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March 31, 2009

Ms. Mary Nichols, Chairman  
Mr. James Goldstene, Executive Officer  
California Air Resources Board  
1001 I Street  
Sacramento, CA 95814

**Re: Pacific Gas and Electric Company Comments on Recognition of Voluntary Early  
Action Under AB 32**

Dear Chairman Nichols and Executive Officer Goldstene:

PG&E believes that early action under AB 32 will be critical to lowering greenhouse gas (GHG) emissions, speeding the transition to a low-carbon economy, and controlling costs. We provide these comments to assist ARB in meeting AB 32's stated goals of encouraging early actions and recognizing, and providing credit for, those who undertake voluntary early action to reduce GHG emissions.

Our comments address four key points:

1. Accelerated, proactive regulatory action is needed to provide certainty and promote early actions;
2. Early actions taken in sources that will not be part of the cap and trade should qualify as offsets for use in complying with AB 32 and should not be restricted by quantity; and
3. Early actions taken by sources that will be part of the cap and trade should be recognized by an allowance allocation that recognizes such early action (for example, by allocating allowances to utilities on behalf of their customers based on sales adjusted for energy efficiency savings).

**Accelerated Schedule and Regulatory Certainty Needed**

Parties attending the Early Action Workshop on March 10, 2009 repeatedly stated that regulatory certainty was crucial to motivate early action. Three of the break-out groups stressed the need for the ARB to act "quickly," "as soon as possible," and "aggressively" to adopt project-based protocols and a methodology to accept other early actions. The Nature Conservancy noted that

Ms. Mary Nichols, Chairman  
Mr. James Goldstene, Executive Director  
March 31, 2009  
Page 2

projects take time to implement, and other parties expressed skepticism that regulatory action would occur swiftly enough for any meaningful development of early action reductions.

PG&E's experience with contracting for offsets through our ClimateSmart program shows that offset dollars enable real emissions reductions within California. Voluntary customer contributions to PG&E's ClimateSmart Program will result in investments creating GHG offsets through high quality<sup>1/</sup> forest conservation and methane gas capture projects. PG&E will not use its ClimateSmart offsets for AB 32 compliance, but if AB 32 regulatory certainty stimulated demand for comparable offsets, California could create millions of tons of reductions over the next few years. The lack of regulatory certainty over how such projects would "count" for AB 32 compliance could lead to missed opportunities.

During the Early Action Workshop, ARB staff expressed that a decision associated with early action may not be possible outside of the cap and trade regulation, which is not expected to be adopted until the end of 2010. PG&E is concerned that without the Board's strong commitment to stand behind such projects, few, if any, projects will occur prior to 2012.

When the Board adopted the California Climate Action Registry (CCAR) protocols for voluntary reductions, they stated, "Before voluntary reductions can be used for AB 32 compliance, regulations to verify and enforce those reductions would need to be developed and adopted by the Board (Health and Safety Code (H&SC) section 38571)" (ARB Resolution 08-37). PG&E agrees with the Board's guidance and strongly urges the ARB to take the regulatory actions deemed necessary to recognize early actions prior to adoption of the cap-and-trade regulation. During this initial period, we also urge ARB to create a streamlined application and approval process for considering all early action projects, including but not limited to those using the adopted protocols.

### **General Discussion on Early Actions**

As appeared to be the consensus at the Workshop, PG&E believes that there are two distinct categories of early action: reductions at emissions sources that will be within the cap and reductions at sources that will not be part of the cap. AB 32 also supports this distinction with two separate references to the two types of early action in Health and Safety Code Sections 38562(b)(1) and 38562(b)(3). Accordingly, PG&E provides the following responses to the ARB's "general questions on early actions" outlined in the March 10, 2009 ARB meeting notice for these two distinct categories. The questions posed by ARB for general discussion in the workshop agenda have been copied below twice, once for each section, and ordered so that responses will not be repetitive.

