

**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMMENT ON
POLICY STATEMENT ON VOLUNTARY EARLY ACCESS TO REDUCE
GREENHOUSE GAS EMISSIONS**

February 19, 2008

To: Staff, California Air Resources Board

The Southern California Public Power Authority (“SCPPA”) hereby comments on the Staff’s draft Policy Statement on Voluntary Early Actions to Reduce Greenhouse Gas Emissions (“Draft Policy Statement”).

The purpose of the Draft Policy Statement is to recognize “emission reduction actions taken on a voluntary basis, while the program to implement AB 32 is being developed...” Draft Policy Statement at 1. The absence of such recognition “could penalize companies that have reduced emissions before the program is put into place, such as by requiring the same percentage of emission reductions for all companies regardless of what an individual company has done in the past to reduce its emissions.” *Ibid.* The Draft Policy Statement would direct Staff to develop a Scoping Plan and implementing regulations to:

- Encourage and reward voluntary reduction of greenhouse gas emissions;
- Ensure that companies are not disadvantaged because they have voluntarily reduced their greenhouse gas emissions; and
- Ensure that any credits or offsets provided for voluntary early actions are based on emission reductions that are real, permanent, quantifiable, verifiable, and enforceable.

Draft Policy Statement at 2.¹

¹ SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Pasadena, and Riverside.

SCPPA supports the Draft Policy Statement and urges the Air Resources Board (“ARB”) to adopt the Draft Policy Statement at its February 28-29 meeting. SCPPA members are aggressively pursuing GHG reduction measures now without waiting for the implementation of AB 32 regulations in 2012. SCPPA believes that appropriate recognition should be given to early actions that are being taken now without awaiting the implementation of AB 32 regulations.

SCPPA also supports the focus on emission reduction actions that are undertaken on a voluntary basis “while the program to implement AB 32 is being developed....” The implication is that the “early actions” that are to be recognized are actions undertaken between the enactment of AB 32 on January 1, 2007, and the date when regulations under AB 32 are to become effective, January 1, 2012. SCPPA has consistently supported recognition of early actions that are undertaken during the five year period 2007-2011 that leads up to the implementation of AB 32 regulations in 2012. For example, in its comments to the California Public Utilities Commission (“CPUC”) and the California Energy Commission (“CEC”) on the allocation of allowances, SCPPA supported an administrative allocation of emissions allowances that would be based on recent pre-AB 32 experienced emissions with the allocation of allowances decreasing with each successive compliance period as necessary to achieve AB 32 GHG reduction goals. *See* SCPPA Opening Comment on Allowance Allocation Issues at 2 (Oct.31, 2007) (Att. A); SCPPA Supplement to Opening Comment and Reply Comment on Allowance Allocation Issues at 9 (Nov. 14, 2007) (Att. B). An administrative allocation of allowances based upon recent pre-AB 32 emissions would result in full credit being given to GHG reduction measures that are undertaken during the period 2007-2012.

There is a clear logic to using January 1, 2007, as the starting date for recognizing “early actions” to reduce GHG emissions. First, entities that are likely to be subject to AB 32 regulation were clearly on notice as of that date about the GHG reduction goals of California. Thus, it is fair to use January 1, 2007, as the starting date for recognizing emission reduction measures by potentially affected entities in California.

Second, using January 1, 2007, as a starting date avoids contentious issues that may arise if an earlier date were selected. If an earlier date were selected, nuclear projects or large hydroelectric projects that were undertaken decades ago could potentially be claimed as being “early” GHG emission reduction measures. That would be inappropriate. Large nuclear projects such as Southern California Edison Company’s San Onofre Nuclear Generation Station or Pacific Gas & Electric Company’s Diablo Canyon Nuclear Generation Station were not undertaken to achieve greenhouse reduction measures. They were undertaken on the basis of other considerations which were primarily economic in nature. Likewise, large hydroelectric projects such as Hoover Dam or Shasta Dam were undertaken for reasons wholly unrelated to GHG emissions reduction. Selecting January 1, 2007, as a starting date for recognizing “early actions” would preclude the categorization of existing nuclear or large hydroelectric projects as being “early actions.”

No protocol for recognizing “early actions” should permit recognition of existing nuclear or large hydroelectric projects as constituting “emission reduction actions taken on a voluntary basis” to meet GHG reduction objectives. If any date earlier than January 1, 2007, were to be considered, there should be a specific provision that *precludes* existing nuclear projects or large hydroelectric projects from constituting “emissions reduction actions taken on a voluntary action” to meet GHG reduction goals.

Additionally, SCPPA supports the development of reporting protocols that would permit the quantification and certification of emissions reduction actions taken between 2007 and 2012 so that emission reductions that are accomplished during that period can be properly tracked and credited as deemed appropriate under the Scoping Plan.

SCPPA appreciates this opportunity to comment on the Staff's policy statement.

Respectfully submitted,

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Dated: January 19, 2008

ATTACHMENT A

SCPPA Opening Comment on Allowance Allocation Issues
(October 31, 2007)

**BEFORE THE PUBLIC UTILITIES COMMISSION
AND THE ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emission Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

Order Instituting Informational Proceeding – AB 32.

CEC Docket No. 07-OIIP-01

**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
OPENING COMMENT
ON ALLOWANCE ALLOCATION ISSUES**

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**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
OPENING COMMENT
ON ALLOWANCE ALLOCATION ISSUES**

In accordance with the October 15, 2007 Administrative Law Judge’s Ruling requesting comments and noticing workshop on greenhouse gas (“GHG”) allowance allocation issues (“Ruling”) in the captioned proceedings, the Southern California Public Power Authority (“SCPPA”) respectfully submits this comment. In accordance with the Ruling, this comment is being submitted simultaneously to both the California Public Utilities Commission (“CPUC”) and the California Energy Commission (“CEC”) (jointly, “Commissions”).

I. OVERVIEW: THE COMMISSIONS SHOULD ADOPT A REGULATORY APPROACH THAT FULLY ACCOMPLISHES THE GREENHOUSE GAS REDUCTION GOALS OF AB 32 WHILE MINIMIZING COSTS TO CALIFORNIA ELECTRICITY CONSUMERS.

The Ruling raises a series of questions about what the Ruling describes as being “two basic options... for distribution of emission allowances.” Ruling at 4. According to the Ruling, those two options are (1) auctioning allowances or (2) allocating allowances administratively.

The Ruling observes that there may be a third option consisting of a combination of auction and administrative allocation. *Ibid.* The options should be evaluated to determine which of the options would best serve to achieve fully the greenhouse gas (“GHG”) reduction goal of AB 32, while simultaneously minimizing the costs of the GHG reduction program for California’s electricity consumers.

As seen from the discussion below, the approach that would best serve to achieve the GHG reduction goal of AB 32 while minimizing costs for California electricity consumers would be to administratively allocate emission allowances to regulated retail providers as the points of regulation for the benefit of the retail providers’ customers with the allocation being based on recent pre-AB 32 experienced emissions and with the allocation of allowances decreasing with each successive compliance period as necessary to achieve the AB 32 GHG reduction goal for 2020. This program would faithfully implement AB 32, would be consistent with the precedent of existing air quality programs in California, and would build upon the foundation for a California GHG regulatory program that was laid by the CPUC in Decision (“D.”) 06-02-032 (Feb.16, 2006).

II. BACKGROUND: THE OPTIONS SHOULD BE EVALUATED IN LIGHT OF THE MOST PROMISING REGULATORY STRUCTURE FOR REGULATING ELECTRIC SECTOR EMISSIONS.

The options for allocating emission allowances should be considered in light of the most promising regulatory structure for regulating electric sector GHG emissions.

A. Possible Regulatory Structures Regulating Electric Sector GHG Emissions.

Four models for regulating GHG emissions from the electric sector are (1) California’s extensive experience in regulating “criteria” pollutants under the Clean Air Act, (2) regulation of retail providers as originally proposed by the CPUC in Decision (“D.”) 06-02-032 (Feb.16, 2006) and as subsequently refined, (3) regulation of electricity generators as “sources” of GHG

emissions as undertaken by the Regional Greenhouse Gas Initiative (“RGGI”) in certain northeastern states, and (4) regulation of “first-sellers” as recommended by the Market Advisory Committee (“MAC”) in its June 30, 2007 Recommendations to the California Air Resources Board (“CARB”).

1. **Regulation of Criteria Pollutants Under the Clean Air Act.**

California has extensive experience with air quality regulation under the Clean Air Act. CARB is the lead state agency charged with regulating sources of air pollution. However, responsibility over air pollution matters is shared between the CARB and local and regional districts.¹ Given the geographical and meteorological diversity of California, regulation of “criteria” pollutants under the Clear Air Act is tailored to specific regions. One of CARB’s key functions is to divide California into air basins and to adopt an ambient air quality standards for each basin. Cal. H & S Code § 39606(b).

Each air district that has been designated as a “non-attainment” area for various ambient air quality standards must develop a district plan for attaining and maintaining the state standards for the pollutants. Cal. H & S Code § 40911(a). The objective of each districts’ plan is to achieve a reduction in district-wide emissions of five percent for each non-attainment pollutant

¹ Local air districts include 20 county Air Pollution Control Districts (“APCDs”), three unified APCDs and 12 Air Quality Management Districts (“AQMDs”). The unified APCDs are the Great Basin APCD, comprising Alpine, Inyo and Mono Counties; the Monterey Bay Unified APCD, comprising Monterey, San Benito and Santa Cruz Counties; and the San Joaquin Valley Unified APCD, comprising Fresno, Kings, Madera, Merced, San Joaquin, Stanislaus, Tulare, and the western portion of Kern Counties. The AQMDs are the Bay Area AQMD, comprising all or part of nine counties in the San Francisco Bay area; the South Coast AQMD. Comprising all or part of Los Angeles, Orange, Riverside and San Bernardino Counties. The Sacramento Metro AQMD; the Feather River AQMD, comprising Yuba and Sutter Counties; the Lake County AQMD; the North Coast Unified AQMD, comprising Humboldt, Del Norte and Trinity Counties; the Northern Sierra AQMD, comprising Plumas, Sierra and Nevada Counties; the Mojave Desert AQMD, comprising the northern portion of San Bernardino County and eastern portion of Riverside County; the Butte County AQMD; the Mendocino County AQMD; the Shasta County AQMD; and the Yolo-Solano AQMD, comprising Yolo County and the eastern portion of Solano County. Although formally denominated a “county” APCD, the Antelope Valley APCD (established as of July 1, 1997) is actually a hybrid air district, encompassing portions of Los Angeles County as well as Kern and San Bernardino Counties. H&S Code §40106.

average over every consecutive three year period. Cal. H & S Code § 40914. The districts were required to incorporate measures sufficient to reduce overall population exposure to ambient pollutant levels in excess of the State Ambient Air Quality Standards by at least 25 percent by the end of 1994, 40 percent by the end of 1997, and 50 percent by the end of the year 2000, using the average level of exposure experienced during 1986 through 1988 as the baseline. Cal. H & S Code § 40920(c).

An air district may adopt a market-based incentive program for emissions reductions as an element of its plan for attainment of state or federal ambient air quality standards. In October 1993, the South Coast Air Quality Management District (“SCAQMD”) adopted the Regional Clean Air Incentives Market (“RECLAIM”) Program. SCAQMD Regulation XX. RECLAIM applies to approximately 400 southern California sources. RECLAIM is designed so that emissions of NO_x and SO_x will be reduced to the level which is required by the Clean Air Act. The SCAQMD grants each RECLAIM facility an annual emissions allocation or “cap” based on historical emissions between 1989 and 1992. SCAQMD Rule 2002. The facility must then reduce emissions between 1994 and 2010, inclusive, pursuant to a formula set forth in the RECLAIM regulation. *Ibid.*

2. The CPUC’s Proposal in D.06-02-032 to Regulate Retail Providers.

The CPUC proposed a GHG emission regulatory program for the electric load serving entities (“LSEs”) that are subject to the CPUC’s jurisdiction in D.06-02-032 (Feb. 16, 2006). Implementation of the program became the subject of the instant proceeding in Order Instituting Rulemaking (“OIR”) 06-04-009 (Apr. 13, 2006). The CPUC’s program was revised to accommodate the passage of AB 32 in 2006 by Assigned Commissioner’s Ruling and Phase II Scoping Memo (“Scoping Memo”) dated February 2, 2007. However, the broad outline of the CPUC’s contemplated program has remained fundamentally constant.

In many regards, the CPUC's program reflects features of California regulatory program under the Clean Air Act. One significant difference is that for jurisdictional reasons the CPUC's program focuses on retail providers of electricity rather than sources of emissions as the point of regulation: "Under a load-based cap, the LSEs would be subject to a GHG emissions cap for all resources procured to serve their load, no matter from what source, including imports." D.06-02-032 at 17. Although the CPUC's proposal originally covered only retail providers that are subject to the CPUC's jurisdiction, the Scoping Memo expanded the program to cover all California retail providers insofar as CARB would ultimately be the jurisdictional agency. Scoping Memo at 8-9.

The CPUC's "preference is to administratively allocate... allowances, rather than auction them." D.06-02-032 at 3. One reason is that "an auction with so few buyers... would be economically inefficient and prone to market power abuses." D.06-02-032 at 42. "Allocation, rather than auction, also avoids a need for the Commission to undertake the set-up of an auction structured rule." *Ibid.*

Given the precedent of Clean Air Act regulation, an obvious basis for allocating allowances among retail providers would be historical emissions. Consistent with that precedent, the CPUC would "develop current GHG emissions levels for each entity by examining individual entities' recent historical emissions profiles." Scoping Memo at 16. These "current emissions levels will be considered, along with other factors, in establishing each entities' allowable GHG emissions going forward." *Ibid.*

Insofar as the point of regulation would be retail providers under the CPUC's program, the recent historical emissions that would be the basis for the administrative allocation of allowances would include both emissions from a retail provider's owned generation and

emissions associated with purchased power. Thus, all emissions associated with service to the retail provider's load would be taken into account. A fully resourced retail provider like the Los Angeles Department of Water and Power ("LADWP") and a retail provider that relies more heavily on purchased power like Southern California Edison Company ("SCE") would be treated even-handedly.

As under the Clean Air Act, allocated allowances would decrease over time as each retail provider is required to reduce GHG emissions to move toward its assigned 2020 GHG reduction target. Those targets will now be established by CARB rather than by being based upon the individual entities' 1990 emissions level as originally envisioned by the CPUC in D.06-02-032.

