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June 2, 2008

**To: THE CALIFORNIA AIR RESOURCES BOARD  
Assembly Bill 32 Stakeholder Working Groups**

**From: Modesto Irrigation District  
Joy A. Warren, Regulatory Administrator**

**Subject: COMMENTS OF THE MODESTO IRRIGATION DISTRICT ON  
SCOPING PLAN ISSUES, INCLUDING EMISSION REDUCTION  
MEASURES, MODELING RESULTS,  
AND OTHER ISSUES**

The Modesto Irrigation District ("Modesto ID") appreciates the opportunity to provide its comments ("Comments") on greenhouse gas (GHG) emission reduction program design issues.

At its May 19, 2008 Scoping Plan Workshop staff of the California Air Resources Board ("ARB") invited comments from stakeholders on design elements of the AB 32 Draft Scoping Plan.

The California Public Utilities Commission and the California Energy Commission ("Joint Agencies") also solicited comments on various potential design elements in preparation for issuing their recommendations to the Air Resources Board regarding emission reduction program elements for the electricity and gas sectors.

Modesto ID believes the same considerations are relevant in response to both requests. Attached for your consideration are Modesto ID's comments as filed with the Joint Agencies on this same date.

Thank you for the opportunity to present these Comments.

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the )  
Commission's Procurement Incentive Framework ) Rulemaking 06-04-009  
And to Examine the Integration of Greenhouse Gas ) (Filed April 13, 2006)  
Emissions Standards into Procurement Policies )

**ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of: Order Instituting )  
Informational Proceeding on a ) Docket 07-OIIP-01  
Greenhouse Gas Emissions Cap )

**COMMENTS OF THE MODESTO IRRIGATION DISTRICT  
ON EMISSION REDUCTION MEASURES, MODELING RESULTS,  
AND OTHER ISSUES**

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Docket 07-OIIP-01

**COMMENTS OF THE MODESTO IRRIGATION DISTRICT  
ON EMISSION REDUCTION MEASURES, MODELING RESULTS,  
AND OTHER ISSUES**

In accordance with Rules of Practice and Procedure of the Public Utilities Commission of the State of California ("CPUC"), and the Administrative Law Judges' Rulings soliciting comments, establishing an outline and setting the schedule for filing<sup>1</sup>, the Modesto Irrigation District ("Modesto ID") hereby files these Comments on certain issues related to the scoping plan for implementation of Assembly Bill (AB) 32 greenhouse gas ("GHG") reductions, including allowance allocation, flexible compliance and non-market based emission reduction measures. Modesto ID also files these Comments with the California Energy Commission ("CEC") in Docket 07-OIIP-01.<sup>2</sup>

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<sup>1</sup> The Assigned ALJs have issued a series of applicable Rulings, including: Administrative Law Judges' Ruling Updating Proceeding Schedule and Requesting Comments on Emission Allowance Allocation Policies and Other Issues dated April 16, 2008; Administrative Law Judges' Ruling Providing Notice of Joint Workshop on Emission Reduction Measures and Opportunity to Provide Comment on Workshop Issues dated April 22, 2008; Administrative Law Judges' Ruling Requesting Comments on Flexible Compliance Policies dated May 6, 2008; Administrative Law Judges' Ruling Requesting Comments on Emission Reduction Measures, Modeling Results, and Other Issues; Incorporating Materials into the Record; and Recommending Outline for Comments dated May 13, 2008; and, Administrative Law Judges' Ruling Modifying Schedule and Correcting Suggested Outline for Comments and Reply Comments dated May 20, 2008.

<sup>2</sup> The CPUC and the CEC may hereinafter jointly be referred to as the "Joint Agencies."

In their May 13, 2008 Ruling, the ALJs provided a suggested outline for parties to use in preparing their comments, but noted that “parties’ are not required to address all issues.”

(5/13/08 Ruling, p. 9.) Accordingly, Modesto ID’s Comments will apply the outline numbering and heading conventions provided by the ALJs but do not address every item. Any failure to address a specific point does not indicate Modesto ID’s agreement or disagreement with any articulated position, and Modesto ID reserves the right to present varying positions in the future.

