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VIA E-MAIL KMKENNED@ARB.CA.GOV AND CCPLAN@ARB.CA.GOV

Kevin Kennedy
Program Evaluation Branch
State of California, Air Resources Board
California Air Resources Board
Office of Climate Change
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Re: Sacramento Municipal Utility District's Comments on the Allocation of Allowances White Paper Presented for Discussion on March 17, 2008 and the Presentation on Scope and Coverage and Point of Regulation for a Potential Greenhouse gas Cap-and-Trade Program Presented on February 29, 2008

Dear Mr. Kennedy:

The Sacramento Municipal Utility District (SMUD) appreciates this opportunity to provide comments on California Air Resources Board (CARB) staff's Allocation of Allowances White Paper presented for discussion on March 17 ("White Paper") and CARB staff's presentation of scope and point of regulation from the February 29th meeting. As a founding member of The Climate Action Registry, SMUD supports California's efforts to reduce the carbon footprint of the state and specifically, the utility industry.

COMMENTS ON ALLOWANCE ALLOCATION

The following comments focus only on the treatment of the regulated utility industry and the unique cost and investment requirements of this industry.

SMUD is a publicly owned utility. There are no profits. All costs of providing electric service to SMUD's customers are born by those customers and all cost savings are used for the benefit of these customers. These customers are Californians who will have to bear the burden of climate change impacts if we fail to move quickly and deliberately to meet the challenges of reducing greenhouse gas emissions. SMUD presents these comments in the interest of making the most effective use of our customer dollars to fight climate change.

Reducing the amount of carbon in the electricity used by Californians and especially that electricity provided by a relatively low carbon utility like SMUD will require very large capital outlays. Markets are not a good way to drive the high-capital long-term infrastructure changes needed for the electric industry. The changes driven by the incremental marginal cost of purchasing an allowance will be insufficient to reach the goals for 2020 and beyond. As recognized by the California Energy Commission and the California Public Utilities Commission in Decision 08-03-018, the vast majority of the carbon reductions from the utility industry will come from expansion of energy efficiency and renewable generation. SMUD will need to invest in or contract for additional low carbon resources; provide backup and balancing generation to support further integration of intermittent resources, such as wind and solar; and build additional transmission to areas where renewable resources are available. These large investments in infrastructure will carry a significant price tag on the order of a hundred billion dollars for California's electricity sector. These infrastructure investments are critical to meeting the greenhouse gas reductions goals beyond 2020.

In addition to investing in low-carbon resources, SMUD is the entity that is in charge of providing sufficient and reliable electric service. Load Serving Entities (LSEs) will be the entities that are required to conduct short- and long-term planning which will include insuring that sufficient allowances are available to provide electric service to its customers within all parts of any compliance period. An LSE is able to review its resource needs, the carbon content of each resource option, and available allowances to find the best solution for reducing carbon while also reliably serving electrical load.

SMUD has two concerns about allowances. The first relates to potentially taking money away from investment in the infrastructure necessary to support a low carbon energy future for California by requiring the regulated utilities to purchase allowances in an auction. SMUD would like instead to use these funds for the large capital projects needed to create real reductions in carbon, to support further expansion of energy efficiency programs including low income energy efficiency programs, and to provide rate relief for those sectors of the population least able to absorb rate increases. SMUD would like to keep its ratepayers from paying for both the infrastructure investments to reduce carbon and the cost of allowances.

SMUD understands the concerns expressed by some regarding administrative allocation of allowances and the potential windfall profits that may be associated with an administrative allocation of allowances. SMUD is not looking for a profit. Instead, SMUD prefers to put the money that would have gone to an auction to pay for allowances into investments in direct carbon reductions and accommodations for low income ratepayers. SMUD would like to reduce the societal cost and the overall cost to California to reduce the amount of carbon in electricity by spending funds on direct emissions reductions rather than for allowances.

