

COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY ON THE
CALIFORNIA AIR RESOURCES BOARD STAFF'S PROPOSED CAP-AND-TRADE
DESIGN AND COMPLIANCE OPTIONS

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I.

INTRODUCTION AND GENERAL COMMENTS

Southern California Edison Company (“SCE”) welcomes this opportunity to submit comments on the California Air Resources Board (“CARB”) staff’s proposed design and compliance options for a cap-and-trade system. SCE appreciates the time and effort from CARB staff in presenting workshops and soliciting stakeholder input on the design of the State’s cap-and-trade system.

CARB staff’s design options for the cap-and-trade program assume that there will be auctioning of greenhouse gas (“GHG”) emission allowances. Assembly Bill (“AB”) 32 requires CARB to distribute emission allowances “in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions.”¹ In order to most effectively achieve these goals, SCE has consistently advocated that allowances should be administratively allocated based on mitigating economic harm to those entities that experience harm due to the implementation of the State’s GHG reduction program. By identifying entities suffering economic harm and allocating allowances to such harmed entities, California can adopt a cap-and-trade approach that produces emissions reductions at the lowest possible cost, and this cost will be borne equitably, as required by AB 32. To do otherwise would mean that some capital investments made prior to the enactment of AB 32 under law and rules that did not require pricing of GHG emissions would have to be abandoned prematurely to some extent. Stranding legal and good faith investments in such a manner raises questions of equitable treatment, creates additional uncertainty regarding current and future capital expenditures, and imposes significant and unnecessary costs on the California economy. Distributing allowances on the basis of economic harm also ensures that windfall profits are not created because entities that have low GHG emissions, or that will receive

¹ Cal. Health & Safety Code § 38562(b)(1).

increased revenue to offset their emissions costs, will receive allowances only to the extent they are harmed economically.

Nevertheless, if CARB chooses to distribute allowances using an auction, the proceeds from such an auction should be distributed according to the economic harm-based allocation method outlined above. Under such a system, harmed entities (including electric utility customers) would be assigned auction revenue rights (“ARRs”) based on a harm-based allocation methodology, prior to conducting allowance auctions. Immediately following the allowance auction, all auction revenue would be distributed by CARB to entities holding ARRs. By identifying harmed entities during the ARR allocation process, ARRs become a means by which harmed entities can mitigate the economic dislocation that will occur as a result of the implementation of a cap-and-trade mechanism, while allowing all compliance entities to acquire allowances at market prices via the auction process. This approach is consistent with AB 32’s requirement that CARB design regulations that “minimize costs and maximize the total benefits to California.”²

One of SCE’s primary concerns with the auctioning of allowances is the potential that auction revenues may not be distributed through ARRs to entities that suffer economic harm from the State’s AB 32 program, including electric utility customers. Accordingly, SCE recommends that should CARB decide on an auction of allowances, such an auction ought to be introduced gradually. The CPUC and California Energy Commission (“CEC”) recommended that auctioning of allowances be phased in for the electricity sector, beginning with 20% of allowances in 2012 and increasing 20% per year so that 100% of allowances are auctioned in 2016.³ SCE is concerned with this recommended rapid transition to 100% auctioning of allowances and the impact of such a quick transition on entities that will suffer economic harm from implementation of AB 32. Any transition to auctioning of allowances should account for

² *Id.*

³ Final Opinion on Greenhouse Gas Regulatory Strategies, CPUC Decision 08-10-037, at 15, 214 (October 16, 2008). Citation is to CPUC version of the decision.

the time needed to develop the technologies necessary to move to a low-carbon future, particularly in the electricity sector. Given the long life of generating assets and the amount of time likely needed to develop and perfect low-emission generating technologies and emission removal systems, sufficient time is needed for entities to transition to low-emission resources. The electricity sector is a capital-intensive industry in which the timeframe for investment decisions is evaluated in decades, not just a few years. The average life of a fossil fuel generation plant exceeds thirty years. Long-term purchase power agreements are typically signed for intervals of between five and twenty years. It takes seven to ten years to plan, permit and construct new high-capacity transmission lines that can access new renewable resources. Thus, it is unreasonable to expect that entities will be able to make significant changes in their generation profiles within a short period. A rapid transition to 100% auction will cause undue economic harm to all California entities and consumers. Therefore, SCE believes that if there is to be a transition to auctioning of allowances, it should be a gradual transition. Furthermore, any transition to an auction should be tied to the development of technology that will allow for the reduction of GHG without an undue financial burden on consumers.

CARB staff presented a number of auction design proposals at the March 23, 2009 workshop. However, CARB has yet to make its final decision on several important issues relating to an allowance auction, including the number of allowances available for auction or the method by which CARB will transition to an auction. These are critical issues that need to be resolved before CARB determines the details of any allowance auction. Although SCE believes that CARB should first focus its attention on determining the method of allowance allocation, in the remainder of these comments, SCE focuses its remarks on the following issues raised in the March workshop: timing of auctions, participation eligibility, auction frequency, reserve price, and non-competitive bids. Additionally, SCE discusses its support for alternative compliance payments as the last resort compliance mechanism in the AB 32 compliance scheme.

II.