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<sup>1/</sup> All projects have been verified and registered by the California Climate Action Registry (CCAR).

## **Voluntary Early Actions Outside of Capped Sources**

Project-based reductions comprise one early action category. Health and Safety Code Section 38562(b)(3) directs the Board to “[e]nsure that entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions.” This provision would appear to support early action credit for entities regardless of whether they are within the capped sectors.

- *What options should California consider for recognizing and appropriately crediting voluntary early actions in a cap-and-trade program?*
- *What options for rewarding voluntary early actions should be considered?*

Consistent with comments raised by many other parties at the workshop, PG&E recommends that project-based early actions from facilities outside the capped sectors qualify as offsets in a cap-and-trade program. In order to encourage early actors to make the necessary investments, the ARB should allow these early action reductions to be used for compliance purposes without a quantitative limit.

- *What criteria should ARB use to choose among options that are consistent with the overall goals of the cap-and-trade program (e.g., no double counting, reductions are permanent, extent of co-benefits associated with the reductions, compatibility with other State policies, etc.)?*
- *What criteria should be used to select projects that would be eligible for credits?*
- *Should project-based voluntary reductions that follow Board-approved protocols qualify for credits in a cap-and-trade program?*

Project proponents should be able to create offset credits through Board-approved protocols or on a project-specific basis. Project proponents should be able to propose projects on an individual basis, as occurs with the Clean Development Mechanism, even if a specific protocol has not yet been approved. The Board should establish a process to approve these individual projects in a timely fashion. The criteria for all of the early action offsets should be the standard criteria associated with quality offsets.

- *How far back should we go to establish eligibility for early action credits (e.g., 2007- 2011)?*
- *Should credits be based on total reductions achieved prior to 2012 without regard to when in the eligibility window these occurred (e.g., one source might have started in 2007, and another source may not have started until 2011)?*
- *Should early reduction credits be treated the same as allowances, and how should they be accounted for in the cap?*
- *If early action projects continue to generate emission reductions after 2012, should they still qualify for early reduction credits, set asides, or offsets?*

Offset projects started any time after the passage of AB 32 should qualify for early action offset credits. As offsets, the offset credits will not impact allowance allocation or the level of the cap and should be fungible with allowances. Projects that continue after the onset of the cap should continue to earn offset credits, but not early action offset credits. However, as stated above, early action credits should not be limited by an offsets quantity limit to give extra incentive to early actors.

### **Voluntary Early Actions for Capped Sources**

- *What options should California consider for recognizing and appropriately crediting voluntary early actions in a cap-and-trade program?*
- *What options for rewarding voluntary early actions should be considered?*

In 38562(b)(1), AB 32 directs the ARB to design the distribution of allowances in a manner that “encourages early action to reduce greenhouse gas emissions.” PG&E believes that early actions taken in sectors that will be covered in the cap-and-trade should be recognized in the allocation of allowance value to the sector in general. In the electricity sector, action by LSEs and their customers to lower the emissions of the portfolio should be rewarded through allocating allowance value to utilities on behalf of their customers based on load served, adjusted for verified customer energy efficiency savings.

- *What criteria should ARB use to choose among options that are consistent with the overall goals of the cap-and-trade program (e.g., no double counting, reductions are permanent, extent of co-benefits associated with the reductions, compatibility with other State policies, etc.)?*

The allowance allocation method chosen to reward early action should meet the following criteria:

1. Speed the transition to a low-carbon economy;
2. Mitigate the costs incurred by customers to achieve these long-term GHG reductions; and
3. Position California well and demonstrate leadership in the context of emerging regional, federal and international GHG programs.

