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Kevin Kennedy
California Air Resources Board
1001 I Street
Sacramento, CA

Re: **Northern California Power Agency Comments *Recognition of Early Action in a Cap-and-Trade System***

Dear Kevin:

In accordance with the direction provided during the March 10 Workshop - "*Recognition of Early Action in a Cap-and-Trade System*," the Northern California Power Agency¹ (NCPA) hereby submits these comments. The comments are provided in the interest of assisting CARB in the formulation of a fair and principled policy to achieve the mandates of Assembly Bill 32 (AB 32) that require both recognition of and credit for early adoption of greenhouse gas (GHG) emission reduction measures that were successfully implemented by stakeholders prior to the implementation of the reduction measures addressed in the Scoping Plan.

NCPA's position on the recognition of early action can be summarized in the following manner: the best mechanism to recognize and credit all early actions within the electricity industry is to base the allocation of allowances on retail sales as of a particular date, and then *credit* the retail provider with "early action allowances" for quantifiable emissions reductions achieved during an intervening period. The date utilized by CARB for the benchmark should be based on the latest available data prior to implementation of the cap-and-trade program. This amount should then be adjusted to provide appropriate recognition for reductions for energy efficiency, demand response, operational improvements, and similar programs that have been successfully utilized by retail providers to reduce the amount of electricity consumed.

¹ NCPA members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

This approach would recognize steps taken by stakeholders to reduce emissions prior to implementation of the Scoping Plan, and avoid penalizing entities that actually experienced load growth due to business development or electrification efforts in other sectors.

COMMENTS

As a preliminary matter, throughout the development of the framework for the upcoming cap-and-trade rulemaking, it is essential to the success of not only the cap-and-trade program, but entities and their ratepayers within that program, that CARB fully develop and foster mechanisms and program features that provide entities with the maximum flexibility to reach the mandated emissions reductions, the ultimate goal of AB 32. This should not affect the integrity of the proposed Scoping Plan measures – both programmatic and market-based – but will ensure emissions reductions in a fair and equitable fashion. The State and its residents will not be well served by the implementation of an emissions reduction scheme that is so draconian that it ignores the very real resulting economic impacts. Costs expended to meet compliance obligations will be borne by California’s residents and businesses. It is incumbent upon CARB and the stakeholders involved in this process to carefully balance the need for real and quantifiable GHG emissions reductions with the resulting effects on the livelihood of the State’s residents.

Retail electric providers must be able to simultaneously balance the competing priorities of ongoing and increasing emissions reduction mandates with the related cost implications to customers -- while also continuing to provide safe and reliable electricity. To most effectively meet or fulfill these multiple public interests, retail providers must have access to alternative and flexible compliance mechanisms.

As with all aspects of developing the AB 32 cap-and-trade program, determining the proper system to recognize and credit entities that took steps to reduce their GHG emissions prior to implementation of the Scoping Plan is a complex process. While it should be relatively simple to state that early actions – an entity’s actions that resulted in a measurable reduction in total GHG emissions – must be credited for those reductions, the number of interrelated factors in quantifying GHG emission reductions makes this exercise complicated.

A first step in this process must be the recognition and definition of several key terms. How the agency intends to define set-asides, for example, will impact whether or not it is appropriate to utilize set-asides as a credit for early actions. Set-asides could be characterized as allowances allocated within a specific cap that are not freely allocated or auctioned, but are held by the allowance issuing agency for the purpose of encouraging specified reduction activities or programs which decrease the cap for all other parties, thereby increasing the costs at a faster rate.² Before an entity can decide if benchmarking will be an appropriate mechanism by which to measure and credit early actions, stakeholders must know what date is being used to set the

² While NCPA proposes this as a workable definition for set-asides, it is important to note that CARB has not yet adopted a definitive definition for set-asides to be used in the context of the cap-and-trade program. Regardless of the definition, there should be no allowance set-asides within the cap if there is an effect on the cap.

benchmark so that the reduction performance can have a definitive time range. Likewise, CARB must be prepared to offer further guidance on matters pertaining to the allocation of allowances.³ Only after providing guidance and definitions, can reasoned and unqualified arguments be made for or against the various options for crediting early actions.

