

San Diego Gas & Electric Response to Questions Posed by ARB Regarding Allowance Allocation; AB 32 Technical Stakeholder Workshop, March 17, 2008

1. What method should we use to distribute the allowances?

It is generally recognized that a substantial portion of the costs associated with a mandatory GHG reduction program for the electric sector will ultimately be borne by the electric consumer. A substantial portion of allowances should therefore be allocated directly to Load Serving Entities (“LSEs” - either PUC-regulated, investor-owned or customer-owned utilities, or energy service providers) on behalf of their customers, who would then make them available to “first deliverers” or “first sellers” on a non-discriminatory basis, subject to regulatory oversight. Revenues from the sale of allowances would then be available to off-set the increased electricity prices consumers would otherwise see, directly through rate adjustments, or indirectly through investments in GHG reduction activities.

Allocating allowances directly to the LSE provides the most direct approach to protecting the electricity consumer. Allocating to LSEs will need to be structured in a manner that ensures: (1) LSE-allocated allowances will be sold within a specified time period on a non-discriminatory basis at competitive price levels; (2) allowance allocations to and sales by LSEs must not be used to provide competitive advantage to affiliated, or LSE-owned generation, or to interfere with the functioning of competitive markets; and (3) the management and sale of allowances must be done under oversight authority of the State and local boards of customer-owned utilities.

To the extent that some non-LSE entities would be adversely affected by the implementation of California’s GHG reduction program, the State should evaluate whether some allowances should be allocated to these entities as well.

2. How should allowance value be used? And, if the allowance value should be used to ease the costs of regulation for entities, who should receive them and how many allowances should each entity receive?

In the electric sector, allowance value should be used to achieve GHG reductions and ease the cost of regulation for consumers. Under the mechanism proposed above, retail providers can use the funds to promote energy efficiency, fund new renewable technology development, contract with or procure ownership interests in cleaner plants to replace aging facilities, and pay for operational changes that may reduce GHG. In addition, allowance value can be applied to offset potential increases in rates for utilities that have already undertaken significant actions and have the cost of those GHG reductions already embedded in rates.

For the electric sector, allowance distribution should be controlled by establishing a retail provider specific straight-line glide path beginning at 2012 output-based GHG emission levels (beginning expected GHG emissions from the electric sector divided by total

MWhs expected and multiplied by the entity's forecasted MWh) and ending at 2020 output-based target emission levels (2020 target GHG emissions from the electric sector divided by total MWhs expected and multiplied by the entity's expected MWh).

3. How should allowances be distributed to new entities and how should entities that cease operating in California be treated?

In the electric sector, if allowances are freely allocated to retail providers, the issue is simple to resolve – have allowances follow customers. If a new retail provider enters the market and secures 5 percent of the MWhs previously served by a utility, 5 percent of the utility's allocation would be transferred to the new retail provider. Conversely, if a retail provider exited the market with its customers returning to the utility, the retail provider's allocation would transfer to the utility.

This procedure is very simple to implement with an output-based allocation since there does not have to be any tracking of the emissions originally assigned to the customer group by the original retail provider. All retail providers would have the same GHG intensity (electric sector GHG emissions allocation divided by electric sector MWh). New first deliverers would be eligible to bid into the auction market along with existing first deliverers.

4. How should the methods of distributing allowances in a cap-and-trade program change in future years?

For the electric sector, based on the Sempra proposal, no change is needed in future years.