#### **I. Summary**

Modesto ID continues to believe that the Joint Agencies should advocate the design of a GHG reductions program that strikes an equitable balance for the entire electric sector. Any recommendations developed by the Joint Agencies must recognize the varied interests of utilities, both private and public, spread throughout the State and protect the interests of all electric and gas utility consumers. The utility industry is an easily identifiable target for emission reduction mandates, and it has repeatedly been noted that the electric sector will certainly be asked to bear more than its proportional share of GHG reduction obligations. Thus it is critical that the industry have an advocate so that compliance with the goals of AB 32 can be achieved while retaining grid and industry stability and without endangering the viability of any existing retail provider.

Each utility is uniquely situated and the most effective emission reduction implementation program will establish an obtainable goal and provide a variety of tools for regulated entities to apply to their own circumstances and determine the best path for achieving reductions. If these tools include a market component that component should be only a single part of the bigger whole and must be carefully harmonized with existing mandates and legislative

structures. As much certainty as possible must be built into the program to allow utilities to successfully plan and manage their resources to meet their service obligations.

If a market tool is developed, it must be broad based and all sectors must be responsible for their own fair share of market reductions. Any cap and trade system integrated into the emission reduction program must be designed to avoid cost shifting among sectors and among utilities. Modesto ID does not support a market system for achieving AB 32 goals, but should the Joint Agencies elect to recommend one to the California Air Resources Board (“CARB”) Modesto ID urges consideration of the following design elements:

- Individual sector and/or entity caps
- Administrative allocation of allowances based on historical emissions.
- Auctions should not be used, but if used should be minimal and phased in slowly.
- In the electric sector allowances should be allocated to retail providers to cover carbon emitting resources associated with load served, commensurate with their reduction obligations.
- Compliance periods should be multi-year and the baseline for allocations should be updated to account for all load growth, including normal economic and sector shifting increases, and other situational changes.
- The full value of emission allowances must be used to minimize the cost impact of emission reductions on all consumers.
- All flexible compliance mechanisms should be considered.
- Any transitions (eg. toward allowances based on load or sales, toward auction) must be gradual and carefully monitored as the market matures.
- The market design must include consumer (price) protections.

- Oversight by a single, identified and accountable entity

## **II. General Issues**

Electric sector parties have been asked to comment on program measures designed to achieve emission reductions, without knowing the level of reductions the electric sector will be responsible for achieving. Thus, parties are being asked to comment on the proper pathway to a destination that has not been identified. Sector and entity reduction obligations must be quantified – either in terms of the percent of total reduction attributable or in a fixed reduction value – before comprehensive positions on program design can be formed.

Emission reduction obligations and concomitant allowance allocations must account for load growth experienced by electric retail providers. Load growth can occur through the transfer of existing consumers from other retail providers, through new growth in previously unserved areas, through population and economic growth within the same area, and through electrification as a means of emission reduction by other sectors. In each case baseline values and allowance allocations must be adjusted. For example, in the case of transferred load, the emission factors associated with transferred load should likewise transfer to the new provider, as would any associated allowance allocation. Where emission reduction obligations are transferred from one sector to another the electric sector consumers must be made whole for the shifted costs of the additional reduction burden.

The baseline factors for determining emission allowance allocations must be the same as the factors for determining emission reduction obligations. In each case the baseline must be based on multiple years experience in order to normalize natural fluctuations in weather, water conditions, and similar impacts.

Program mandates must be based on goals and measures that are feasible, cost effective and achievable based on current knowledge, not based on available potential.

The role of carbon fees must not be discounted. See, for example, the February 2008 Congressional Budget Study which summarized "A tax on emissions would be the most efficient incentive-based option for reducing emissions and would be relatively easy to implement."<sup>3</sup>

Early action and voluntary reductions can be fully recognized through credits factored into established caps and through the lessening of future emission reduction obligations. In other words, a properly factored baseline for reductions will account for reductions already achieved.

Reliability is a key concern in the design of an emission reduction program. The existence of resource adequacy mandates independently of such program neither assures continuous supply nor resolves the shortfalls if supplies willing and able to meet program constraints are unavailable or inaccessible. Potential impacts on reliability must be considered in the program design.

California's emission reduction program must meld with any regional and federal program ultimately adopted. While it is hoped that such larger scale programs will take their lead from California's program, California must lead with an eye toward events around it and be sensitive to signals as such broader programs are developed. The goal must be to design a state program that will transition seamlessly into a single overarching system of compliance that ensures consistency of goals without duplication of obligations. California's program design must include a process for addressing regional and federal developments.