Early Voluntary Reductions Must Be Recognized

In adopting AB 32, the California Legislature sent a clear signal to the entire state (and indeed the world) that California is not only concerned about the impacts that global warming is having, but that the State intends to take a leadership role and in shaping the development of regional and federal climate policy. The legislation set forth the goals and objectives of the State and mandated specified reductions in GHG emissions by a date certain. The legislation also, however, acknowledged that entities that have already taken steps to reduce their carbon footprint should be recognized, and specifically directed CARB to “ensure that entities that have *voluntarily reduced their greenhouse gas emissions prior to the implementation* of this section *receive appropriate credit* for early voluntary reductions”. Health and Safety Code Section 38562(b)(3),⁴ emphasis added.

It is important to distinguish between voluntary early reductions noted in § 38562(b)(3) and the “early actions” of § 38562(b)(1) that were the subject of CARB’s *Early Action Policy Statement* issued in February 2008, which directed CARB to “design the regulations, including distribution of emissions allowances where appropriate, in a manner that ... *encourages early action to reduce greenhouse gas emissions.*” (Emphasis added)

The *voluntary early reductions* referenced in 38562(b)(3) are the reductions at issue here. The Legislature clearly recognized that many California stakeholders did not wait until the enactment of the legislation to begin efforts to reduce their carbon footprint. In order to ensure that these early actors would not be somehow adversely impacted by the regulations and allowance allocation mechanisms implemented pursuant to the Scoping Plan, the Legislature requires CARB to recognize these early actors and ensure that entities that implemented successful measures “receive appropriate credit” for GHG emissions reductions. This also provides assurance to those who are actively reducing carbon emissions today, that these actions will be appropriately recognized.

Early Voluntary Reductions Must Receive Appropriate Credit

It has been suggested by some that reductions resulting from early actions can be adequately

3 NCPA notes that while CARB has expressed a desire to auction emissions allowances, crucial issues regarding allowance allocation remain outstanding. Included amongst those is the overall timing of such an auction, whether an auction will be phased-in, and how some allowances may be allocated without cost at the beginning of the program.

4 Unless otherwise noted, all code section references shall be to the California Health and Safety Code.

recognized through benchmarking and use of an auction to purchase allowances.⁵ Entities with lower GHG emissions will be required to purchase fewer allowances in a cap-and-trade auction than those with higher GHG emissions levels, and therefore, will benefit from the fact that they took early actions to reduce their emissions profile. This form of an early action recognition is, however, entirely dependent upon the benchmark utilized. If a benchmark date is chosen that is close to the implementation of the Scoping Plan measures, such a mechanism must be based on retail sales in order to comply with the mandates of AB 32 that the emissions reductions realized prior to the implementation of the Scoping Plan programs *receive appropriate credit*. Appropriate crediting of such actions requires that the reducing entity's reductions be recognized in the face of their current obligation; for example, in the electric industry, retail providers that were able to institute programs and measures that resulted in decreased electricity usage should receive credit for those early reductions even if their overall electric load increased due to other factors such as population growth or increased electrification of transportation alternatives. In order to ensure that these actors are "credited," the benchmark period would have to be clearly established and cover a sufficient time period to capture early action efforts by stakeholders.

Therefore, it is important that CARB establish that the benchmarking for purposes of determining emissions reduction obligations, and distribution of allowances be based on the last verified reporting period prior to implementation of the cap-and-trade program. Such a benchmark, combined with an allowance allocation methodology based on retail sales, will allow for the proper crediting of early emissions reductions, as called for in §38562(b)(3).⁶

Furthermore, credits received for early voluntary reductions should be equivalent to an allowance allocation, and entities with a compliance obligation would be allowed to utilize the early voluntary reduction credit in the same manner as an allowance allocation. There is no distinguishable difference in reductions achieved prior to the implementation of the cap-and-trade program and those achieved thereafter.