Ibid.

"[S]ome form of penalty structure is necessary or else a program will only be a voluntary one." D.06-02-032 at 47. However, as under the Clean Air Act, some incentives might be made available. Allowances would be stated in the form of "tons of carbon-dioxide equivalent." *Ibid.* at 2. As a result, if retail providers accomplish greater GHG emission reductions through "superior performance," the allowances would be tradable so that retail providers "could sell outside of California to the benefit of their shareholders." *Ibid.* at 3. Allowance trading as well as other market-oriented "flexible compliance mechanisms" were left to be determined later in this proceeding. Scoping Memo at 16.

3. **Regulatory Programs in Which Generators as "Sources" of GHG Emissions are the Point of Regulation.**

A third of potential GHG regulatory program is one in which sources of GHG emissions would be the point of regulation as under the program developed for the northeastern states that participate in RGGI. However, a problem with a "source-based" program is that it would fail to reach out-of-state electric sector emissions. The MAC observed:

The Committee considered and rejected a pure generator-based approach in which emissions from California generators are capped but emissions associated with out-of-state generation are not. Such an approach would not deal with leakage and would be inconsistent with the Global Warming Solution Act, which aims to reduce emissions associated with the state's consumption (not just generation) of electricity.

MAC Recommendations at 42 (footnote omitted).

4. Regulatory Programs with “First-Sellers” as a Point of Regulation.

Given the problem with a purely source-based program, the MAC proposed that California adopt a “first-seller” approach which “places a legal obligation for compliance on the first seller of power into California electricity markets.” *Ibid.* The MAC explained:

Under the first-seller approach, the responsible entity or point of regulation is either the owner or operator of the California power plant, or the importing contractual party, depending whether the electricity involves in-state or out-of-state generation. The importing contractual party could be any wholesale power marketer (it need not be an LSE).

Ibid.

B. SCPPA Recommends that the Commissions Reject and No Longer Give Consideration to GHG Regulatory Programs in Which “Sources” or “First-Sellers” Would Be the Point of Regulation.

SCPPA recommends that the Commissions reject and no longer give any consideration to electric sector GHG regulatory programs in which either “sources” or “first-sellers” would be the point of regulation. California does not have jurisdiction to compose a regulatory program on out-of-state generators. Thus, a source-based program would not reach emissions associated with out-of-state generation which delivers electricity to California. Under AB 32, however, the GHG regulatory program that is ultimately to be adopted by CARB for California must address all emissions associated with “generation of electricity delivered to and consumed in California... whether the electricity is generated in state or imported.” Cal. H & S Code

§38505(m). Thus, a program in which generators or “sources” are the point of regulation would not be lawful under AB 32 insofar as the reach of the program would be insufficient.

Likewise, a program in which “first-sellers” are the point of regulation would not be lawful. Insofar as such a program would reach out-of-state generators by regulating wholesale for resale deliveries at the point of delivery into California, a first-seller program would be preempted by the Federal Energy Regulatory Commission’s exclusive jurisdiction over wholesale sales in interstate commerce under the Federal Power Act. *See* SCPPA Reply to Comments on Market Advisory Committee Report, R.06-04-009 (August 15, 2007). Thus, neither a “source-based” program nor a “first-seller” program should not be given further consideration by the Commissions or CARB for the electric sector.

For the reasons presented by the CPUC itself in D.06-02-032, OIR 04-06-009, and in the Scoping Memo, SCPPA recommends that the Commissions continue to pursue and develop the retail provider regulatory program as originally envisioned by the CPUC with the modifications that were recognized in the Scoping Memo as being necessary to accommodate the passage of AB 32. The CPUC’s program is consistent with California’s existing air quality programs, although the CPUC’s program would focus on retail providers instead of sources so as to accommodate the requirement that emissions associated with out-of-state generation be reached as well as emissions from in-state regulation. Cal. H & S Code §38505(m).

C. Regional Implementation of the AB 32 Program Should Be Evaluated.

Given California’s success with regionalized air quality regulation under the Clean Air Act, consideration should be given to implementing the AB 32 program on a regional basis, although not with as much localization as under the Clean Air Act. California is diverse in geography and air quality. California is also diverse in patterns of GHG emissions. Northern California enjoys the benefit of greater precipitation than southern California. As a result,

hydroelectric generation is a substantial component of the resource mix of northern California retail providers of electricity. Southern California has much less precipitation. Although some hydroelectric generation such as SCE's "Big Creek" complex or LADWP's Castaic storage project is available to southern California retail providers, much less hydroelectric generation is available for southern California retail providers as a percentage of available generation. As a result, southern California retail providers are heavily dependent on fossil fuels. Currently, 76 percent of SCPPA members' resources are carbon-based: 47 percent coal and 29 percent gas.

SCPPA suspects that there are other substantial differences between northern California and southern California beyond GHG emissions associated with serving electrical load that are relevant to designing a GHG regulatory program. Percentage emissions from agriculture, forestry, and landfills are likely to be very different between northern California and southern California. Similarly, the percentage contribution of the transportation sector to overall GHG emissions is likely to differ between southern California and northern California.

Given the diversity between northern California and southern California in factors that are relevant to a GHG regulatory program, SCPPA recommends that the Commissions and CARB consider developing separate 1990 baselines for southern California and northern California. The development of two baselines would be consistent with AB 32. The sum of the two regional baselines would be equal to the statewide baseline. Thus, attaining the two regional GHG emission baselines would result in attainment of the statewide 1990 emission baseline

Developing two 1990 baselines would permit each of California's two major regions to develop its own inter-sector allocation responsibility for meeting the 1990 baseline emission target by 2020. It would also result, most likely, in different intra-sector allocations of GHG

reduction responsibility. The differing allocations would be consistent with the geographic, meteorological, and economic differences between the regions.

III. SCPPA RESPONSES TO SPECIFIC QUESTIONS RAISED IN THE RULING.

In this section of this Comment, SCPPA responds to the 28 questions raised in the Ruling in the order in which the questions were posed.

A. Evaluation Criteria (Question 1).

QUESTION NO. 1: *Please comment on each of the criteria listed by the MAC:*

- a. Reduces the cost of the program to consumers, especially low-income consumers,*
- b. Avoids windfall profits where such profits could occur,*
- c. Promotes investment in low-GHG technologies and fuels (including energy efficiency),*
- d. Advances the state's broader environmental goals by ensuring that environmental benefits accrue to overburdened communities,*
- e. Mitigates economic dislocation caused by competition from firms in uncapped jurisdictions,*
- f. Avoids perverse incentives that discourage or penalize investments in low-GHG technologies and fuels (including energy efficiency),*
- g. Provides transition assistance to displaced workers, and*
- h. Helps to ensure market liquidity.*

Are these criteria consistent with AB 32? Should other criteria be added, such as criteria specific to the electricity and/or natural gas sectors? In making trade-offs among the criteria, which criteria should receive the most weight and which the least weight?

The MAC recommended that California distribute allowances in accordance with the objectives *a* through *h* as listed in Question No. 1. MAC Recommendations at 55. Although the objectives are generally meritorious, the primary objective of the GHG allowance allocation protocol should be to achieve AB 32 GHG reduction goals *while simultaneously minimizing the cost to consumers*.

Under AB 32, the GHG Reduction Goal Is to Be Met While Minimizing Costs.

While AB 32 mandates a reduction in California’s GHG emissions to 1990 levels by 2020, AB 32 also requires that the reductions shall be “implemented in an *efficient and cost-effective* manner.” Cal. H & S Code § 38561 (a) (emphasis added). AB 32 requires CARB to adopt GHG “emission reduction measures by regulation to achieve the maximum technologically feasible and *cost-effective* reductions in greenhouse gas emissions....” Cal. H & S Code § 38562 (a) (emphasis added). CARB shall “[d]esign the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to *minimize costs* and maximize the total benefits to California....” Cal. H&S Code § 38562 (b) (1) (emphasis added). Thus, the Legislature clearly and unequivocally expressed its intent in AB 32 that while the GHG reduction goal is to be met, the goal shall be met in such a way to minimize costs to the consumer.

The MAC Disagreed with the Legislature’s Cost Minimization Objective.

The MAC disagreed with the Legislature. In the MAC’s view, “lower retail electricity rates ... have a downside.” MAC Recommendations at 47. The MAC was concerned, for example, about regulators preventing regulated LSEs from passing “through the opportunity cost of [administratively allocated] allowances” because that “implies even lower electricity prices and thereby widens the gap between electricity prices and social cost.” *Id.* Restraining

electricity rates would “mute price signals.” The MAC opposed measures that would “mute price signals.” If any such measures were undertaken, they should be, at most, temporary:

While the Market Advisory Committee acknowledges that choices concerning the price structure for electricity are largely political in nature, we recommend that any decision to cushion the price impact of carbon constraints on consumers should focus on promoting energy efficiency and other measures that reduce energy costs but do not mute price signals, and should focus particular attention on low-income customers. Broader, direct mitigation should be temporary in nature, and designed to ease the transition to an economy where all actors face electricity prices representing the full cost to society associated with the generation and transmission of electricity.

Id. In the MAC’s view, “[u]nder a cap-and-trade program for GHG emissions, the cost to the LSE of electricity goes up,” and that would be a positive development: “This increase in cost gives the LSE an even stronger incentive to promote end-use efficiency among its customers.”

Id. at 50. Given their interest in not “muting price signals,” some of the MAC members “favor a 100 percent auction from the outset. Other Committee members favor a mixed approach with some free allocation initially, transitioning to a full auction over time.” *Id.* at 60.

The AB 32 Program Should Reduce GHG Emissions While Minimizing Costs.

In implementing AB 32, the Commissions and CARB should focus on the Legislature’s intent to achieve GHG reduction goals while restraining electricity prices and reject the MAC’s approach. Achieving GHG reduction goals while restraining electricity prices is especially important when social equity is considered. To the extent to which attaining GHG reduction goals increases prices for products such as electricity on consumers, the price increases will tend to be regressive. Poor households will bear a larger burden relative to the incomes of wealthier households. The Congressional Budget Office recently explained the regressive effect of the higher electricity prices that were touted by the MAC:

Researchers conclude that much or all of the allowance cost would be passed on to consumers in the form of higher prices. Those price increases would disproportionately affect people at the bottom of the income scale. For example, the Congressional Budget Office (CBO) estimated that the price rises resulting from a 15 percent cut in CO₂ emissions would cost the average household in the lowest one-fifth (quintile) of the income distribution about 3.3 percent of its average income. By comparison, a household in the top quintile would pay about 1.7 percent of its average income (*see* Table 1). That regressivity occurs because lower-income households tend to spend a larger fraction of their income than wealthier households do and because energy products account for a bigger share of their spending.

Tradeoffs in Allocating Allowances for CO₂ Emissions, Economic and Budget Brief at 3, Congressional Budget Office (April 25, 2007) (footnotes omitted). An administrative allocation of allowances to regulated retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would best meet the Legislature's AB 32 goal of meeting GHG reduction goals while minimizing regressive rate increases. If there is an administrative allocation of allowances to regulated retail providers, the regulatory authorities can take measures to ensure that the value of the allowances will flow through to ratepayers *Ibid.* at 5.

An administrative allocation of allowances to retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would also best serve to meet the objectives *a* through *h* as identified by the MAC and listed by the Commissions in Question 1, as shown by the following evaluation of those criteria:

a. Reduces the cost of the program to consumers, especially low-income consumers:

An administrative allocation of allowances to retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would best accomplish the goal of reducing the cost of the GHG regulatory program to consumers, including

the low-income consumers who would be hit the hardest by unnecessarily increased electricity prices. Each retail providers' consumers will be required to bear increased costs of expanding energy efficiency programs and restructuring generation portfolios to replace high GHG emission resources with less carboniferous resources. However, an administrative allocation of allowances would avoid requiring consumers to bear the *additional* costs of paying for allowances. The regulators of the retail providers will be well positioned to ensure that the full benefit of administratively allocated allowances will be passed through to consumers and not siphoned off by shareholders.

By contrast, an auction would serve the MAC's objective of "sending a price signal" to consumers. However, as discussed above, the Legislature clearly embraced the principle that AB 32 GHG reduction goals should be met while *minimizing* the cost to the program to consumers, not maximizing costs. *See also* SCPPA's response to Question No. 2 below.

The burden of meeting AB 32 goals is going to be substantial enough without also requiring consumers to bear the additional cost of auctioned allowances. SCPPA members, in particular, have borne substantial costs and are going to be required to bear vastly more costs to enhance their energy efficiency and load-GHG resource portfolios to meet AB 32 goals. As a result of geographical and historical circumstances, SCPPA and its members are encumbered by electrical generation resources that are heavily carbon-based.

Reliance by SCPPA members on coal resources, primarily the Intermountain Power Project in Utah and the San Juan Project in New Mexico, is a legacy of the 1970s. In 1978, Congress adopted the Powerplant and Industrial Fuel Use Act ("PIFUA"). This Act prohibited development of new gas-fired baseload resources. The national policy was to encourage the use of coal, a domestic resource. When confronted by the need to add capacity, state and public

resistance to developing nuclear facilities, and the unavailability of hydroelectric options in the region, SCPA and its members resorted to coal-fired facilities located in nearby western states, consistent with PIFUA and national policy. The addition of the coal-based resources was driven by a combination of legal, geographical, and economic circumstances. The global warming consequences of such resources were not understood at the time.

The shift from carbon-based generation to non-carbon resources is going to take time and is going to be costly. The SCPA members have already spent nearly \$800 million from 1997 through 2006 on public benefits programs, with the highest percentage (34 percent or \$262 million) being spent on energy efficiency. The cost of new and expanded end-use efficiency programs is going to be even more substantial in the future.

In addition to vigorously pursuing energy efficiency and demand reduction measures, the SCPA members are aggressively adding renewable resources. SCPA is also undertaking substantial transmission projects in order to bring renewable energy to load centers in southern California. These initiatives are going to be very expensive.