### **III. Allowance Allocation**

#### **A. Detailed Proposal**

It is difficult to assess all the various allowance allocation options since reduction goals have not been clearly identified for the electric sector. Options that appear to present cost

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<sup>3</sup> [www.cbo.gov/ftpdocs/89xx/doc8934/summary.4.1.shtml](http://www.cbo.gov/ftpdocs/89xx/doc8934/summary.4.1.shtml)

effective methodologies under one set of assumptions may pen out quite differently under a different set of assumptions.

Further, the “devil” as they say “is in the detail.” None of the potential allocation options presented to date are fully defined. Any allocation method can be skewed if not properly couched.

Generally, however, if a market system is included as part of CARB’s AB 32 implementation program, Modesto ID believes that emission allowances should be allocated to regulated electric sector entities administratively based at least initially on historic emissions and accounting for all types of load growth. Modesto ID does not support auctions; however, if auctions are utilized the auction of allowances should be minimized and delayed until a robust market has matured. All proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency or direct rate relief. Any market system put in place must be closely monitored by a single, identifiable regulatory body to avoid manipulation, fraud and other abuses.<sup>4</sup>

Compliance with AB 32 should be achieved with the lowest possible impact on consumers and emission allowances will play a critical role in meeting this goal. Allocation of the value of allowances should be returned to retail service providers<sup>5</sup> for investment in measures that will reduce the emission reduction program costs ultimately to be borne by their consumers.

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<sup>4</sup> Modesto ID detailed its recommendations in a prior filing with CARB dated April 8, 2008. A copy of that submittal is attached to these comments for your convenience.

<sup>5</sup> The National Association of Regulatory Utility Commissioners (“NARUC”) has recently suggested that value from emission allowances only be assigned to “regulated” utilities. Modesto ID strongly disagrees. First, this is a false distinction. Publicly owned utilities are regulated. Just as the CPUC regulates investor owned utilities popularly elected or appointed governing boards regulate publicly owned utilities. Second, consumers served by publicly owned utilities are equally impacted by the cost of emission reduction programs as consumers served by investor owned utilities. To discriminate against and penalize publicly owned utility customers, and force them to bear an unfair and disproportionate burden for emission reductions constitutes an unlawful cost shift and is bad public policy.

If necessary, acceptable investments and expenditures for such value can be specified as part of CARB's program parameters. Included in any list of investment/expenditure options should be a process for reviewing and allowing additional innovations.

**B. Response to Staff Paper**

If a market system is included as an element of a broader emission reduction program, the design of such market must avoid shifting costs or transferring wealth among consumers of various utilities. Thus, any option that results in such shifting or transfer should be disregarded. The market design must protect electric consumers who will already be bearing a significant portion of the cost of emission reductions.

Allowances should be allocated to cover emitting resources. Thus, allocation should be to all retail providers commensurate with reduction obligations through an emission based methodology or, if a load based allocation is used, through a load based methodology applied only to and weighted for emitting resources. Many significant market problems may be avoided by not allocating allowances where they are not needed for compliance. Allowances that are in excess of the recipient's need should be returned for free to form a bank for use by those that need an interim loan of allowances. Charges for such allowance "loans" can also be used for emission reduction.

As noted above any market system must be phased in slowly and sufficient market protections in place before implementation. Participation in the market should be limited to regulated entities to avoid false pricing signals and other negative market impacts.

Auctions are included as a potential component in every program design proposed by staff. Modesto ID does not support the inclusion of auctions as part of the electric sector's inclusion in a cap and trade system. An auction component will create additional uncertainties which lead to reliability and cost impacts.

However, in the event auctions are implemented, all auction revenue must be dedicated to activities that result in reduced costs for consumers. These revenues can be used to defray the cost of achieving reductions, such as investments in obtaining renewable resources and developing new technology, as well as the cost of obtaining allowances. All these purposes can be most efficiently achieved through the retail provider. Thus, auction revenues should be retained in the electric sector and allocated to all retail providers based on historical emissions. Under no circumstances should auction proceeds be delivered to any general fund authority or otherwise exposed to potential diversion to any purposes other than defraying the cost of achieving AB 32's GHG reduction goals.

