increase Economic Burdens on Consumers and Fail to Reduce the Carbon Footprint of Natural Gas Consumers:
Including residential and commercial customers (i.e. sources emitting less than 10,000 - 25,000 metric tons of carbon dioxide equivalent per year) under a cap-and-trade scheme is not an effective way to reduce emissions. Thirty years of experience show that it is more effective to reduce emissions from this sector through conservation and efficiency programs, tightened building codes and standards, and appliance efficiency standards.

It is important to note that in the residential and commercial sectors:

- Natural gas is used to meet essential human needs for residential consumers - 98% of all residential natural gas is used for space heating, water heating and cooking

- Residential and commercial natural gas consumption accounts for less than 6 percent of total U.S. greenhouse gas emissions

- Emissions from residential use of natural gas are already at 1970s levels

- The greenhouse gas emission reductions per household experienced during the past four decades are largely attributable to tighter homes and more efficient natural gas appliances

- Use of natural gas in homes and businesses is part of the climate change solution. Converting small-volume customers to high-efficiency natural gas appliances is one of the best ways available today to reduce greenhouse gas emissions

- Climate change legislation will significantly increase the demand for natural gas-fired electricity generation and will significantly increase the cost of natural gas to all consumers

Including natural gas homeowners and small businesses within the cap-and-trade program would create significant price uncertainty, would add the cost of allowances to the existing barriers due to the higher initial cost of buying and installing natural gas equipment and currently high natural gas prices, and could have the unintended consequence of creating an incentive for these customers to switch from natural gas to electric appliances and equipment. This would be counterproductive in many cases because, on a total fuel cycle (i.e., carbon footprint) basis, natural gas appliances and equipment are more efficient than comparable electric appliances and equipment. Particularly during the early phase of compliance with AB 32, this would increase demand for electricity and the need for additional power plant capacity at a time when low carbon generating options within and outside California (i.e. extensive new renewable energy, clean coal or new nuclear) are not yet widely available. The increased demand for natural gas for electric power plant generation would likely further increase natural gas prices that consumers must pay, in the absence of significant new production and supplies. High commodity prices are already hurting residential customers, especially low income customers. It makes no sense to increase economic burdens on the poor, while gaining nothing for energy efficiency or greenhouse gas reductions. There is a better way to reduce economic burdens while also increasing energy efficiency and reducing greenhouse gas emissions.

A recent study by the American Gas Foundation (AGF) demonstrates that using natural gas directly in homes and businesses to serve their energy needs is more efficient than burning it in a power plant, converting it to electricity and transporting the electricity to customers to serve the same energy needs. For a copy of the AGF Direct Use study, see http://www.gasfoundation.org/ResearchStudies/directuse.htm . The AGF study shows that increased direct use of natural gas in residential, commercial and high-efficiency industrial applications can improve the productivity of available energy supplies, reduce overall energy cost, and reduce related carbon dioxide (CO2) emissions.

AGF's study concludes that increasing the direct use of natural gas by homes and businesses rather than the indirect use of natural gas for power generation can be expected to decrease energy consumption in the U.S. and could help avoid the need to install additional power plant capacity. This could take some of the demand pressure off natural gas prices as well as provide relief to electric utilities seeking to comply with new climate restrictions in the near term, before significant renewable, clean coal and nuclear capacity can be deployed.

We recognize that the benefits will be greater in areas of the country that do not have as clean a mix of electric power generation sources as California, but we believe in the near term, direct use of natural gas can also help Californians reduce their carbon footprint.

Together with enhanced energy efficiency programs, efficient direct use of natural gas could help reduce greenhouse gas emissions from this sector. Whereas, placing a cap on this sector at this time could act as a disincentive for using natural gas directly and efficiently in homes and businesses. Direct use of natural gas for appliances in the home can be part of an integrated plan for cleaner, more efficient decentralized energy production that could include some increase in solar hot water heaters (as contemplated in ARB's Draft Scoping Plan – subject to the availability and cost concerns raised in comments by our member Southwest Gas) and natural gas for heat and cooking needs. For even greater efficiency, new natural gas heat pumps could offer the ability to reuse waste thermal energy for residential and commercial heating and air conditioning.

New Thinking in Utility Ratemaking Can Boost Energy Efficiency Programs:

It is also important to find ways to remove barriers to implementing aggressive energy efficiency programs. Utility rates developed a century ago typically allow investor owned natural gas utilities to earn their allowed return on equity only if they deliver a certain volume of natural gas to their customers. In other words, under traditional rates, the utility's ability to recover its fixed costs plus a return on equity depend on the volume of natural gas transported in the system – which can vary depending on the weather – and the degree to which customers

become more efficient. Traditional rates create a disincentive for utilities to promote energy efficiency. California has been a leader in this regard, by developing innovative utility rates that have helped California achieve dramatic increases in energy efficiency in the past. Further innovations in rate regulation could help achieve additional gains in energy efficiency.

AGA has partnered with the Natural Resources Defense Council (NRDC) to champion "decoupled" rates that encourage energy efficiency. In May 2008, AGA and NRDC issued a joint statement reiterating our support for rates that not only remove disincentives but also create *incentives* for adopting more aggressive energy efficiency programs. We encourage ARB's support for such environmental incentive rates both in California and other WCI states, in order to achieve even greater energy efficiency and greenhouse gas reductions.

See http://www.aga.org/NR/rdonlyres/618DCA49-B046-4D5C-8A83-3A8A658AAA78/0/NRDCAGA2ndJointStatmentBOARDAPPROVEDMay2008.pdf

CONCLUSION

For the foregoing reasons, AGA urges ARB to cover residential and commercial natural gas customers through enhanced energy efficiency programs rather than by including them under an emissions cap-and-trade system at this time. During the initial phase of the program, carbon emissions from residential and commercial natural gas consumers would be more effectively addressed through increased efficiency efforts, appliance standards and building codes. In a later phase, ARB could evaluate the effectiveness of this approach in reducing carbon emissions from the commercial and residential sectors and, based on this experience, ARB could consider whether it makes more sense to continue this approach or to extend the scope of the cap-and-trade program to cover such end users.

AGA appreciates the opportunity to comment. If you have any questions, please contact Pamela Lacey, AGA Senior Managing Counsel, Environment, at (202) 824-7340 or placey@aga.org .