It would be punitive to require SCPA and its members to bear *both* the massive cost of shifting from their historical reliance carboniferous resources *and* the cost of acquiring allowances through an auction. Conservatively assuming an annual cost of \$25 CO₂/ton, SCPA members would have to expend nearly \$600 million annually to buy emission allowances. The cost of emission allowances would increase electricity rates and consumer bills substantially. The allowance-driven rate increases would be *additional* to the rate increases that will be needed to pay for new and expanded energy efficiency programs, new low carbon and non-carboniferous resources, and associated transmission capacity that will be needed for the SCPA members to meet GHG reduction goals.

The consequence of requiring the SCPA communities to spend hundreds of millions of dollars for auctioned allowances would result in a wealth transfer from the SCPA communities to others in the state. An administrative allocation of allowances to retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would ensure that retail providers and their consumers that will be challenged to meet AB 32 goals will be able to concentrate their resources on producing greenhouse gas emissions without *also* cross subsidizing other retail providers and their consumers.

Avoiding wealth transfers from communities that are most challenged to reduce their reliance on carboniferous resources would accomplish the Legislature's goal of minimizing the cost of the GHG reduction program, especially the low-income consumers who would be most affected by regressive increases in electricity prices, while accomplishing GHG reduction goals.

b. Avoids windfall profits where such profits could occur:

Administratively allocating allowances to regulated retail providers for the benefit of their consumers with the retail providers being the point of regulation and the allocation being based on pre-AB 32 experience would avoid windfall profits. By contrast, an administrative allocation to electric generators would be likely to yield windfall profits: "When allowances are given out for free to generators, generators capture these rents." MAC Recommendations at 48. Likewise, an administrative allocation on the basis of retail sales for a statewide "benchmark" for GHG emissions per kilowatt hour produced or sold would produce windfalls for entities that are allocated allowances in excess of their actual need for the allowances.

Although an auction or carbon tax would not produce windfall profits, an auction or carbon tax would be likely to produce economic hardship for consumers, particularly low income consumers, by forcing them to bear *both* the cost of enhanced energy efficiency programs and generation portfolio restructuring *and* the cost of paying for allowances to cover their retail

providers' GHG emissions. The largest member of SCPPA, LADWP, has the highest percentage of low-income households of any major utility in California.

c. Promotes investment in low-GHG technologies and fuels (including energy efficiency:

Either an auction approach *or* an administrative allocation of allowances on the basis of recent pre-AB 32 experience emissions would be likely to produce aggressive investment in low-GHG technologies and fuels. Under either approach there will be a ratcheting down of available allowances as California progresses toward 2020 and the achievement of AB 32 GHG reduction goals. Thus, retail providers will receive progressively fewer allowances than they may need, prompting them to invest in low-GHG technologies and fuels.

By contrast, an administrative allocation on the basis of population, retail sales, or a statewide “benchmark” stated in pounds of GHG emissions per kilowatt hour would result in some utilities losing interest in investment in load-GHG technologies. For example, utilities that due to their geographic circumstances have access to substantial large hydroelectric generation resources would be likely to need far fewer allowances than they would receive if the allowances were allocated on the basis of service territory population, retail sales, or a “benchmark.” Absent other programs such as renewable portfolio standard (“RPS”) programs, they would not have an incentive to invest in low-GHG technologies except to the extent to which there would be an opportunity cost associated with achieving further GHG reductions so as to result in even more excessive allocations of allowances to the load-GHG retail providers. Thus, from the standpoint of promoting investment in load-GHG technologies, the least effective programs would be those that would provide for an administrative allocation of allowances with allowances being allocated on the basis of population, retail sales, or benchmarks.

d. Advances the state’s broader environmental goals by ensuring that environmental benefits accrue to overburdened communities:

An administrative allocation of allowances to regulated retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would benefit overburdened communities. The communities that will be likely to be most heavily burdened by AB 32 requirements are those such as the SCPPA members that have a higher carbon footprint.

For example, assume two utilities, one that is completely dependent upon coal-fired resources with the other being dependent upon half gas resources and half hydroelectric resources. The first utility would have a carbon footprint of, perhaps, 2,000 lbs. per megawatt hour, while the second would have a carbon footprint more in the range of 500 lbs. per megawatt hour. If both are required to make a 25 percent reduction in their GHG emissions, the first would be required to achieve 500 lbs. per megawatt hour in reductions, but the second one would need to achieve only 125 lbs per megawatt hour in reductions. Thus, the utility with the higher carbon footprint would bear the largest burden of achieving GHG reductions, even assuming an administrative allocation of allowances on the basis of recent pre-AB 32 experienced emissions.

An administrative allocation of allowances will ensure that the heavily burdened community that is investing in reducing its emissions will not additionally be required to bear the cost of purchasing allowances from, for example, a hydro-rich utility with the revenues being transferred elsewhere. By contrast, if allowances were to be allocated administratively on the basis of retail sales, population, “benchmarking” or an auction, there would be likely to be a wealth transfer away from overburdened communities.

e. Mitigates economic dislocation caused by competition from firms in uncapped jurisdiction:

An administrative allocation of allowances to regulated retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience would best mitigate economic dislocation cost by competition from firms in uncapped jurisdictions. To the extent to which allowances are auctioned or are administratively allocated on the basis of sales, population, or “benchmarking,” retail providers that have the largest carbon footprint would be required to bear the substantial cost of reducing their GHG emissions while simultaneously bearing the cost of allowances and the burden of a consequential transfer of wealth to other retail providers. The rate increases that will be caused by the need to reduce GHG emissions while simultaneously buying allowances will be the greatest, and those communities will be the most exposed to injurious competition from firms and uncapped jurisdictions. Accordingly, the best way to mitigate economic harm caused by competition from firms in uncapped jurisdictions is *not* to require retail providers to bear both the cost of GHG reduction efforts and the cost of buying allowances.

f. Avoids perverse incentives that discourage or penalize investments in low-GHG technologies and fuels (including energy efficiency):

Any allocation methodology that is based on any measure other than emissions will be likely to create perverse incentives. For example, if a more carbon intensive retail provider were required to both invest in enhanced energy efficiency programs and restructuring its high-GHG emission portfolio *and* buy allowances, the rate impact on the retail providers’ consumers could be so great as to cause a rate-pressured retail provider to actually defer renewable acquisition. An administrative allocation of allowances on the basis of recent pre-AB 32 emissions would result in the retail provider not having to bear allowances so as to focus resources entirely on

investments in low-GHG technologies, including energy efficiency, thereby encouraging such investments instead of diverting resources away from the investments.

g. Provides transition assistance to displaced workers:

None of the emission allowance allocation proposals, in itself, provides for transition assistance to displaced workers. It certainly should not be assumed that if there were an auction there would be a generation of fees that would then go to transition assistance for displaced workers. There would be many other demands for the available funds.

The only provision in AB 32 that addresses the disposition of revenues in any way provides: “The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division.” Cal. H & S Code §38597. It appears that this provision addresses fees rather than auction proceeds. Indeed, as discussed below, there is no provision anywhere in AB 32 that provides for auctioning allowances. In any event, under Section 38597, it would be up to the Legislature to decide how revenues are to be allocated. It is unclear that the Legislature would determine that revenues should be dedicated to assistance to displaced workers. Further, it is unclear that transition assistance to displaced workers would be consistent with using funds for “purposes of carrying out this division,” namely, the California Global Warming Solutions Act of 2006, AB 32.

h. Helps to ensure market liquidity:

An allocation of allowances through an auction would be the most likely to jeopardize liquidity of any market for allowances. If entities that have no need to obtain allowances other than to remarket them are permitted to participate in the auction, such entities may participate and then hoard allowances, jeopardizing market liquidity and increasing allowance prices. That is only the most obvious form of potential market abuse that could arise under an auctioning

program. By contrast, an administrative allocation of allowances to regulated retail providers for the benefit of their consumers with the allocation being based on pre-AB 32 experience would ensure that allowances go to entities that need the allowances. That would reduce the potential for entities that do not need the allowances to hoard allowances so as to distort market prices.

Thus, in order to assure that the twin objectives of achieving GHG reduction goals while simultaneously minimizing costs is achieved, it is imperative that allowances be administratively allocated to retail providers for the benefit of their consumers with the allocation being based on recent pre-AB 32 experience.

B. Basic Options (Questions 2 through 4).

QUESTION NO. 2: *Broadly speaking, should emission allowances be auctioned or allocated administratively, or some combination?*

Emission Allowances Should Be Administratively Allocated.

Emission allowances should be administratively allocated in order to accomplish the objective of achieving AB 32 GHG reduction goals while *minimizing* the cost to consumers, consistent with the intent of the Legislature. In order to be sure that the shareholders of recipients of administratively allocated allowances do not reap windfall profits, the allowances should be administratively allocated exclusively to retail providers that are subject to regulatory authorities, as proposed by the CPUC in D.06-01-032. That would assure that the benefits of administrative allowance allocation are passed through to consumers and not diverted to shareholders.

Emission Allowances Should Not Be Auctioned in the Electric Sector.

Emission allowances should *not* be auctioned in the electric sector. AB 32 does not authorize the allocation of allowances through auctions. The clear implication of various passages in AB 32 is that there should *not* be an allocation of allowances through an auction. As

discussed above, the Legislature intended that the GHG regulatory program should be aimed at achieving AB 32 GHG reduction goals through regulations that would “minimize costs....” See Cal. H & S Code § 38562 (b)(2). By contrast, an auction would *raise* the cost of the GHG regulatory program for California’s electricity consumers. Insofar as the effect of an auction on electricity prices would directly conflict with the mandate in AB 32 to achieve the 2020 GHG reduction goal while *minimizing* costs, an auction is impermissible under AB 32.

As the Commission recognized in D.07-01-039 earlier in this proceeding, “California courts have long observed the canon of statutory construction that when attempting to ascertain the meaning of a statute, ‘effect should be given...to the statute as a whole and to every word and clause thereof, leaving no part of the provision useless or deprived of meaning.’ [citing *Gay Law Students Association v. Pac. Tel. & Tel. Co.*, (1979) 24 Cal.3d 458, 478].” D.07-01-039 at 58. The “[w]ords must be construed in context, and statutes must be harmonized, both internally and with each other, to the extent possible.” *California Manufacturers Assn. v. Public Utilities Commission*, 24 Cal. 3d 836, 844 (1979). “It is a well-settled rule of statutory interpretation that courts must consider the statutory language in the context of the entire statute and the statutory scheme of which it is a part.” *Phelps v. Stostad*, 16 Cal.4th 23, 32 (1997). In statutory construction, the courts “do not consider ... statutory language in isolation.” *Flannery v. Prentice*, 26 Cal.4th 572, 578 (2001). Instead, the court will “examine the entire substance of the statute in order to determine the scope and purpose of the provision, construing its words in context and harmonizing its various parts.” *Alford v. Superior Court*, 29 Cal.4th 1033, 1040 (2003). Given the AB 32 requirement that the AB 32 regulatory program must *minimize* costs while attaining the mandated GHG reduction goals, auctioning allowances in the electric sector must be rejected as conflicting with the statute.

The Legislature Disagreed with the MAC's View.

The MAC advocated auctioning allowances to the electric sector precisely because the MAC believed, contrary to the Legislature, that raising electricity prices would be a positive development. Auctioning GHG emission allowances would raise prices so as to send “price signals” to consumers. MAC Recommendations at 47. It would send a “carbon price signal” that would provide “an even stronger incentive to promote end-use-efficiency....” *Ibid.* at 50. In the MAC’s view, changes in the price of electricity” would “induce the efficient level of investment [in energy efficiency] by consumers....” *Ibid.* Given this view, various committee members favored a “100 percent auction from the outset” while others favored a mixed approach with some free allocation initially, transitioning to a full auction over time.” *Ibid.* at 60.

The MAC was certainly correct in its assessment that auctioning allowances would raise electricity prices and increase the cost of the GHG regulatory program to consumers. However, while the MAC thought raising electricity prices would be laudatory, the Legislature disagreed in AB 32. Given that there is no authorization for auctions in AB 32 and that auctions would have a result that is directly contrary to the clearly expressed intent of the Legislature in AB 32 that the costs of the GHG regulatory program should be minimized, auctions are precluded by any reasonable interpretation of the AB 32.

The AB 32 Market-Mased Compliance Mechanisms Do Not Include Auctions.

AB 32 did contain a provision for market-based compliance mechanisms: “The State Board may include in the regulations adopted pursuant to Section 38562 the use of market-based compliance mechanisms to comply with the regulations.” Cal. H & S Code §38570(a). However, these mechanisms did not include an auction.

During the spring and summer of 2006 when the Legislature was developing AB 32, the Legislature had before it the program that was proposed by the CPUC and its landmark D.06-02-032. CPUC's program provided for an administrative allocation of allowances, not an auction. D.06-02-032 at 3, 42-43. The CPUC's program did recognize that there could be "market-based" components to the program, but these components were not an auction. They were the "flexible compliance options that were envisioned by the CPUC such as offsets, trading, banking, and borrowing of allowances. The CPUC specifically provided that the emission allowances under its program would be in the form of "tons of carbon-dioxide equivalent" specifically for the purpose of permitting these envisioned allowances to be traded. *See* D.06-02-032 at 34. The "flexible compliance provisions" envisioned by the CPUC were clearly the "market-based compliance mechanisms" that were before the Legislature when it was drafting the section of AB 32 that permits "market-based compliance mechanisms." Auctions had been specifically and unequivocally rejected by the CPUC. D.06-02-032 at 42.

QUESTION NO. 3: *If you recommend partial auctioning, what proportion should be auctioned? Should the percentage of auctioning change over time? If so, what factors should be used to design the transition toward more auctioning?*

As explained in the response to Question No. 2 above, auctioning allowances in the electric sector is not permissible under AB 32. That applies to partial auctioning as well as full auctioning. To the degree to which allowances are auctioned, the cost containment benefits of administrative allocation of allowances for consumers would be eroded, contrary to Legislative intent.

QUESTION NO. 4: *How should new market entrants, such as energy service providers, community choice aggregators, or (deliverer/first seller system only) new importers, obtain emission allowances, i.e., through auctioning, administrative allocation, or some*

New market entrants that are retail providers that are points of regulation should receive allowances through an administrative allocation as do existing market participants. Allowances would be allocated periodically, with a number of allowances being reduced each time allowances are allocated among retail providers. In order to accommodate the entry of some retail providers into the market place, there could be a retention of allowances to accommodate an allocation of allowances to participants that might enter the market in an intra-period basis. However, if allowances are reallocated as frequently as annually, providing for an intra-period allocation of allowances to new market entrants may not be necessary.