CARB SHOULD CONDUCT ANY AUCTIONS BEFORE REGULATED ENTITIES INCUR COMPLIANCE OBLIGATIONS

At the March 23, 2009 workshop, CARB staff did not make clear whether the auction for GHG allowances will be conducted *ex ante*, i.e., before the obligated entities incur the compliance obligations, or *ex post*, i.e., at the end of the compliance period. SCE strongly urges CARB to conduct any auctions *ex ante* so that compliance entities have a clear idea of the availability and price of the GHG allowances. To make appropriate electricity dispatch decisions in the electricity sector, it is essential that the compliance entities know the number of allowances available, and at what cost. Once a cap-and-trade system is in place, the cost of GHG allowances will become part of the incremental cost equation for generation and dispatching electricity. Just as a generator of electricity would calculate the cost of fuel before determining whether to burn it to produce electricity, the generator would also wish to calculate the cost of allowances that would need to be retired before deciding whether to produce electricity from a GHG-emitting resource. If the allowances are not already available and priced in the market, the electricity dispatch decision maker would be unable to take into account the cost of the GHG compliance obligation before electing which resource (zero GHG emissions, low GHG emissions, or high GHG emissions) to dispatch. This uncertainty in pricing and resource election would defeat the fundamental design objective of a cap-and-trade system.

III.

SCE SUPPORTS CARB STAFF'S PROPOSAL LIMITING GHG ALLOWANCE AUCTION PARTICIPATION TO COMPLIANCE ENTITIES

SCE supports CARB staff's proposal to limit participation in GHG allowance auctions to compliance entities. As noted by staff, this will ensure that compliance entities have priority access to allowances and prevent speculators and other non-compliance entities from unnecessarily driving up prices. SCE also recommends that CARB allow a secondary market to

develop for allowances, as secondary market transactions will make the allowance market more efficient. However, secondary market transactions should be limited to compliance entities and such transactions should be recorded with CARB. Additionally, SCE suggests that CARB allow entities that wish to sell allowances in the secondary market to utilize CARB's auction process to sell these allowances. In other words, SCE suggests that CARB auctions be used to not only identify the price and distribute the allowances that CARB injects in the market, but also to identify the price and distribute the allowances from compliance entities that wish to utilize the CARB auction process to liquidate its surplus allowances.

IV.

SCE SUPPORTS CARB STAFF'S PROPOSAL FOR HIGHER AUCTION FREQUENCY

In order to provide sufficient liquidity and create broader and more frequent price signals, SCE supports CARB staff's proposal to conduct frequent, quarterly, auctions. Should CARB allow compliance entities to liquidate their surplus allowances via CARB auctions, as suggested earlier, more frequent auctions will assist the compliance entities in doing so. These auctions will play a key role in determining the market price of GHG allowances and in ensuring that all compliance entities have adequate opportunities to participate in these auctions. Given these important considerations, the additional administrative costs from holding more frequent auctions are easily justified.

V.

CARB SHOULD NOT ADOPT A RESERVE PRICE FOR AUCTIONS

SCE does not support CARB staff's proposed reserve price for allowances in an auction, which would create a minimum bid below which bids would not be accepted. This proposal creating a price floor should be rejected because it would artificially raise the cost to compliance entities by unnecessarily withholding allowances from the market. Instead, SCE believes that CARB should inject an appropriate amount of GHG allowances into the market consistent with

the AB 32 GHG reduction goals. CARB can then rely on market efficiencies to determine the correct price of allowances without artificial price floors.

VI.

CARB SHOULD CAREFULLY MONITOR ANY NON-COMPETITIVE BID PROCESS

CARB staff have proposed a non-competitive bid process whereby parties wishing to avoid a quantity risk may look to a reserve to purchase allowances. This plan would reduce the number of allowances auctioned by the amount of the reserve. The rest of the allowances would then be auctioned using competitive bids. The non-competitive buyers would then pay the auction price. While some compliance entities may prefer this method of acquiring allowances, SCE is concerned that if unmanaged, such an arrangement could increase the cost of compliance in unintended ways. SCE encourages CARB to closely monitor such an arrangement to make sure that non-competitive bidders do not impact the market clearing price in a material way. Additionally, participation in such an arrangement should be limited to compliance entities. CARB has indicated that one benefit of using an auction to distribute allowances is price revelation. While SCE recognizes that a non-competitive bid process may be desirable to some, CARB must weigh this benefit against the stated benefit of price revelation and efficient distribution of allowances to all compliance entities.

VII.

CARB SHOULD ADOPT AN ALTERNATIVE COMPLIANCE PAYMENT APPROACH

SCE supports alternative compliance payments as the last resort compliance mechanism in the AB 32 compliance scheme. Given the long-term nature of the GHG emissions reduction program, a situation may arise where no additional, real reductions may reasonably be found. For example, there may be a time when constraints beyond a compliance entity's control, such as delay in the creation of new technologies or delay in changes to legislation regarding zero-

emissions technologies, may make it difficult for the compliance entity to both serve load and meet its GHG reductions targets. While penalties may be designed to send a strong signal to compliance entities, they should not be applied to entities that take all possible actions to reduce emissions and comply with AB 32. Penalties are ineffective in such scenarios where insufficient real reductions can be reasonably found during the compliance period. This is particularly important in the electricity sector, recognizing that the alternative in the electricity sector is the inability to serve firm electric load. In such a situation, an alternative compliance payment would provide a relief valve for the compliance entity and avoid the only other alternative for obtaining emissions reductions – curtailing of firm electric load.

VIII.

CONCLUSION

SCE thanks CARB and its staff for their diligent efforts in attempting to address the various issues raised by the implementation of AB 32 and the Scoping Plan. SCE urges CARB to adopt regulations which are in line with the principles SCE set forth herein.

Respectfully submitted,

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