The most equitable methodology by which to allocate emission allowances in the Electric Sector, and the one we believe will best expedite the transition to a low carbon economy, is based on an output metric, such as retail electricity sales adjusted for verified customer energy efficiency savings. An output allocation method achieves the following objectives:

- Recognizes and encourages early action, including the years leading up to 2012, as required by AB 32

- Encourages aggressive deployment of energy efficiency
- Is consistent with the recommendations the State has made on national climate change policy and supports California's leadership position in the context of emerging regional, national and international programs.
- *How far back should we go to establish eligibility for early action credits (e.g., 2007- 2011)?*
- *Should credits be based on total reductions achieved prior to 2012 without regard to when in the eligibility window these occurred (e.g., one source might have started in 2007, and another source may not have started until 2011)?*

Allowance allocation should update, to reward continued GHG emissions reductions. An updating method that allocates based on an output metric renders when the activity occurs moot. Allocating allowances based on an output method, such as retail electric sales adjusted for verified energy efficiency savings, recognizes the investments made by utility customers who have already paid for increased supplies of low-carbon energy or for energy efficiency and demand response programs. At the same time, an updating output-based approach encourages utilities who have not made these early investments on behalf of their customers to find the most expedient and cost-effective methods of doing so as soon as possible.

- *Should firms that voluntarily reported emissions to the California Climate Action Registry receive credit for actions they took to reduce emissions? If so, what years of registry reporting should be considered?*

PG&E has reported the company emissions profile through the CCAR voluntary protocol, which is distinct from the emissions of our capped sources. We look to continued discussion with and between CCAR and the ARB to further develop this issue.

- *Should early reduction credits be treated the same as allowances, and how should they be accounted for in the cap?*
- *If allowances are set aside for this purpose, should the number of allowances set aside be limited?*

The majority of the workshop participants expressed that allowance allocation should reward early action by capped sources. Environmental Defense Fund (EDF), among others, stated that auctioning allowances automatically rewards those sources that have taken action to reduce emissions. PG&E believes that, for the electricity industry, the preferable method of allowance allocation that rewards consumers for their early actions is awarding allowances to utilities on behalf of their customers, rather than the electricity generators.

- *How should credits provided for early actions affect the level of the cap at the start of the program?*

Ms. Mary Nichols, Chairman  
Mr. James Goldstene, Executive Director  
March 31, 2009  
Page 6

- *Should the 2012 cap increase to include early action credits from capped sources, and what conditions or criteria should apply in making that determination?*

PG&E agrees that offset limits and allocating allowances cannot be resolved in isolation from the cap level and trajectory. For example, when the US Climate Action Partnership (USCAP) made its cap and trajectory recommendations to Congress in the January 2009 USCAP Blueprint for Legislative Action, the partners stated, “USCAP believes the targets recommended above are achievable at manageable costs to the economy ***provided that the offsets and other cost containment measures we recommend in Section 4-B are enacted*** [emphasis added]” (Page 5). However, there should be no limit on the number of early action credits granted to projects outside of the capped sectors that occur before 2012. The impact that these credits have on the cap can be determined later but there needs to be accelerated adoption of an early action policy. When it comes time to determine the impact of early action credits on the cap, PG&E believes that if these actions occur outside the capped sectors, before 2012, and are surplus and permanent, then they should not result in a reduction of the initial cap and trajectory.

In conclusion, PG&E recommends:

- In the immediate future, the Board should provide certainty that project-based early action emission reductions will count as offsets in the cap-and-trade market. The Board should adopt regulations to authorize ARB-adopted CCAR protocols and create a system to allow individual project-based methodologies.
- Project-based early actions reducing GHG emissions between the passage of AB 32 and the start of the market should earn early action offset credits. These early action offset credits should not be limited by quantity.
- Allowance allocation based an updating, output-based metric method should reward early action in capped sectors.

Thank you for the opportunity to submit these comments. Please call me at (415) 973-6617 if you have any questions or if we may be of further assistance.

Sincerely,

/s/

JOHN W. BUSTERUD  
JWB:kp

cc: Kevin Kennedy  
Lucille Van Ommering  
Sam Wade