C. Auction of Emission Allowances – General Questions (Questions 5 through 9).

QUESTION NO. 5: *What are the important policy considerations in the design of an auction?*

Allowances should not be auctioned. Auctions are neither authorized nor permitted under AB 32.

QUESTION NO. 6: *How often should emission allowances be auctioned? How does the timing and frequency of auctions relate to the determination of a mandatory compliance period, if at all?*

Under AB 32 the compliance period is to be one year. Cal. H & S Code §§38505(a),(k)(1). Insofar as the number of emission allowances that are made available for each compliance period would be reduced for each successive compliance period, there would need to be a new distribution of allowances prior to the beginning of each compliance period.

Thus, if allowances were to be allocated through an auction, new auctions would occur prior to each allocation period.

QUESTION NO. 7: *How should market power concerns be addressed in auction design? If emission allowances are auctioned, how would the administrators of such a program ensure that all market participants are participating in the program and acting in good faith?*

Market power concerns could be addressed in auction design by requiring that only regulated entities (retail providers) be permitted to participate in the auction from the electric sector.

To prevent hoarding and consequent market manipulation, the acquisition of allowances by any entity should be limited on the basis of an objective standard such as a percentage of prior year emissions. Further, there could be a requirement that the recipient of allowances use or sell the allowances by a given date. However, the market power concerns that would need to be addressed by limitations on the design of an auction could be reduced if allowances were administratively allocated.

QUESTION NO. 8: *What criteria should be used to designate the types of expenditures that could be made with auction revenues (including use to reduce end user rates), and the distribution of money within those categories?*

If allowances were to be auctioned, the result would be the generation of a large fund. In order to reduce the cost of GHG emission reduction for consumers, the fund should be used for activities that directly contribute to a reduction of GHG emissions, including energy efficiency, renewable energy acquisition, energy R&D, and carbon sequestration. Social programs such as low income assistance and displaced worker assistance should be separately funded.

However, it is unlikely that revenues generated through auctioning will, over time, be consistently applied to the proper objectives. California has diverse and pressing needs for additional revenues for purposes unrelated to GHG emission reduction ranging from prison construction to health care and education. It is implausible that auction revenues will over time be consistently applied to the objectives that program designers might intend for them at the outset.

Regardless of whether an auction is administered by a state agency such as CARB or a non-profit organization similar in structure to the California Independent System Operator (“CAISO”), it is likely that revenues will be diverted away to what should be the primary use of revenues, namely, defraying the cost of GHG reduction efforts by entities proportional to those entities’ need to reduce GHG emissions to meet AB 32 GHG reduction goals as applied to the entities.

QUESTION NO. 9: *What type of administrative structure should be used for the auction? Should the auction be run by the State or some other independent entity, such as the nonprofit organization being established by the Regional Greenhouse Gas Initiative?*

There should not be an auction. See SCPPA’s response to Question No. 2 above.

D. Electricity Sector.

1. Administrative Allocation of Emission Allowances (Questions 10 through 20).

QUESTION NO. 10: *If some or all allowances are allocated administratively, which of the following methods should be used for the initial allocations?*

- a. **Grandfathering:** *“A method by which emission allowances are freely distributed to entities covered under an emissions trading program based on historic emissions.” (MAC report, p. 93.)*
- b. **Benchmarking:** *“An allowance allocation method in which emissions per unit of input or output” (e.g., fuel used or sales to*

customers (pounds (lbs.)/megawatt-hour or lbs/million British thermal units (MMBtu)). (MAC report, p. 90.)

- c. **Updating:** *“A form of allowance allocation in which allocations are reviewed and changed over time and/or awarded on the basis of changing circumstances (such as output) rather than historical data (such as emissions, input or output). For example, allowances might be distributed based on megawatt-hours generated or tons of a product manufactured.” (MAC report, p. 96.)*
- d. **Other:** *Such as population (lbs of carbon dioxide (CO₂/customer or lbs CO₂/capita), or cost of compliance (based on retail provider supply curves of emission reduction measures, or a comparable metric).*

If you prefer an option other than one of those listed above, describe your preferred method in detail. In addition to your recommendation, comment on the pros and cons of each method listed above, especially regarding the impact on market performance, prices, costs to customers, distributional consequences, and effect on new entrants.

Administrative Allocation on the Basis of Recent Pre-AB 32 Emissions Experience.

As discussed above, allowances should be administratively allocated to regulated retail providers on the basis of recent pre-AB 32 experienced emissions both initially and for subsequent compliance periods, with the quantity of allowances being progressively reduced over time.

Administrative Allocation on the Basis of Statewide Benchmarks.

Statewide “benchmarking” is infeasible insofar as California retail providers are so diverse in the structure of their existing and potential resource portfolios. Northern California retail providers are geographically situated so as to be able to take advantage of hydroelectric resources have zero emissions and simultaneously provide flexibility to integrate additional renewable resources into their systems without generating GHG emissions. Such retail providers

do not have to burn fossil fuel to provide spinning and/or operating reserves to the extent that hydroelectric resources serve those functions.

By contrast, entities in southern California that have substantially less access to hydroelectric resources than northern California retail providers require fossil fuel generation to “firm” intermittent renewable resources such as wind generation. Thus, in general, even with equivalent levels of renewable resources, the southern California retail providers will tend to have higher average emissions per kilowatt hour than northern California retail providers. As a result, statewide “benchmarking” is unworkable. If the Commissions or CARB were to desire to pursue statewide benchmarking for retail providers, some accommodation would be required. One option would be to omit large hydroelectric and nuclear resources from the calculation of the statewide benchmark. Another would be to allocate the large hydroelectric and nuclear resources of California retail providers to all retail providers, north and south. Undoubtedly, however, such accommodations would most likely meet with resistance from retail providers that would be deprived of the benefit of their hydroelectric and nuclear resources or were asked to share their resources with others.

Another option would be to pursue benchmarking but on a regional rather than statewide basis. For example, southern California retail providers could be benchmarked against southern California utilities, and northern California retail providers could be benchmarked against northern California retail providers. This would recognize the difference between the northern California mix of generation resources and the southern California mix of resources. However, different retail providers within a region might be so differently situated that even regional benchmarking may be inequitable or even infeasible.

Insofar as there is a much superior option to administratively allocating allowances—allocating allowances among regulated retail providers on the basis of recent pre-AB 32 experienced emissions—SCPPA recommends that the Commissions abandon consideration of benchmarking and focus on the superior option.

Administrative Allocation on the Basis of Current Output; Updating

Allocating allowances on the basis of current output would be inconsistent with reducing allowances over time to reach the AB 32 GHG reduction goal, unless the allocation of allowances on the basis on current output were married to benchmarking with the benchmark becoming progressively more stringent.

Although updating allowance allocations for a retail provider to accommodate changed circumstances may be reasonable in some demonstrated hardship cases, it is suspect in general. In order to achieve the AB 32 goal of 1990 emissions by 2020, it is going to be necessary to reduce the available allowances progressively during each succeeding compliance period. To the extent to which updating to accommodate changing circumstances may result in an allocation of an increasing rather than decreasing amount of allowances, updating would be clearly contrary to achieving AB 32 objective.

Administrative Allocation on the Basis of Population or Retail Sales.

An administrative allocation of allowances to retail providers on bases that are not related to recent historical emissions such as population or retail sales would result in some retail providers getting more allowances than they need while others receive less. To the extent to which those who receive less would be required to acquire allowances from those who receive more, there would be a wealth transfer and, ultimately, a windfall to the consumers of the retail provider that obtains more than necessary allowances to the detriment to the consumers served

by a retail provider who received fewer than necessary allowances. An administrative allowance allocation program that provided for transfers of wealth from the consumers served by one retail provider to another would be unfair, inequitable, and indefensible.

Administrative Allocation on the Basis of the Cost of Compliance.

An administrative allocation of allowances on the basis of the cost of compliance would involve forecasting the cost of compliance. If a consequence of a higher forecast were receipt of more allowances, there would be an incentive to forecast higher rather than lower costs. The higher forecasts could result in higher actual costs. Thus, an administrative allocation of allowances on the basis of the forecasted cost of compliance could conflict with the AB 32 mandate to adopt a regulatory program that is consistent with minimizing the cost of attaining AB 32 goals.

QUESTION NO. 11: *Should the method for allocating emission allowances remain consistent from one year to the next, or should it change as the program is implemented?*

The method for allocating emission allowances should remain consistent from one compliance period to the next, with allowances being ratcheted down over time as California moves towards attainment of AB 32 2020 goal. This should not be a change from administrative allocation allowances on the basis of historical emissions to an administrative allocation on some other basis such as benchmarking, population, or retail sales. To the extent to which the administrative allocation were to regressively reflect benchmarking, population, or retail sales, the inequities of those allocation methodologies would progressively increase, thereby progressively introducing inequity into the administrative allocation process. At no point should there be a shift from administrative allocation allowances to auctioning for the same reason.

QUESTION NO. 12: *If new market entrants receive emission allowance allocations, how would the proper level of allocations be determined for them?*

Administrative allowances should be allocated to retail providers for the benefit of consumers. Presumably, new market entrants would be energy service providers (“ESPs”) or an entity that would acquire a portion of a service territory of an existing service provider. In either case, consumers from given retail provider would be shifted to another retail provider. Accordingly, the historical load associated with those consumers would be shifted. In the next compliance period, the allowances that were provided to the retail provider for the benefit of the consumers that depart from the retail provider should be allocated to the consumers’ new retail provider.

QUESTION NO. 13: *If emission allowances are allocated based on load/sales, population, or other factors that change over time, how often should the allowance allocations be updated?*

In no event should emission allowances be allocated on the basis of retail sales, population, or any other factor that does not bear a direct one-to-one correlation to a retail provider’s actual historical emissions. As discussed above, any allocation on a basis that is not correlated to emissions and need for allowances would result in retail provider cross-subsidies and wealth transfers among retail providers. It would be inequitable and would degrade the integrity of the GHG regulatory program.

QUESTION NO. 14: *If emission allowances are allocated based on historical emissions (“grandfathering”) or benchmarking, what base year(s) should be used as the basis for those allocations?*

Consistent with the tentative views expressed by the CPUC in D.06-12-032, a multi-year period should be used to identify the recent historical emissions that would provide the basis for allocating allowances administratively among retail providers. Using a multi-year period would tend to result in a time period that would reflect the average hydroelectric conditions and average temperature conditions.

Furthermore, the selected period should be recent, as contemplated by the CPUC in D.06-02-032. As discussed in the Commissions' June 12, 2007 workshop on emission allocation issues, the three year pre-AB 32 period 2004-2006 appears to be appropriate. It would be long enough (three years) to normalize any anomalies that might have occurred during any particular year. Furthermore, insofar as the three years 2004-2006 precede AB 32, retail providers would get the full benefit of GHG reduction efforts they may undertake after enactment of AB 32. That would provide an incentive for retail providers to undertake "early action" to achieve GHG reductions prior to AB 32 regulations becoming operative on January 1, 2012.

QUESTION NO. 15: *If emission allowances are allocated based initially on historical emissions ("grandfathering"), should the importance of historical emissions in the calculation of allowances be reduced in subsequent years as providers respond to the need to reduce GHGs? If so, how should this be accomplished? By 2020, should all allocations be independent of pre-2012 historical emissions?*

As has occurred in the existing regulatory programs to control "criteria" pollutants in California, the availability of allowances should be ramped down over time. If the objective of the Legislature and CARB is to reduce GHG emissions to 20 percent of 1990 levels by the year 2050, then allowances should be ramped down during each successive compliance period at a rate that would result in accomplishment of the legislatively and administratively decreed

objective of 20 percent GHG emissions by 2050. This would probably result in allowances in 2020 that are *lower* than the rate of reduction that would be needed to achieve the 2020 goal mandated by AB 32.

As under existing regulatory programs for “criteria” pollutants, the administrative basis for allocating allowances should not change over time. This should continue to be a direct correlation between the administrative allocation of allowances and progressive reductions in GHG emissions from the level that was established at the outset of the program on the basis of recent actual historical experience. Maintaining a direct correlation between the administrative allocation of allowances and successive reductions in the number of allowances that are made available as a percentage of historical emissions would maintain the integrity of the program both objectively and in the eyes of consumers who are going to be adversely economically even with an administrative allocation of allowances.

QUESTION NO. 16: *Should a two-track system be created, with different emission allowances for deliverers/first sellers or retail providers with legacy coal-fueled power plants or legacy coal contracts? What are the factors and trade-offs in making this decision? How would the two tracks be determined, e.g., using an historical system emissions factor as the cut-off? How should the allocations differ between the tracks, both initially and over time? What would be the market impact and cost consequences to consumers if a two-track method were used?*

A two-track system would be needed only if the administrative allocation of allowances was not based on historical emissions. If the administrative allocation of allowances were based on recent pre-AB 32 experienced emissions as recommended by SCPPA, all retail providers would be treated equitably. There would be no need for a two-track system. SCPPA urges the

Commissions to recommend to CARB an administrative allocation of allowances among regulated retail providers that is inherently equitable, as would be an allocation based on historical emissions, instead of recommending an inherently inequitable allocation that would require ad hoc fixes to cure the inequities.

In any event, SCPPA recommends that the Commissions and CARB consider establishing separate 1990 baselines for the northern and southern California regions. The reliance of southern California retail providers on coal-fueled resources is just one of many features that distinguish southern California from northern California. As noted above, there are other differentiating features that are equally or more significant. For example, the agricultural, forestry, and livestock sectors tend to be more heavily represented in northern California than in southern California. In the electric sector, northern California is favored by substantial hydroelectric resources while southern California is not. In transportation, southern California has the two largest ports in the nation (which happen to be located side-by-side). Northern California ports are smaller. SCPPA urges the Commissions and CARB to evaluate setting separate baseline standards for northern California and southern California and separately allocating GHG reduction responsibility in the two regions.