SMUD's second concern about markets relates to the potential volatility in the price of allowances. An auction market with carbon prices from $5 to $50 dollars a ton would present a difference in cost to SMUD annually of $15,000,000 to $150,000,000. Not only does this type of price swing present budget planning difficulties but it also presents a highly volatile revenue stream for funding real reductions in greenhouse gas. As we have seen in production tax credits for wind development, when the credit is available wind resources are developed. But when the credit is in question, development stops. The on again, off again nature of this credit has given inconsistent signals to development and has contributed to the delay or reduction in the amount of wind resources in operation. In SMUD's experience, a stable funding source is not only critical to developing resources but also to support high-quality energy efficiency programs. The benefits that funding certainty and consistency bring to the development and deployment of new technologies should not be overlooked.

While SMUD does not support an auction, SMUD does see the value of a secondary market wherein bilateral transactions between those who need credits would be helpful in smoothing out the lumpy nature of long lead time infrastructure improvements. A bulletin board type of secondary market would support market driven efficiencies at the margin and would provide an incentive for entities to install carbon reduction improvements sooner than needed.

If the State insists on the use of an action, it is imperative that the State take steps to ensure that the action does not become a profit center. The participants should be limited to those who actually need credits and their participation should be limited so that any entity cannot hoard allowances or corner the market, driving up prices and squeezing out smaller players.

For the regulated utility industry SMUD favors an administrative allocation of allowances to take advantage of the following benefits:

1. All funds are used for direct reductions, investments in energy efficiency and support for low income ratepayers;

2. The regulated nature of the industry could be structured to avoid the "windfall" profit concern; and

3. The LSE's with resource planning responsibility would be best able to select the most cost effective solution for balancing reliability, allowances over the life of the compliance period and direct investments in the infrastructure needed for direct greenhouse gas reductions.

OBSERVATIONS FROM THE WORKSHOPS

What we found most interesting in attending both the CARB workshop on March 17 and the workshop on February 29 was the general rejection by those entities that would be required to participate in using an auction to achieve emission reductions. Not only were the publicly owned utilities speaking out against auctions but representatives from other industries were requesting to be excluded from the cap-and-trade program and any auction. We found it very interesting to see Southern California Gas Company as represented by Sempra support a broad cap-and-trade and auction but not for the natural gas sector and instead favored a directive on energy efficiency. We also saw a representative from an oil company speak out against including transportation fuels in the cap-and-trade program and auction, and instead wanted to rely upon the low carbon fuel standard and the Pavley Bill requirements. We heard similar concerns from industrial representatives.

None of these entities expressed a lack of commitment to reducing carbon emissions, instead all parties wanted to avoid the potential costs and uncertainties associated with a market based compliance mechanism. SMUD recommends to CARB that it look long and hard at the "benefits" of auctions before putting the burdens on California business.

SMUD also notes that environmental groups and some others supported the cap-and-trade and auction method of meeting the requirements of AB 32. SMUD has reviewed recent comments entitled "Statement of Support for Auctioning All Allowances in Any Global Warming Cap-and-Trade Program" from some of these auction supporters. One concern expressed in the statement is a desire to "prevent the accumulation of billions of dollars in windfall profits by polluters". SMUD reiterates that with respect to the regulated utility industry, the people who will pay the costs of the auction are utility customers. Utility customers will bear the costs to reduce the carbon in the energy they use and to reduce the overall amount of energy used in California. Because utility rates are regulated, there should be no "windfall profit by polluters" if allowances are allocated to regulated entities, be they public or investor-owned.

SCOPE

Our general comment on scope is that it is poor policy to in fact give some sectors a pass from cap-and-trade while including others. We are concerned with giving natural gas and transportation a pass from a cap-and-trade system while including the electric sector. While the natural gas sector is asked to meet energy efficiency goals and the transportation sector is asked to produce low carbon fuel, the electric sector is asked to meet energy efficiency goals, meet renewable portfolio standard goals and participate in a cap-and-trade market with an auction. The discrepancy clearly signifies a belief that electric customers can and potentially should carry a great portion of the greenhouse gas reduction burden. SMUD questions this assumption and requests that all sectors be required to carry their fair share of the greenhouse gas reduction burden.

Very truly yours,

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cc: Bud Beebe
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