#### **IV. Flexible Compliance**

##### **A. Detailed Proposal**

It is premature to eliminate any flexible compliance options. There are numerous uncertainties associated with the design and implementation of any emission reduction program and flexible compliance tools such as offsets and banking are necessary to provide balance to fluctuating allowance prices. Ideally, an emission reduction obligation would be assigned to each regulated entity and that entity would be provided a wide variety of tools for meeting its obligation. Each entity would be given the discretion to apply the tools in accordance with established protocols to achieve the assigned obligation in the manner best suited to the entity's individual circumstances. Thus an emission "budget" is established and regulated entities are provided the flexibility to follow an adjustable "glide path" to meet that budget.

Maintaining a broad spectrum of flexible compliance options for sectors that are made or choose to bear a disproportionate burden for reduction is especially critical to successfully maintaining service obligations.

**C. Price Triggers and Other Safety Valves**

If an emission allowance market is implemented, caps on allowance prices, at least initially, will protect consumers and provide certainty that will encourage continued participation in the California electricity market.

**D. Linkage**

Any systems with which California trades, be it trading allowances or offsets or otherwise, must have established protocols commensurate with California standards.

**E. Compliance Periods**

Multi-year compliance periods are necessary to ensure normalization of water conditions and the availability of hydro resources, of weather, and of other fluctuating impacts. A minimum of three years is consistent with other market systems.

Updating the baseline for each compliance period will help account for growth issues and technological advances.

**F. Banking and Borrowing**

Again, Modesto ID urges the Joint Agencies not to eliminate any flexible compliance options before a more detailed scoping design has been developed.

**H. Offsets**

Modesto ID supports the Comments submitted by the California Municipal Utilities Association on the subject of offsets.<sup>6</sup>

Although a hybrid system provides the broadest coverage while maintaining quality control over the program, it is too early in the design process to determine whether and at what level a cap on offsets may be beneficial. Providing a broad base of offset options will help

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<sup>6</sup> Letter to Kevin Kennedy from Bruce McLaughlin dated April 18, 2008. A copy of the letter is attached to these Comments for your convenience.

control emission allowance prices absorbed by utility consumers. Thus, offsets from outside California, and potentially outside the U.S. should be considered to the extent they meet or are equivalent to California standards. Again, in setting its standards California must be aware of standards being developed on a regional, national and even international level to ensure the California program is able to interact with such broader programs.

An offset program must include protections against gaming and speculating by non-regulated entities.

#### **V. Treatment of CHP**

MID does not forecast CHP load in its service area at this time

#### **VI. Non Market Based Emission Reduction Measures (Other than CHP) and Emission Caps**

##### **A. Electricity Emission Reduction Measures**

The two main non-market reduction measures identified for the electricity sector are energy efficiency and renewable procurements. It is well recognized that emission reduction goals cannot be reached without these measures – the question is whether additional mandates must be imposed. Additional energy efficiency and renewable resources procurement mandates are unnecessary and would be counterproductive to the goals of AB 32.<sup>7</sup>

Utilities will look to energy efficiency and renewable resources by necessity to meet their emission reduction obligations. However, the optimal mix of resources and reduction measures to achieve emission goals may differ for each utility depending on size of load, location, nature of load, weather impacts, and other factors.

All energy efficiency and renewable procurement goals must be realistic and achievable without creating undue hardship on consumers.

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<sup>7</sup> See Comments of the Modesto Irrigation District on Interim Opinion on Greenhouse Gas Regulatory Strategies dated February 28, 2008.

Increasing renewable procurement goals may cause transmission and reliability issues for the State of California. In workshops held in September, 2007 the California Independent System Operator concluded that the current statewide renewable portfolio standard ("RPS") goal of twenty percent can be met without adverse transmission impacts; however, assuming a large portion of renewable energy would come from wind projects, an increase in the RPS target to thirty-three percent could adversely impact system reliability. Additional wind generation will likely require additional regulation capacity and supplemental energy resources due to intermittency and new transmission projects. Intermittent resources must be firmed or shaped by other available resources – load must be served even when the wind does not blow. These firming resources are generally fossil fuels. Additionally, unlike fossil fuels, most renewable resources cannot be shut down in times of higher than forecast generating conditions if load is low; thus, renewable resources may be forced to curtail operations in low load, heavy hydro conditions. Moreover, increased RPS mandates will put additional pressure on a renewables market where many utilities have already experienced difficulty in acquiring renewable resources and have already fallen behind their RPS targets.