QUESTION NO. 17: *If emission allowances are allocated administratively to retail providers, should other adjustments be made to reflect a retail provider's unique circumstances? Comment on the following examples, and add others as appropriate:*

- a. Climate zone weighting to account for higher energy use by customers in inclement climates.***

If GHG emission allowances are allocated administratively to retail providers for the benefit of their customers *and* the administrative allocation is based upon recent historical emissions from for example, the immediate pre-AB 32 period 2004-2006, the allocation of

allowances would reflect the higher energy used by customers in inclement climates inherently. No further adjustment would be necessary. This is yet another reason for allocating allowances administratively to regulated retail providers for the benefit of their customers with the allocation being based upon recent pre-AB 32 historical experience.

b. Increased emission allowances if there is a greater-than-average proportion of economically disadvantaged customers in a retail provider's area.

As discussed above, one of the primary reasons for establishing retail providers as a point of regulation and for administratively allocating GHG emission allowances to the retail providers on the basis of recent pre-AB 32 emissions is that the regressive features of an auction would be avoided as well as the wealth transfer features of allocations based upon sales, population, or similar non-emission-related factors. If retail providers as a point of regulation were required to acquire allowances through an auction in addition to bearing the cost of energy efficiency programs and restructuring the generation resources to reduce or eliminate the more carboniferous resources, the cost of buying the auctioned allowances for buying allowances from other utilities that got more than they need would fall disproportionately on lower income customers. An administrative allocation of allowances on the basis of recent historical experience to retail providers as a point of regulation for the benefit of retail providers' customers is a single best step that the Commissions and CARB could take to protect lower income customers through design of AB 32 program.

QUESTION NO. 18: Should differing levels of regulatory mandates among retail providers (e.g., for renewable portfolio standards, energy efficiency investment, etc.) be taken into account in determining, entity-specific emission allowance allocations going forward? For example, should emission allowance allocations be adjusted for retail providers with high historical investments in energy efficiency or renewables due to regulatory mandates? If those

differential mandates persist in the future, should they continue to affect emission allowance allocations?

Differing levels of regulatory mandates among retail providers for renewable portfolio standards or energy efficiency investment, should *not* be taken into account in determining entity-specific emission allowance allocations, assuming that such allocations are to regulated retail providers for the benefit of their customers with the allocations being based on recent historical experience. Some retail providers may have undertaken investments in energy efficiency or renewables in response to regulatory mandates while others undertook the investments for policy reasons without being required to undertake the investments. Still others may have undertaken the investments in energy efficiency or renewables simply because investments constituted good or best business practices in the judgment of the retail providers. There should not be discrimination in favor of or against retail providers that undertook investments in renewable resources energy efficiency in response to regulatory mandates rather than response to social policy or business reasons. In SCPPA's view, there should be an administrative allocation of allowances on the basis of historical emissions from the recent pre-AB 32 period without complex adjustments that would favor some retail providers against others.

QUESTION NO. 19: How often should the allowance allocation process occur? How far in advance of the compliance period?

Although there may be arguments that compliance periods should last two or three years rather than one year, AB 32 appears to contemplate an allocation of allowances every year. Cal. H & S Code §38505 defines "allowance" as meaning "an authorization to emit, *during a specified year*, up to one ton of carbon dioxide equivalent." Thus, insofar as allowances are to

have a duration of one year, it appears that the legislative intent was that compliance periods be one year in duration. This interpretation of legislative intent is reinforced by the fact that “market-based compliance mechanism” is defined in AB 32, in part, as being a “system of market-based declining *annual* aggregate emissions limitations for sources or categories of sources that emit greenhouse gases.” Cal. H & S Code §38505(k).

QUESTION NO. 20: *What are the distributional consequences of your recommended emission allowance allocation approach? For example, how would your method affect customers of retail providers with widely differing average emission rates? Or differing rates of population growth?*

The biggest single argument for allocating allowances to retail providers as a point of regulation for the benefit of the retail providers’ customers with the allocation being based on recent pre-AB 32 historical experience is that the resulting distribution of allowances would be fair to the customers of all of the retail providers. The customers of all of the retail providers would be required to bear the cost of increased funding for energy efficiency and for investments in low GHG resources, but the customers would *not* be required to bear the *additional* cost of acquiring allowances.

However, allocating allowances exclusively on the basis of recent pre-AB 32 emission levels would not result in allowances being adjusted during each successful compliance period to reflect population growth or increase of load for other reasons that might be experienced by individual retail providers. Some accommodation for load growth might be appropriate. Certainly, if a retail provider experiences load growth because of a dramatic increase in electric vehicle or plug-in hybrid electric vehicle load, the transportation sector will have reduced its GHG emissions by shifting transportation requirements to the electric sector. The shift would be

quantifiable, and there should be some shift of allowances from the transportation sector to the electric sector to make the electric sector whole to the extent to which its GHG burden is increased by the transportation sector shedding its burden.

However, SCPPA is hesitant to recommend that there be adjustments to the allocation of allowances that would be based upon recent pre-AB 32 experience to accommodate population growth or load growth in a retail provider service territory. Reforming land use patterns as well as “Title 24” building standards are both going to be critical components of California’s GHG reduction program. To the extent to which allowances are increased to accommodate population growth or load growth, the additional allocation of allowances may encourage rather than discourage the sprawling growth that has occurred in northern California’s Central Valley or southern California’s Moreno Valley. In the time allowed for preparation of these comments, SCPPA has not been able to analyze sufficiently the policy implications of an electric sector allowance adjustment to accommodate population growth to determine whether the adjustment would be consistent with or contradictory to the policy reasons for changes land use policy or in “Title 24” building standards. Thus, SCPPA cannot recommend adjustments to emission allowances to accommodate load or population growth at this time.

2. Emission Allowances with a Deliverer/First Seller Point of Regulation (Questions 21 through 25).

QUESTION NO. 21: *Would a deliverer/first seller point of regulation necessitate auctioning of emission allowances to the deliverers/first sellers?*

If a program were adopted in which “first-sellers” were the point of regulation in spite of the fact that such a program would most likely, be found to be unlawful as preempted under the Federal Power Act, allowances should not be allocated to first-sellers that are not subject to a regulatory authority that could require that the benefit of the administrative allowance be passed

through to consumers. An administrative allocation of allowances to first-sellers that are not subject to a regulatory authority that could enforce pass-through of the benefit of the administrative allowance to consumers would result in a windfall to unregulated electricity producers. As the Congressional Budget Office explains:

A common misconception is that freely distributing emission allowances to producers would prevent consumer prices from rising as a result of the cap. Although producers would not bear out-of-pocket costs for allowances they were given, using those allowances would create an “opportunity cost” for them because it would mean forgoing the income that they could earn by selling the allowances. Producers would pass that opportunity cost on to their customers in the same way that they would pass along actual expenses. That result was borne out in the cap-and-trade programs for sulfur dioxide in the United States and for CO₂ in Europe, where consumer price rose even though producers were given allowances for free.

Thus, giving away allowances could yield windfall profits for the producers that received them by effectively transferring income from consumers to firms’ owners and shareholders.

Trade-offs and Allocating Allowances for CO₂ Emissions, Congressional Budget Office, Economic and Budget Issue Brief at 5 (April 25, 2007). *See also* MAC Recommendations at 44, 54 (June 30, 2007). Windfalls would not occur if there were an administrative allocation of allowances to electricity generators (i.e., retail providers) whose rates are set by regulators:

One exception is if allowances were given to electricity generators whose rates were set by regulators. In that case, regulators might prevent generators from passing the opportunity cost of holding an allowance along to consumers.

CBO, *Ibid.*; MAC Recommendations, *Ibid.*

QUESTION NO. 22: *Are there interstate commerce concerns if auction proceeds are obtained from all deliverers/first sellers and spent solely for the benefit of California ratepayers? If there are legal considerations, include a detailed analysis and appropriate legal citations.*

There is a potential for Commerce Clause violations if auction proceeds are obtained from all deliverers/first sellers and spent solely for the benefit of California ratepayers. Where a state government regulates local aspects of interstate commerce, the regulation is generally valid if it (1) does not facially, or in its practical effect or purpose, discriminate against out-of-state competition to benefit local economic interests *and* (2) is not unduly burdensome, *i.e.*, the incidental burden on interstate commerce does not outweigh the legitimate local benefits produced by the legislation. *See, e.g., Pike v. Bruce Church, Inc.*, 397 U.S. 137, at 142 (1970) (If there is no discrimination and “the state regulates evenhandedly, the regulation is valid unless the plaintiff can show that it imposes a burden on interstate commerce ‘clearly excessive in relation to the putative local benefits’”); *Davrod Corp. v. Coates*, 971 F.2d 778 at 789 (1992) (the Supreme Court upheld a state's limitation on the size of the vessels that could fish in its waters, finding that the limitation applied to all in-state vessels as well as all out-of-state vessels and that the out-of-state vessels were only incidentally burdened); *Goya de P.R., Inc. v. Munoz*, 95 F.Supp.2d 61, 69-70 (regulation requiring canned pigeon peas to be labeled with the place of origin not facially discriminatory because it applied to both in-state and out-of-state pigeon pea producers). In addition, in determining whether a non-discriminatory law violates the Commerce Clause, courts may consider whether less restrictive alternatives are available.

Nevertheless, a discriminatory law may be valid if it furthers an important, non-economic state interest, *e.g.*, health or safety, and there are no reasonable alternatives. *See, e.g., Maine v. Taylor*, 477 U.S. 131, 138 (1986) (state was allowed to prohibit the importation of live baitfish because the state could demonstrate that it had no other way of effectively avoiding the possibility that such baitfish might bring certain parasites into the state or, in other ways, have a detrimental effect on the state’s wild fish population).

The auctioning of emissions allowances and the allocation of the auction proceeds raise two general issues. The first is whether requiring all deliverers/first sellers to purchase emissions allowances is itself discriminatory. Assuming that all market participants are participating on a level playing field, an auction would not be likely to be considered discriminatory on its face. However, there could be a question as to whether the requirement is discriminatory in its practical effect. Out-of-state first sellers may have to purchase more emissions allowances relative to in-state first sellers due to the significantly higher use of coal and other fossil fuels outside of California. The answer is not entirely clear. If a court were to find the emissions allowance requirement discriminatory, the state would have to “show that it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives. *See, e.g.,* 477 U.S. at 138; *Oregon Waste Sys., Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 101-102 (1994) (recognizing that “interstate commerce may be made to ‘pay its way’”). Even if the auction is found not to be discriminatory, there is still the question whether the emissions allowance requirement as applied to deliverers/first sellers is unduly burdensome on interstate commerce, given that out-of-state deliverers/first sellers will be the primary purchasers of emissions allowances. In addition, a court could also consider that the state could have implemented a load-based approach which would result in a less direct impact on interstate commerce.

The second issue involves the auction and use of the proceeds as part of a single scheme. Consider a situation in which an in-state group of first sellers is allocated a subsidy or other payment from the proceeds generated from the auction while out-of-state first sellers do not receive a similar subsidy or payment, effectively putting out-of-state first sellers at a competitive disadvantage.

West Lynn Creamery v. Healy makes clear that where funds generated by a non-discriminatory tax/surcharge/etc. assessed against both in-state and out-of-state entities are allocated to all or a subset of in-state competitors in the form of a credit/subsidy/etc., the tax/subsidy scheme violates the dormant Commerce Clause. *See West Lynn Creamery v. Healy*, 512 U.S. 186, 200-201 (1994); *Environmental Techs. Council v. South Carolina*, 901 F.Supp 1026, 1037 (1995); *see also Maryland, et al. v. Louisiana*, 451 U.S. 725, 756 (1981) (“Tax unquestionably discriminates against interstate commerce in favor of local interests as the necessary result of various tax credits and exclusions”). Here, the requirement to purchase emissions allowances is similar in effect to a tax imposed on GHG emissions. Thus, where revenues generated from an auction of emissions allowances in which *all* first sellers – both in-state and out-of-state – are required to purchase allowances to the extent necessary to remain within specific GHG limits are allocated only to in-state first sellers or a subset thereof, such as to generators to offset costs of installing filters or the like, the scheme will likely be deemed discriminatory against out-of-state first sellers. Such a scheme gives in-state competitors an advantage over out-of-state competitors by effectively offsetting the cost of the emissions allowances – or at least some portion thereof.

All first sellers would likely be considered competitors for sales of electricity, whether they are generators, importers or “the entity that first sells power into California’s electricity system” at the first point of delivery in CA. Thus, granting in-state first sellers a subsidy from auction proceeds so as to put them at a competitive advantage *vis a vis* out-of-state first sellers would likely violate the dormant Commerce Clause.

The situation becomes less clear if the charge for allowances is applied to both in-state and out-of-state market participants on a non-discriminatory basis, but then the revenues go to

other areas, such as providing money to groups not paying for the emissions allowances (low-GHG technology developers or to ratepayers for lowering electricity consumption) or to California's general fund. *See* 512 U.S. at 199-200 (noting that direct subsidies and nondiscriminatory taxes are generally upheld despite some adverse impact on interstate commerce, but finding unconstitutional a non-discriminatory tax coupled with a subsidy to one of the groups taxed). The question will be whether the particular scheme impermissibly burdens out-of-state interests in favor of in-state economic interests.

Although the state may be able to justify the discriminatory effect or the burden on interstate deliverers/first sellers by virtue of the seriousness of the global climate change problem, such justification would likely take place through costly litigation. The load-based approach avoids the problems associated with the deliverer/first seller approach and allows the state more control over how emissions allowances and auction proceeds are allocated.

QUESTION NO. 23: *If you believe 100% auctioning to deliverers/first sellers is not required, explain how emission allowances would be allocated to deliverers/first sellers. In doing so, answer the following:*

If, contrary to SCPPA's recommendation, the Commission were to pursue a "first-seller" regulatory scheme, allowances should still be administratively allocated on the basis of recent pre-AB 32 historical experience to regulated generators (i.e., regulated retail providers) for the benefit of their consumers so as to minimize the cost of the GHG regulatory program to consumers, consistent with AB 32 directives. The MAC specifically recognized that if allowances are administratively allocated to regulated retail providers with the value of the allowances being required by the regulator to be passed along to consumers, the impact of the GHG regulatory program on consumers would be reduced:

If allowances are allocated for free, the impact on consumer prices could be smaller than in the case of auctioning (regardless of whether the first-seller or load-based approach is adopted). Using an allowance has an opportunity cost regardless whether the allowance was purchased or given away. However, in California utility regulators are likely to prevent LSEs, whose rates they regulate, from passing allowance opportunity costs along to consumers in cases where the LSE receives allowances for free. This is likely to be particularly true of the municipal utilities, which are effectively owned by consumers. If the LSEs are prevented from passing along opportunity costs associated with the use of free allowances, the impact on consumer prices will be less under a free allocation than under a system that auctions allowances.