Appropriate Crediting for Voluntary Early Reductions Must Not Be Counted Against the Overall Cap

It is imperative that early action "credits" not be used to adjust the overall cap downward. The purpose of complying with the mandates of § 38562(b)(3) is to develop an appropriate crediting mechanism that recognizes the additional early actions and maintains the integrity of the cap. This exercise is not only pointless, but contrary to the mandates of AB 32 if it is used solely for

5 For example, in the "Final Opinion on Greenhouse Gas Regulatory Strategies," the CPUC and CEC stated that "If, for example, the base period used for determining historical emissions were a period immediately prior to the enactment of AB 32, retail providers would be rewarded for any early action they take to reduce emissions after that base period noted that early actions are awarded." (D.08-10-03, October 16, 2008, pp. 229-230) NCPA notes that the true conundrum lies in addressing the contingency of "when" the base period is set.

6 As more fully set forth below, within the electricity sector, such an allocation methodology also recognizes actions in the form of portfolio changes that reduce overall emissions taken between the enactment of AB 32 and the implementation of a cap-and-trade program.

the purpose of determining an amount by which to reduce the overall cap. As discussed more fully below, that is why having a clear and definitive definition of early actions is imperative. These early actions must be recognized and credited in stand-alone fashion, and must not be used to adjust the State's overall cap on mandated emissions. Indeed, to do otherwise would be to penalize the very entities that the Legislature intended to recognize in § 38562(b)(3).

Early Actions and Allowance Allocation Mechanisms Must be Defined

While NCPA understands CARB's desire to have a discussion regarding the appropriate credit for early actions at this time in order to further incentivize entities to act now to reduce their GHG emissions, it is imperative that the scope of early reductions not be limited only to recent actions. Stakeholders that acted in anticipation of AB 32-like measures, or based on the same concerns that prompted the legislature to enact AB 32, must receive *appropriate credit* for those actions that resulted in clear emissions reductions.

Accordingly, the first step in the process of determining how to credit early actions must be to define what quantifiable emissions reductions are so that appropriate early actions can be identified as "eligible" for a credit. Action eligibility must include a clear timeline for when those actions were commenced in order to receive such credits. As it pertains to the electricity sector, NCPA believes that all actions and programs that resulted in quantifiable emissions reductions within the capped sector that occurred between 2006 and the implementation of the cap-and-trade program should be recognized by CARB.

As noted above, the means by which early actions are credited is closely tied to the appropriate allowance allocation mechanisms. For example, if an earlier-in-time baseline is not adopted, early actions would need to be separately calculated. The only equitable solution, and best mechanism to recognize and credit all early actions within the electricity industry, is to base the allocation of allowances on retail sales as of a date-certain, and then *credit* the retail provider with "early action allowances" for quantifiable emissions reductions achieved during an intervening period. This would both recognize steps taken to reduce emissions prior to implementation of the Scoping Plan, and avoid penalizing entities that actually experienced load growth due to business development or electrification efforts in other sectors. The date utilized by CARB for the benchmark should be based on the latest available data prior to implementation of the cap-and-trade program. This amount is then adjusted to provide appropriate recognition for reductions for energy efficiency, demand response, operational improvements, and similar programs that have been successfully utilized by retail providers to reduce the amount of electricity consumed.

This approach is the only equitable way to properly credit all early actions. The key to fairly adjusting the total emissions allowances is linked to allocation of allowances based on retail sales only. Such is the only option that recognizes both portfolio changes and load reductions resulting from other efforts between 2006 and 2012.

CARB Should Prepare a Critical Path of Cap-and-Trade Related Issues and Definitions as Soon as Possible

As noted above, it would be helpful to establish a clear “critical path” for defining key elements of the cap-and-trade program. This would facilitate deliberations on all aspects of the cap-and-trade program, and would provide both CARB and stakeholders with a more definitive framework in which to provide guidance and comments.

CONCLUSION

NCPA appreciates the opportunity to offer these comments, and looks forward to continued efforts toward the development of a viable cap-and-trade program. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or scott.tomashefsky@ncpa.com.

Sincerely,

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