The CEC staff addressed the issue of reasonableness of proposed energy efficiency targets for investor and publicly owned electric utilities in compliance with AB 2120 mandates at its September 17, 2007 workshop. The CEC developed recommended goals for each utility. These recommendations were based on technical, economical and feasible achievability of utility targets. Modesto ID's governing board has adopted the CEC recommended energy efficiency target of 140 GWh by 2020 as its long-term goal.

Previously the Joint Agencies adopted recommendations that CARB impose mandatory minimum energy efficiency and renewable portfolio levels and require publicly owned utilities

such as Modesto ID to comply with programs and goals adopted by the CPUC. As noted above and in previous filings by Modesto ID and others, special mandates for publicly owned utilities are improper. However, if new energy efficiency and renewable procurement standards are to be initiated, CARB must develop its own regulations through its own procedures and collaborative process. It cannot simply rubber stamp and impose CPUC mandates on publicly owned utilities. The CPUC cannot exert jurisdiction over publicly owned utilities through such a back door. Publicly owned utilities that will be impacted must be involved in developing the standards that will apply to them.

Additional mandated reduction measures incorporated into any AB 32 program design must set realistic and achievable goals based on current knowledge and availability. New measures should also be consistent with existing legislative structures.

**C. Annual Emission Caps for the Electricity and Natural Gas Sectors**

Sector and entity specific reduction goals need to be established before caps can be set and a program effectively designed to achieve such goals.

**VII. Modeling Issues**

**C. Results Reported by E3**

The modeling performed by E3 as presented at the May 6, 2008 workshop provides no guidance or insight for the majority of utilities that are in the aggregated groups. Although the model results may show “trends” and indicate “stressors” it cannot indicate impacts to individual utilities that are included into the northern or southern averages. The E3 model provides no way to determine various impacts on Modesto ID from any one of the various market designs tested.

**VIII. Conclusion**

Modesto ID is fully committed to reducing its emission levels and meeting the goals of AB 32. It has participated in the Joint Agencies and CARB AB 32 program scoping

proceedings. Modesto ID's total energy requirement for 2008 is forecasted to be approximately 2,770 GWh, representing almost one percent of overall California requirements, and 3.5 percent of load served by publicly owned utilities. Without additional increases created by the AB 32 program itself, Modesto ID anticipates that for the next ten years it will experience load growth of almost 2.8 percent annually, factoring in energy efficiency. Modesto ID's energy efficiency savings for 2008 are estimated to be 37 GWh in accordance with the targets adopted by Modesto ID's governing board as recommended by the CEC. Modesto ID's governing board has also adopted renewable targets in compliance with existing laws. Modesto ID forecasts that in 2008 approximately eleven to twelve percent of its sales will be met by renewable resources. Any program to meet AB 32 GHG emissions reduction goals must be designed to allow electric utilities, such as Modesto ID, to serve its existing and growing load reliably and economically. Consumers must be protected from unwarranted rate increases.

Respectfully Submitted,

/s/ Joy A. Warren

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## CERTIFICATE OF SERVICE

I, Linda Fischer, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On June 2, 2008, I served the attached:

### **COMMENTS OF THE MODESTO IRRIGATION DISTRICT ON EMISSION REDUCTION MEASURES, MODELING RESULTS, AND OTHER ISSUES**

on the service list for R.06-04-009 by serving a copy of each party by electronic mail, or by mailing a properly addressed copy by first-class mail with postage prepaid to each party unable to accept service by electronic mail.

Copies were also sent by first-class mail with postage prepaid to Commissioner Peevey and Administrative Law Judges Charlotte F. TerKeurst and Jonathan Lakritz.

A copy was also sent by first-class mail with postage prepaid to the California Energy Commission, Docket Office, MS-4, Re: Docket No. 07-OIIP-01, 1516 Ninth Street, Sacramento, CA 95814-5512.

Copies were also submitted by email to the CEC docket office at [docket@energy.state.ca.us](mailto:docket@energy.state.ca.us) and to project manager Karen Griffin at [kgriffin@energy.state.ca.us](mailto:kgriffin@energy.state.ca.us).

A copy of the service list is attached hereto.

Executed on June 2, 2008, at Modesto, California.

/s/ Linda K. Fischer  
Linda Fischer