MAC Recommendations at 44. Additionally, insofar as the cost of electricity to retail consumers would be reduced from what it would be if regulated generators (i.e., retail providers) were required to buy allowances through an auction, the regressive effect of the GHG program on lower income customers would be, also, reduced.

a. How would the amount of emission allowances given to deliverers/first sellers be determined during any particular compliance period?

In general, allowances should not be administratively allocated to *unregulated* first-sellers that could receive a windfall if they were the recipients of the free allowances: “When allowances are given out for free to [unregulated] generators, generators capture those rents.”

MAC Recommendations at 48. However, as MAC noted, there may be some exceptions which should be evaluated:

Some independent power producers may operate under long term fixed price contracts and thereby not be able to pass through costs until those contracts expire. Whether these producers should receive a free allocation in the interim should be evaluated carefully.

Independent power producers under long-term fixed-price contracts cannot necessarily pass through changes in their costs to their customers. Some contracts allow for adjustment of price in response to changes in cost, but they are unlikely to designate

allowance cost explicitly. Under an upstream program (Program 4) allowance cost would be embedded in fuel price and this would be passed through automatically. Under a downstream program the interpretation of cost will be important for parties to these contracts. It is unclear what are the terms of existing contracts. The PUC could investigate this issue by issuing a data request to investor owned utilities to determine the incidence of changes in cost under these contracts, and policy makers could consider an explicit compensation for harmed parties if deemed appropriate. The Committee notes that even when contracts are silent on an issue such as changes in environmental policy, they may be silent intentionally and thereby describe a conscious assignment of risk. In the long run these contracts will be renegotiated and climate policy risks are likely to be an explicit consideration.

MAC Recommendations at 56.

However, as discussed above, if a “first-seller” regulatory program were adopted and survived legal challenges, emission allowances should still be administratively allocated to *regulated* retail providers for the benefit of their customers in order to minimize the cost of the regulatory program and to reduce the regressive impact of the program on lower income consumers. “When allowances are given out for free to [regulated] LSEs, consumers enjoy the rents (in the form of lower electricity prices). . . .” *Ibid.*

- b. How would importers that are marketers be treated, e.g., would they receive emission allowance allocations or be required to purchase all their needed emission allowances through auctions? If allocated, using what method?*

There should not be an administrative allocation of allowances to unregulated marketers. As unregulated entities, they would be able to capture the economic rents that could result from an administrative allocation of allowances.

- c. How would electric service providers be treated?*

To the extent to which electric service providers are regulated retail providers, they should receive an administrative allocation of emission allowances on the basis of recent pre-AB 32 experience like any other regulated retail provider. If the current freeze on new direct access

service were lifted by the CPUC or the Legislature and ESPs assumed service to customers which had previously been served by LSEs, there could be an adjustment of the LSEs' allowances so as to switch the allowances to ESPs that acquire the LSE load.

d. How would new deliverers/first sellers obtain emission allowances?

New unregulated first-sellers should be required to purchase emission allowances to avoid permitting them to get a windfall.

e. Would zero-carbon generators receive emission allowance allocations?

Zero-carbon generators would not need allowances.

f. What would be the impact on market performance, prices, and costs to customers of allocating emission allowances to deliverers/first sellers?

If allowances were administratively allocated to unregulated generators, the unregulated generators could receive a windfall, as discussed above, although there may be some exceptions as discussed in the response to Question 23.a. The realization of windfall profits would increase market prices. If, on the other hand, unregulated generators acquired allowances through an auction, the wholesale market price for electricity would also be increased, although the unregulated generators would not receive a windfall. The increase in wholesale market prices would increase the cost of electricity delivered to consumers, contrary to the AB 32 directive that the cost of the GHG regulatory program be minimized and contrary to the need to avoid a regressive impact on the GHG regulatory program on consumers.

g. What would be the likelihood of windfall profits if some or all emission allowances are allocated to deliverers/first sellers?

If emission allowances were administratively allocated to unregulated first sellers, they could receive a windfall, although there may be some exceptions as discussed in the response to

Question 23.a. There should not be an administrative allocation of allowances to unregulated generators that could realize a windfall.

h. How could such a system prevent windfall profits?

As the MAC noted, windfall profits for unregulated first sellers may be avoided by requiring them to purchase their allowances. MAC Recommendations at 47-48. Allowances could still be administratively allocated to regulated first sellers (i.e., retail providers):

Using an allowance has an opportunity cost regardless whether the allowance was purchased or given away. However, in California utility regulators are likely to prevent LSEs, whose rates they regulate, from passing allowance opportunity costs along to consumers in cases where the LSE receives allowances for free. This is likely to be particularly true of the municipal utilities, which are effectively owned by consumers. Thus, if allowances are freely allocated to LSEs and the LSEs are prevented from passing along the opportunity costs associated with the use of free allowances, the impact on consumer prices will be less than under a system that auctions allowances or one that freely allocates allowances to generators.

MAC Recommendations at 47.

The MAC observed that independent power producers might claim that requiring unregulated generators to buy allowances but administratively allocating allowances to regulated retail providers may give a market advantage to generation that is owned by regulated retail providers: “The possible free allocation of allowance value to LSEs has raised concerns by independent power producers that this allocation would give an advantage to investor-owned utilities, with whom IPPs compete to provide generation services.” *Ibid.* If retail providers were the point of regulation of the GHG regulatory program rather than first sellers, this concern of independent power producers would not arise. The elimination of that concern is yet another good reason for the Commissions to abandon their consideration of the unlawful first seller

regulatory approach and to adopt retail providers as the point of regulation of the electric sector regulatory program.

QUESTION NO. 24: *With a deliverer/first seller point of regulation, should administrative allocations of emission allowances be made to retail providers for subsequent auctioning to deliverers/first sellers? If so, using what allocation method? Refer to your answers in Section 3.4.1, as appropriate.*

Retail providers should be permitted to receive an administrative allocation of emission allowances for the benefit of their customers on the basis of their recent pre-AB 32 actually experienced emissions, as reduced during successive compliance periods as progress is made toward achieving AB 32 goals. To the extent to which the retail providers achieved GHG reductions in excess of that required under the regulatory program, the retail providers should be permitted to sell the allowances with the benefit of the proceeds being dedicated to consumers.

There should not be an allocation of allowances to retail providers on any basis that is unrelated to emissions such as population or retail sales with a subsequent auctioning to market participants that need the allowances. That would result in retail providers that acquire allowances in excess of their actual need realizing a windfall to the detriment of other retail providers that would need to buy the allowances in order to maintain service to their customers. Permitting some retail providers to enjoy a windfall at the expense of others would be unjust, unreasonable, and inequitable.

QUESTION NO. 25: *If you recommend allocation of emission allowances to retail providers followed by an auction to deliverers/first sellers, how would such an auction be administered? What kinds of issues would such a system raise? What would be the impact on market performance, prices, and costs to customers?*

As discussed in the response to Question 24, there should not be an allocation of emission allowances to retail providers that would result in the retail providers potentially receiving allowances that would be so excessive to actual need to cover emissions.

E. Natural Gas Section (Questions 26 through 27).

QUESTION NO. 26: *Answer each of the questions in Section 3.4.1 except Q16, but for the natural gas sector and with reference to natural gas distribution companies (investor- or-publicly-owned), interstate pipeline companies, or natural gas storage companies as appropriate. Explain if your answer differs among these types of natural gas entities. Explain any differences between your answers for the electricity sector and the natural gas sector.*

The regulation of the natural gas sector as discussed in the June 12, 2007 Preliminary Staff Recommendations for Treatment of Natural Gas Sector Greenhouse Gas Emissions should parallel SCPPA's recommendations for the electric sector. Regulated retail providers should be the point of regulation with an allocation of allowances based upon recent pre-AB 32 experience and with allowances being ratcheted down over time as a natural gas utilities, like electric retail providers, move closer to 2020. The administrative allocation of allowances to natural gas retail providers should be for the benefit of the retail providers' consumers so that the retail providers' shareholders would not realize a windfall from the administrative allocation of allowances.

To the extent to which the electric sector acquires a portion of the natural gas sector's burden or the transportation sector's burden by substituting electricity for natural gas uses or substituting electricity for motor fuel as a result of increased electric vehicle or plug-in hybrid electric vehicle penetration, allowances that would have gone to the natural gas sector or the transportation sector should be made available to the electric sector regulated retail providers.

QUESTION NO. 27: *Are there any other factors unique to the natural gas sector that have not been captured in the questions above? If so, describe the issues and your recommendations.*

Regulation of the natural gas sector should parallel regulation of the electric sector.

F. Overall Recommendation (Question 28).

QUESTION NO. 28: *Considering your responses above, summarize your primary recommendation for how the State should design a system whereby electricity and natural gas entities obtain emission allowances if a cap and trade system is adopted.*

SCPPA recommends that the Commissions reject and no longer give any consideration to electric sector GHG regulatory programs in which either “sources” or “first-sellers” would be the point of regulation. Neither program can lawfully be pursued at this time. Instead, SCPPA recommends that the Commissions continue to pursue and develop the regulatory program as originally envisioned by the CPUC in its landmark decision, D.06-02-032, and as subsequently modified to accommodate the passage of AB 32. Such a program would be consistent with the intent of the Legislature as expressed in AB 32 and would be consistent with the precedent established by the existing air quality programs in California.

In determining the methodology that should be used to allocate allowances in the GHG electric sector, SCPPA recommends that there be an administrative allocation of allowances to retail providers as a point of regulation as contemplated by the CPUC in its development of its “load-based” GHG regulatory program. The allocation of allowances should be based upon recent pre-AB 32 experience (probably, experience from the years 2004 through 2006) with the allowances declining over time as necessary for each retail provider to progress toward achievement of the AB 32 GHG reduction goal. Auctioning allowances in the electric sector would conflict with the legislative intent expressed in AB 32 and would, thus, be unlawful.

Accordingly, auctioning should not be given further consideration as a means for allocating allowances among the retail providers as points of regulation of the GHG regulatory program.

SCPPA recommends that regulation in the natural gas sector parallel regulation in the electric sector. Thus, the point of regulation in the natural gas sector should be the regulated retail providers. There should be an administrative allocation of allowances with the allocation being based upon recent pre-AB 32 experience. The quantity of allowances should be reduced progressively over time as a natural gas retail providers, like electric retail providers, move closer to 2020. The administrative allocation of allowances to natural gas retail providers should be for the benefit of the retail providers' consumers so that the retail providers' shareholders would not realize a windfall from the administrative allocation of allowances.

Given the substantial differences between northern California and southern California both within the electric sector and in other sectors, SCPPA recommends that the Commissions and CARB evaluate whether there should be separate baselines under AB 32 for southern California and northern California with differing allocations of allowances that are tailored to each region's circumstances.

IV. CONCLUSION.

For the reasons set forth above, SCPPA urges the Commissions to adopt SCPPA's recommendations as set forth herein and as summarized in response to Question 28 and in the introduction to this comment.

Respectfully submitted,

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Dated: October 31, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY OPENING COMMENT ON ALLOWANCE ALLOCATION ISSUES** on the service list for CPUC Docket No. R.06-04-009 and CEC Docket No. 07-OIIP-01 by serving a copy to each party by electronic mail and/or by mailing a properly addressed copy by first-class mail with postage prepaid.

Executed on October 31, 2007, at Los Angeles, California.

/s/ Sylvia Cantos

Sylvia Cantos

ATTACHMENT B

SCPPA Supplement to Opening Comment and
Reply Comment on Allowance Allocation Issues
(November 14, 2007)

**BEFORE THE PUBLIC UTILITIES COMMISSION
AND THE ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emission Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

Order Instituting Informational Proceeding – AB 32.

CEC Docket No. 07-OIIP-01

**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SUPPLEMENT TO OPENING COMMENT
AND REPLY COMMENT
ON ALLOWANCE ALLOCATION ISSUES**

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**BEFORE THE PUBLIC UTILITIES COMMISSION
AND THE ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the Commission’s Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emission Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

Order Instituting Informational Proceeding – AB 32.

CEC Docket No. 07-OIIP-01

**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SUPPLEMENT TO OPENING COMMENT
AND REPLY COMMENT
ON ALLOWANCE ALLOCATION ISSUES**

In accordance with the Administrative Law Judge’s Ruling Requesting Comments and Noticing Workshop on Greenhouse Gas Allowance Allocation Issues (“Ruling”) issued on October 15, 2007 in the captioned proceedings, the Southern California Public Power Authority (“SCPPA”) respectfully submits this Reply Comment. In accordance with the Ruling, this Reply comment is being submitted simultaneously to both the California Public Utilities Commission (“CPUC”) and the California Energy Commission (“CEC”) (jointly, “Commissions”).

Additionally, in accordance with Administrative Law Judge (“ALJ”) TerKeurst’s e-mail Ruling issued on November 8, 2007, SCPPA supplements its October 31, 2007 Opening Comment.

I. SUPPLEMENT TO SCPPA’S OPENING COMMENT.

In accordance with the direction received from ALJ TerKeurst, SCPPA supplements its Opening Comment with the following information about the cost of auctioned greenhouse gas

(“GHG”) emission allowances and about the wealth transfer that would occur if allowances were administratively allocated among retail providers on the basis of retail sales.

