



M E M O R A N D U M

TO: California Air Resources Board

FROM: Modesto Irrigation District
Redding Electric Utility
Turlock Irrigation District

SUBJECT: Offsets

DATE: April 17, 2009

Introduction

Modesto Irrigation District (“MID”), Redding Electric Utility (“REU”), and Turlock Irrigation District (“TID”), collectively the “Utilities,” appreciate the opportunity to propose a design for the use of Offsets as a part of California’s cap-and-trade program.

The Utilities agree that Offsets must be “real, permanent, quantifiable, verifiable, enforceable and additional” emission reductions and can only be created within the uncapped sectors. Offsets must be made available to capped entities throughout the cap-and-trade program to meet their compliance obligation. Offset credits should act as a pressure relief valve to avoid drastic unanticipated spikes in the price of Allowances and should be recognized as the equivalent of allowances.

The Utilities

MID, REU and TID are local publicly owned electric utilities. MID and TID are irrigation districts located in the Central Valley and REU is a municipal utility within the City of Redding. MID serves over 110,000 electric customers with a peak load around 650 Megawatts (MW). TID serves about 100,000 electric customers with a peak load of approximately 600 MW. REU serves 42,000 customers with a peak load of 247 MW. The Utilities maintain similar resource mixes, including hydroelectric, eligible renewables and fossil fuel sources. They also share similar challenges, including weather patterns, demographics and economics. The Utilities have consistently supported the goals of AB 32 and participated in CARB’s effort to create a

successful program to implement these goals. The Utilities continue to urge CARB to move forward in a manner that protects the reliability of the electric grid and maintains the Utilities' efforts to provide reliable and affordable power to their customers.

What is An Offset Credit?

Offset credits are certificates awarded only for projects meeting specific protocol guidelines. Offset projects must be “real, additional, quantifiable, permanent, verifiable, and enforceable”, and are beyond what would have otherwise happened under regulation and common practice.

By the above definition, entities in capped sectors are not eligible to develop Offset credits. Offset credits should be available to be earned by entities in uncapped sectors in order to encourage emission reductions that would have not otherwise been achieved.

Because the reduction of greenhouse gases is a global issue, the Utilities believe that the use of Offset credits should have no geographic restrictions. Offset credits provide a necessary alternative compliance mechanism, and limiting the geographic area from which Offset projects can be developed would defeat this purpose. Utilizing strict Offset protocols will provide adequate protections to ensure the benefits of real reductions are achieved and to prevent manipulation. This allows Offsets to achieve the goals of the cap-and-trade system in the most efficient manner.

Offset credits, once obtained, would have the same use as an Allowance – to ensure logistical capability of capped entities to meet their AB 32 obligations. The Utilities envision a 1 to 1 ratio of Allowance to Offset credit value. For example, if an Allowance represents one ton of carbon dioxide equivalent, an Offset credit would be awarded for one ton of carbon dioxide equivalent reduction achieved through the qualified Offset protocol and verified through the established procedures. Likewise, one Offset credit can be turned in as one Allowance during the compliance period. Offset credits should possess all other characteristics as Allowances, such as having an unlimited lifespan and can be bankable.

Because one ton of real emissions reduction would occur for every one ton of Offset credit created, the overall ratio of emission reductions under the cap-and-trade stays the same, protecting the integrity and the benefits and co-benefits of the program. The development of Offset credits essentially decreases the State's overall emissions at a faster rate, allowing California to reach its AB 32 goals sooner. In contrast, if Offset protocols are not developed to encourage specific types of projects, emission reduction goals may not be reached.

Offset credits should not be taken out of the cap in any form of set asides for the reasons set forth above.

What Should the Offset Limit Be?

The Utilities acknowledge that a limit on the use of Offset credits has been proposed, however we believe such a limit is counterproductive. If a limit is to be imposed, the Utilities recommend setting a fixed limit on the quantity of Offsets that each entity can use towards meeting its

compliance obligation; this is the simplest approach. Any limit should be based on a percentage of each entity's compliance obligation and not on the total amount of allowances.

There should not be a fixed limit on the amount of Offsets that could be created or accepted into the program. Such a criteria would limit the options for Offset projects that an entity could invest in, and has the potential to increase the total cost of the Allowance market while reducing the incentive for uncapped sectors to act.

A hybrid option should not be considered.

How Should the Limit be Calculated and Applied Across the WCI?

As described above, the Utilities do not believe a limit is necessary. However if a limit is imposed it should be based on each capped entity's compliance obligation. Whatever calculation methodology is adopted should be applied uniformly across the WCI jurisdictions.

Should the Offset Limit Change Over Time?

To simplify the system, if a limit is imposed, the limit should remain constant over time. That said, the WCI has indicated a desire to reduce the amount of Offset credits a capped entity can use to meet its compliance obligation to 10% by 2020. This would indicate a desire to include a declining trajectory from 49% to 10% over time. The Utilities disagree with including a declining trajectory because this has the potential to complicate the cap-and-trade program. As set forth above, if the overall ratio of Allowances to Offsets, or emission reductions, under the cap-and-trade stays the same, the integrity and benefits of the program are maintained.

CARB must acknowledge that if a long-term viable Offset program is developed for a specific sector, this sector and the accompanying Offset program may need to eventually be included under the cap. Until such time, as stated above, the Utilities believe that imposing a limit is unnecessary and counterproductive.

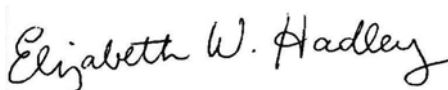
Conclusion

The Utilities appreciate the opportunity to put forth the above proposal on Offsets and would welcome the chance to work with CARB and a designated working group to develop these concepts further.

Respectfully submitted,



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