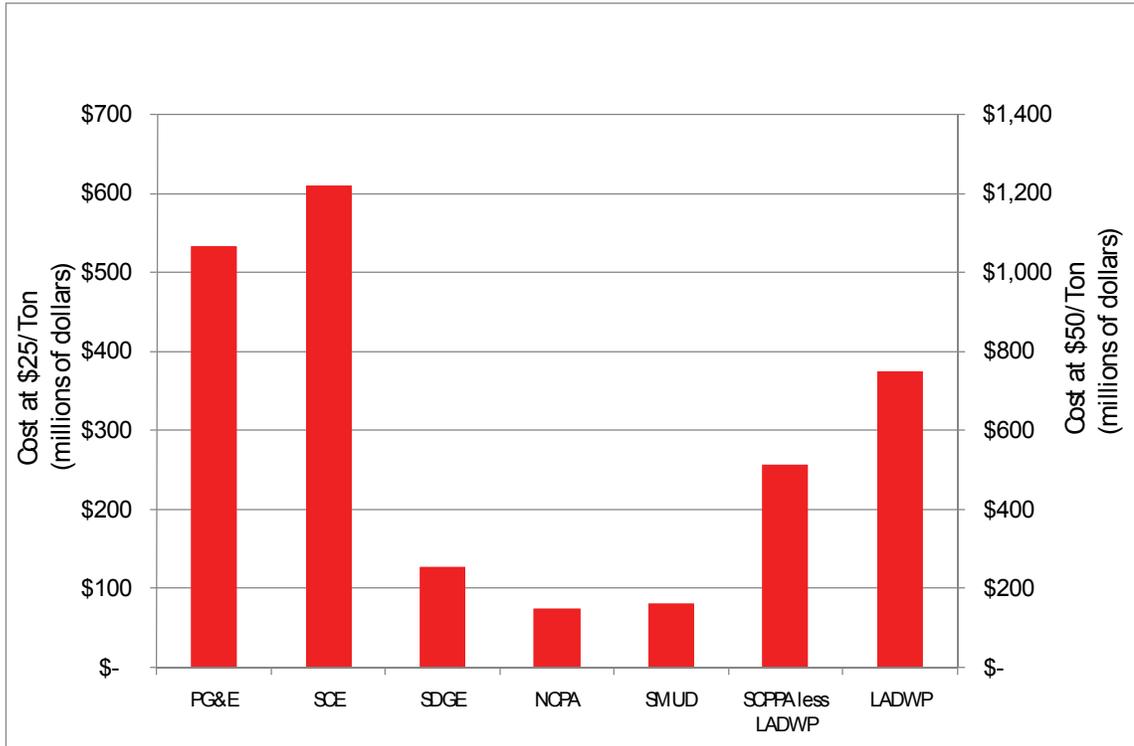
A. The Cost of Auctioning Allowances.

Auctioning allowances for greenhouse gas emissions would have a potentially massive impact on the retail price of electricity that is charged to consumers. If retail providers were the point of regulation and were required to acquire allowances to cover the emissions associated with serving their forecasted 2008 load, the retail providers would need to acquire 82.5 million tons worth of allowances. At \$25 per ton, the cost of the allowances would be over \$2 billion.¹ At \$50 per ton, the cost would double to over \$4 billion dollars. That would be for *one year alone*. The breakdown among California retail providers -- Pacific Gas & Electric Company (“PG&E”), Southern California Edison Company (“SCE”), San Diego Gas & Electric Company (“SDG&E”), Northern California Power Agency (“NCPA”), the Sacramento Municipal Utility District (“SMUD”), SCPPA members² other than the Los Angeles Department of Water and Power (“LADWP”), and LADWP -- would be as shown in the following Figure 1:

¹ Some estimates of the cost of allowances per ton are much higher. The Electric Power Research Institute, (“EPRI”) estimates California CO₂ prices of about \$110 per metric ton. EPRI Program on Technology Innovation: Economic Analysis of California Climate Initiatives: on Integrated Approach at 3-13 (May, 2007).

² SCPPA is a joint power authority. Twelve publicly owned utilities are members of SCPPA: Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. These members, in aggregate, serve over 2 million customer meters in a population of over 5 million people. SCPPA members own and control over 9,000 megawatts of electric generation capacity.

Figure 1. Annual Cost to Obtain Auctioned Allowances (2008 Base Case)³



For Southern California publicly owned utilities, the cost of auctioned allowances is estimated to be over \$700 million per year, based on 2008 projected emissions at \$25/ton. The cost is estimated to be over \$1.4 billion per year if auctioned allowances cost \$50/ton.

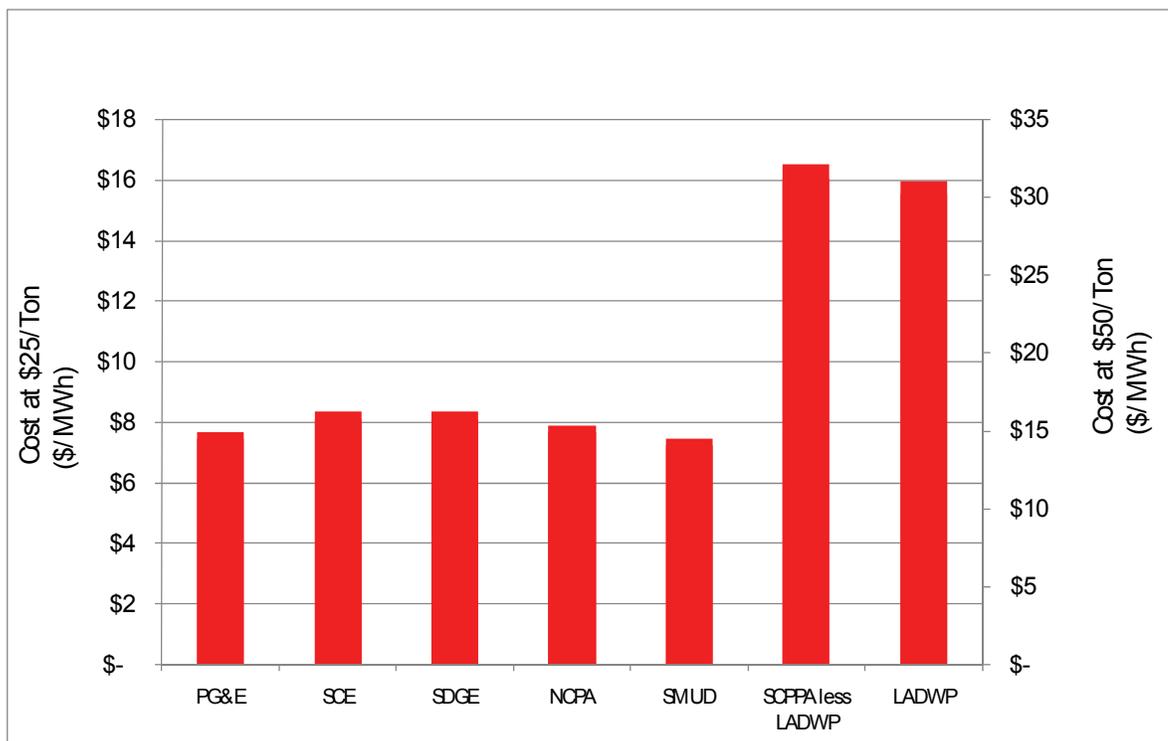
The cost of the auctioned allowances would ultimately be recovered from retail ratepayers. This cost would be *additional* to the cost of enhanced energy efficiency programs, the cost of adding renewable resources, the cost of new transmission systems, and the other costs of GHG reduction that are going to be imposed on retail ratepayers.

³ At \$25 per ton, the cost of auctioned allowances is estimated to be \$2.06 billion, based on projected sample year 2008 emissions. The breakdown is estimated to be (in millions of dollars): PG&E: \$533; SCE: \$610; SDG&E: \$128; NCPA: \$76; SMUD: \$81; SCPPA less LADWP: \$257; LADWP: \$374

At \$50 per ton, the breakdown is estimated to be (in millions of dollars): PG&E: \$1065; SCE: \$1219; SDG&E: \$255; NCPA: \$151; SMUD: \$162; SCPPA less LADWP: \$514; LADWP: \$749.

The customers of the southern California publicly owned utilities would be disproportionately burdened by the cost of auctioned allowances in comparison to the customers of other California utilities. Not only would the cost of auctioned allowances be huge in absolute terms, as shown by Figure 1 above. The cost for the Southern California publicly owned utilities would be approximately *double* the cost for the other California utilities on a unit (per MWh) basis, as shown by Figure 2 below:

Figure 2. Per MWh Cost of Auctioned Allowances (2008 Base Case)



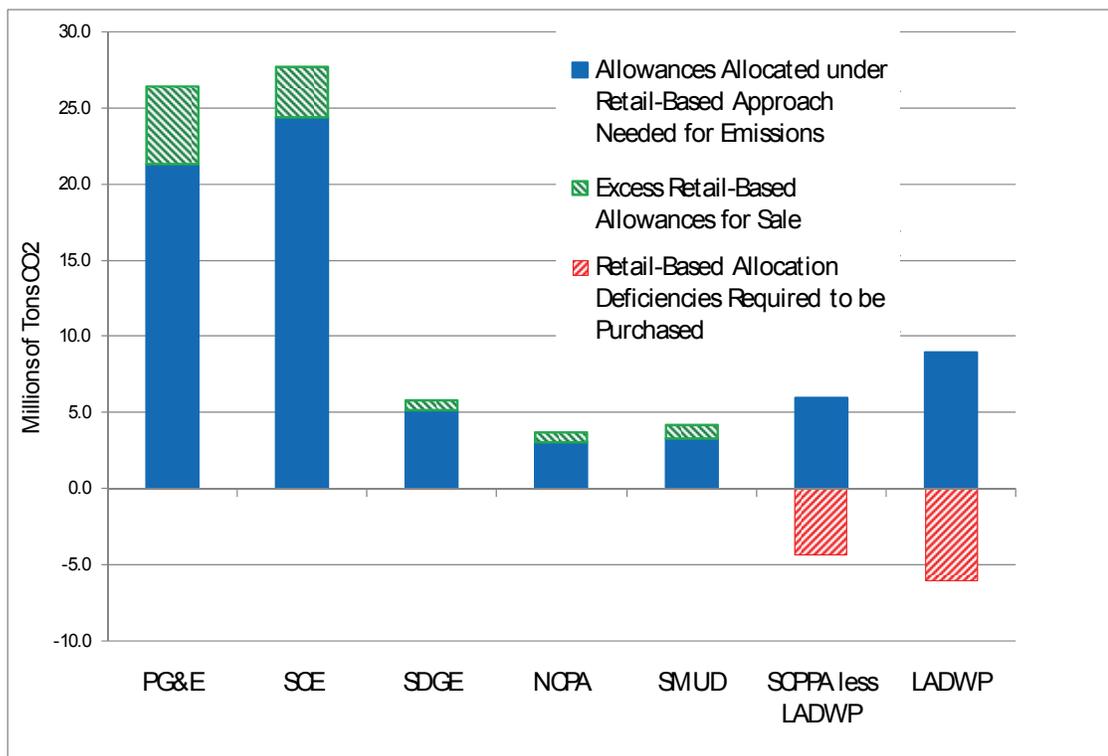
B. The Wealth Transfer Effect of Administratively Allocating Allowances on the Basis of Each Retail Provider’s Retail Sales.

PG&E, SDG&E, and NCPA advocate allocating allowances among retail providers on the basis of each retail provider’s retail sales. This would result in a wealth transfer from the

retail providers that currently have a more carbon intensive resource mix to those that do not.

Figure 3 below shows the amount of allowances that California retail providers would receive if allowances were allocated among retail providers on the basis of retail sales. Figure 3 shows the estimated amount of allowances that PG&E, SCE, SDG&E, NCPA, and SMUD would receive in *excess* of their actual need, and it shows the estimated *shortfall* in allowances that would be received by the southern California publicly owned utilities:

Figure 3. Allowances Allocated by Retail Sales -- Excess and Deficiency



The following Figure 4 shows the estimated quantity of excess allowances that PG&E, SCE, SDG&E, NCPA, and SMUD would receive and also shows the shortfall in allowances for southern California publicly owned utilities:

Figure 4. Quantity of Excess or Deficiency of Allowances Allocated Under Retail-Based Allocation Approach (2008 Base Case)

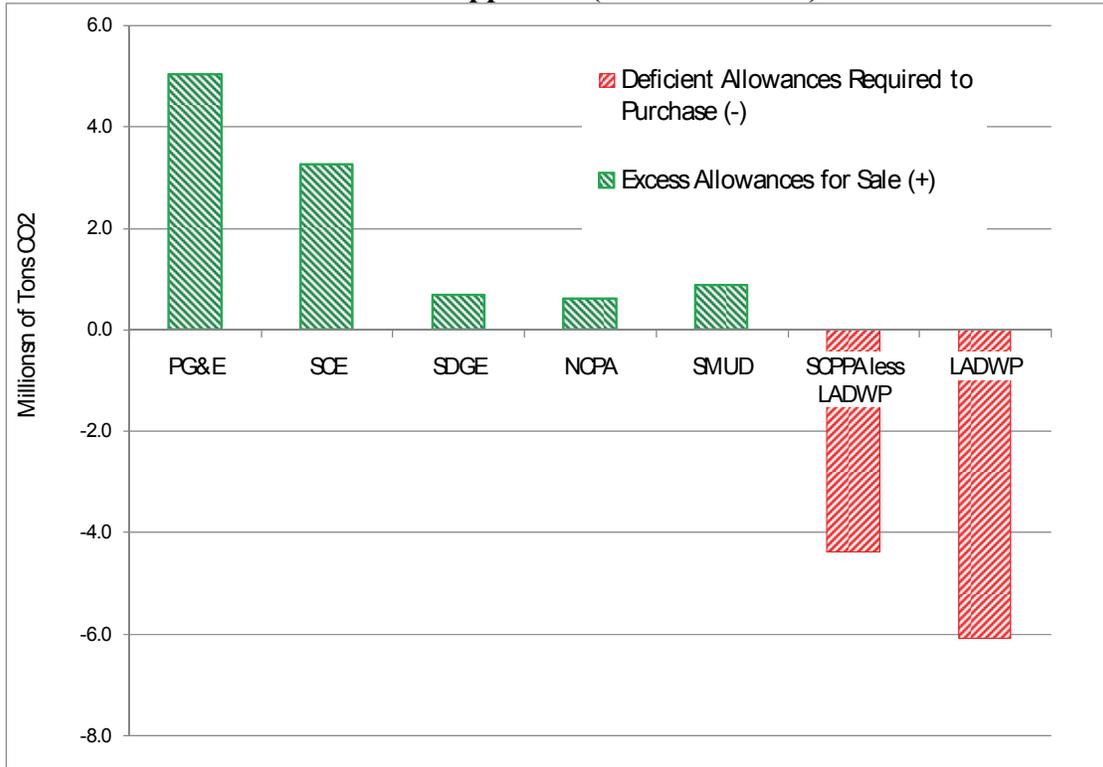
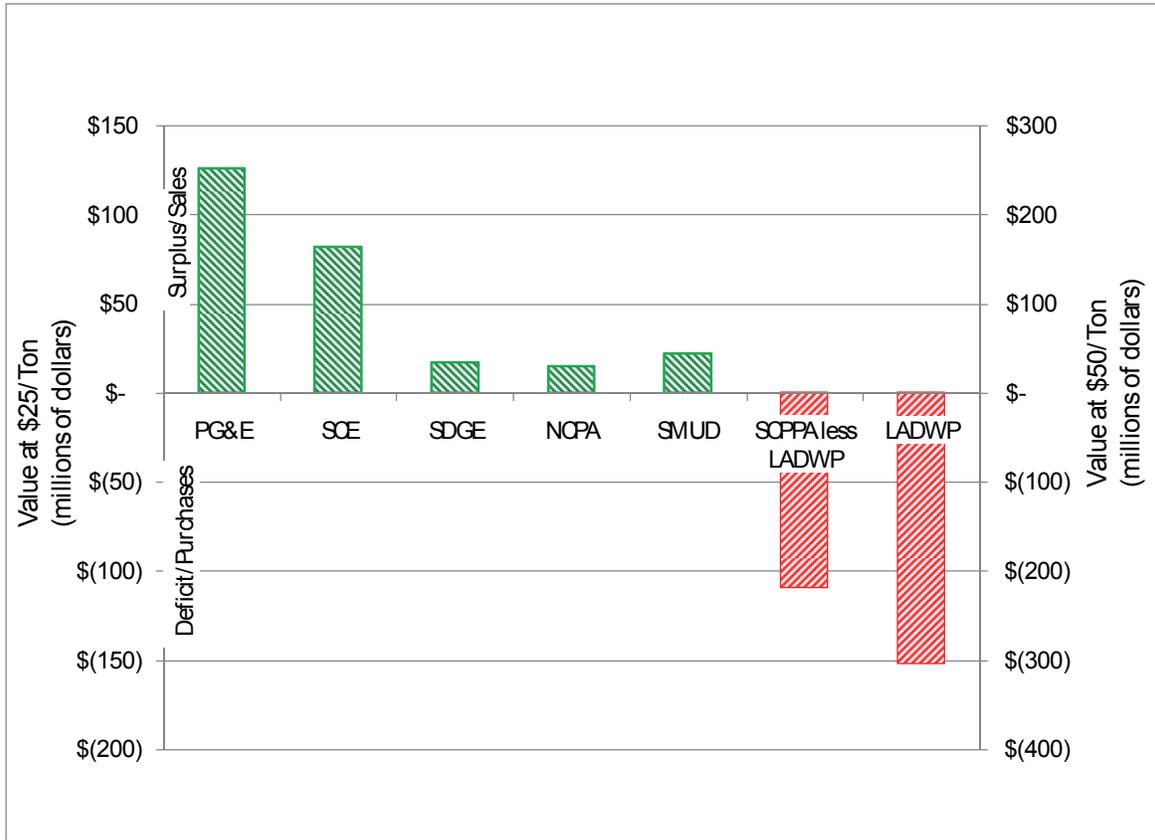


Figure 5 below shows the estimated value of the excess allowances that would be received by PG&E, SCE, SDG&E, NCPA, and SMUD if allowances were administratively allocated on the basis of retail sales, assuming allowances are valued at \$25 and \$50 a ton. Correspondingly, Figure 5 shows the estimated *cost* that LADWP and the SCPPA members other than LADWP would incur to make up the shortfall in allowances that they would receive if allowances were administratively allocated on the basis of retail sales, assuming allowances are valued at \$25 and \$50 a ton:

Figure 5. Value of Excess or Deficit of Allowances Allocated Under Retail-Based Allocation Approach (2008 Base Case)



As shown by Figure 5, if allowances were valued at \$25/ton, an allocation of allowances based upon 2008 sample year emissions would result in a wealth transfer of over **\$250 million** for just one year from southern California publicly owned utilities to other California utilities. The wealth transfer would swell to over **\$500 million** for just one year if allowances were valued at \$50/ton. This wealth transfer would be a cost for the southern California publicly owned utility ratepayers that would be *additional* to the enormous cost that those ratepayers are going to have to incur to wean themselves from the carboniferous resources that were added decades ago in compliance with state and national policies that existed at the time.

II. OVERVIEW: SCPPA'S RECOMMENDATION IN RESPONSE TO OPENING COMMENTS.

SCPPA has reviewed the 31 opening comments filed by other parties in this proceeding on October 31, 2007. After carefully considering the points raised by the parties, SCPPA remains convinced that the CPUC and CEC should stay on course and recommend to the California Air Resources Board ("CARB") a greenhouse gas ("GHG") emission reduction program for the electric sector that builds upon the framework as proposed by the CPUC in Decision ("D") 06-02-032 (February 16, 2006), as modified to accommodate Assembly Bill ("AB") 32 in CPUC President Peevey's Assigned Commissioner's Ruling and Phase 2 Scoping Memo ("Scoping Memo") (Feb. 2, 2007).

A. The Key Features of the CPUC's Program.

The CPUC's program provides for direct regulation of retail providers' GHG emissions with an element of flexibility being provided by allocating allowances to the retail providers and allowing allowance trading. The key features of the CPUC's program are as follows:

- Retail providers would be the point of regulation in the electric sector. D.06-02-032 at 1, 18; Scoping Memo at 9.
- Current emission levels would be determined for each retail provider on the basis of each retail provider's "recent historical emission" profile. Scoping Memo at 16.
- Allowances would be administratively allocated to the retail providers. D.06-02-032 at 2-3, 42-43. The amount of allowances that are allocated to retail providers would be reduced progressively over time as retail providers move toward their GHG reduction goals. D.06-02-032 at 2-3, 39; Scoping Memo at 4.
- Retail providers would be required to hold an adequate number of allowances to cover the emissions associated with their service to load during any given compliance period. Failure to hold the requisite allowances would result in the assessment of a penalty. D.06-02-032 at 2, 47.

- The allowances would be stated in “tons of carbon-dioxide equivalent” so as to be tradable. A retail provider that achieved greater GHG reductions than required would be permitted to sell excess allowances. D.06-02-032 at 3, 19.

The CPUC’s program is consistent with traditional air quality regulation in California under the Clean Air Act. *See* SCPPA Opening Comment at 3-6. Wisely, the CPUC’s program would take full advantage of California’s extensive experience with Clean Air Act regulation.

B. SCPPA Recommends that the Commissions Continue to Develop the CPUC Program.

In its Opening Comment, SCPPA recommended that the Commissions adopt a GHG emission allowance allocation methodology which would simultaneously accomplish the twin objectives of *achieving the GHG reduction goal of AB 32 while minimizing GHG reduction costs for California electricity consumers*. SCPPA Opening Comment at 2. To that end, SCPPA recommended that the Commissions build upon the foundation laid by the CPUC in D.06-02-032 and the Scoping Memo. SCPPA continues to support that recommendation.

GHG emission allowances should be administratively allocated to regulated retail providers as the points of regulation in the electric sector for the benefit of the retail providers’ customers. The allocation should be based upon recent pre-AB 32 actually experienced emissions, with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionally over time as necessary to achieve the AB 32 GHG reduction goals for the electric sector and for each retail provider by 2020. SCPPA Opening Comment at 51.

SCPPA’s recommended approach to allocating allowances would be fair. Insofar as each retail provider would be required to reduce emissions associated with its service to load by the same percentage amount, each retail producer would be required to contribute to meeting the statewide goal of reducing California greenhouse emissions to the 1990 level by 2020. On the

other hand, utilities such as the southern California publicly owned utilities that are more carbon-intensive than others would have to do more on a per MWh basis than others to accomplish the same percentage reduction.⁴ Retail providers that undertake GHG reduction programs prior to implementation of AB 32 regulations in 2012 would benefit insofar as the base period for calculating allowances would be set prior to enactment of AB 32.

III. THE COMMISSIONS SHOULD REJECT ARGUMENTS FOR ALLOCATING ALLOWANCES THROUGH AN AUCTION.

The Natural Resources Defense Counsel (“NRDC”) and the Union of Concerned Scientists (“UCS”) advocate 100 percent auctioning of allowances. NRDC/UCS Opening Comment at 5. Auctioning allowances would have a potentially massive impact on the price of electricity. As an illustration, as shown in Figure 1 above, if retail providers were the point of regulation and were required to acquire auctioned allowances to cover their 2008 emissions at \$25 per ton, the cost would be over \$2 billion for the year. At \$50 per ton, the cost would double to over \$4 billion. The Commission should reject the arguments for allocating allowances through auction.

A. Auctioning Allowances Would Be Unlawful.

This cost of auctioned allowances would have to be recovered from consumers through increases in electricity rates. The Legislature insisted in AB 32 that the mandated GHG reductions be achieved in an “efficient and cost-effective manner” Cal. H & S Code at §38561 (a). The Legislature required the California Air Resources Board (“CARB”) to design its regulations under AB 32, including specifically the regulations governing the “distribution of

⁴ For example, LADWP has a carbon intensity of approximately 1300 lbs.CO₂/MWh. LADWP Opening Comment at 3. Some other major California utilities have a carbon intensity that is less than half LADWP’s. *Id.* If LADWP is required to make a 25 percent reduction in GHG emissions, it will have to achieve a reduction of 325 lbs.CO₂/MWh. A utility that has a carbon intensity that is half of LADWP’s will have to achieve a reduction of only 162.5 lbs.CO₂/MWh. *See* SCPPA Opening Comment at 18.

emission allowances,” so as to “*minimize costs....*” Cal. H & S Code at §38561 (b)(1) (emphasis added). *see* SCPPA Opening Comment a 11.

Electricity is a necessity. Not only would auctioning raise electricity prices. The cost of the auctioned allowances would be just as regressive as a food tax. “For example, the Congressional Budget Office (“CBO”) estimated that the price rises resulting from a 15 percent cut in CO₂ emissions would cost the average household in the lowest one-fifth (quintile) of the income distribution about 3.3 percent of its average income. By comparison, a household in the top quintile would pay about 1.7 percent of its average income....” Tradeoffs in allocating allowances for CO₂ emissions, economic and budget brief at 3, Congressional Budget Office (April 25, 2007).

Auctioning would be completely contrary to the Legislature’s directive in AB 32 that the GHG reduction program should be undertaken in such a way as to minimize costs. Cal. H & S Code §38562 (b)(1). As such, it would be unlawful. *See* SCPPA Opening Comment at 22; *see also* LADWP Opening Comment at 21; Energy Producers and Users Coalition (“EPUC”) and Cogeneration Association of California (“CAC”) Opening Comment at 4-5.

B. Allocating Allowances Through an Auction Gives Rise to Market Power and Manipulation Concerns.

Numerous parties express concerns about how an improperly designed auction could result in an exercise in a market power or manipulation. *See e.g.*, LADWP Opening Comment at 9. Even though it is an advocate for 100 percent auctioning of allowances, NRDC and UCS admit “that auctions must be designed to avoid market manipulation....” NRDC/UCS Opening Comment at 8.

EPUC/CAC caution that there would, particularly, be “a potential exercise of market power if non-generator interests are permitted to participate in the initial auction.” EPUC/CAC

Opening Comment at 29. Accordingly, various parties argued that any auction “should be limited to those entities that need the allowances.” SMUD Opening Comment at 7. *See also* NCPA Opening Comment at 6; PacifiCorp Opening Comment at 10. However, limiting participation in the auction would not, in itself, be sufficient to alleviate concerns about the exercise of market power. As The CPUC itself has observed, “an auction with so few buyers (as would be the case with the load-based cap for LSEs under CPUC jurisdiction) would be economically inefficient and prone to market power abuses.” D.06-02-032 at 42.

There is a simple solution to the Gordian Knot of quandries about how design a GHG allowance auction to avoid market power and market manipulation issues: reject auctioning of allowances and adopt a program under which allowances would be administratively allocated, as recommended by SCPPA.

1. **Partial Auctioning Is Not a Palliative to Market Power and Manipulation Concerns.**

Given California’s relatively recent experience with the 2000-2001 electricity market meltdown, various parties propose that if the Commissions are determined to proceed with auctioning, then the number of allowances that are made available through the auction should be sharply limited at the outset until California can gain hands-on experience with the auctioning mechanism. EPUC/CAC advises: “California needs to learn by doing, as the European Union has done. Auctions should be phased in a cautious, measured manner, after valuations are completed....” EPUC/CAC Opening Comment at 28. EPUC/CAC recommends that auctioning “should be limited to a nominal percentage” of auctionable allowances, pointing out that the EU-ETS sets the auction percentage at 5 percent. *Id.* SMUD recommends limiting the auction to two to three percent of available allowances. SMUD Opening Comment at 6. The Division of Ratepayer Advocates (“DRA”) notes: “In the acid rain program, the Virginia NOX program, and

the EU carbon market only 2.8-5 percent of allowances were auctioned, and the vast majority of allowances were given away for free.” DRA Opening Comment at 9. FPL Energy Project Management, Inc. (“FPL”) advocates an eventual transition to 100 percent auctioning but cautioned: “Economic modeling is necessary to determine the percentage of allowances to be auctioned in the first compliance period and determine which auctions should reach 100 %.” FPL Opening Comment at 7. FPL notes that the National Energy Commission on Energy Policy recommended that no more than 50 percent of allowances should be allocated through an auction.

If the Commissions are inclined, contrary to SCPPA’s recommendation, to allow auctioning of some portion of allowances, the Commissions should heed the call of numerous parties for restraint. There is overwhelming support for only a small percentage of allowances to be auctioned at the outset of the program.

However, the better course would be to avoid any auctioning whatsoever. Limiting the auction of allowances to a small percentage of available allowances would not solve the problem of market power and manipulation. It would only limit the size of the potential adverse consequences. Furthermore, limiting the percentage of allowances that would be auctioned to a small percentage would result in a smaller and less liquid market. That would increase the potential for the exercise of market power and manipulation. Auctioning should be avoided altogether.

2. PG&E’s Proposal for Auctioning Allowances to First Sellers as a Point of Regulation After an Administrative Allocation of Allowances to Retail Providers Should Be Rejected.

PG&E supports making “first-sellers” rather than retail providers the point of regulation in the electric sector under AB 32, but PG&E recommends that all emission allowances be allocated to retail providers on the basis of each retail provider’s retail sales. PG&E Opening

Comment at 2. In order to get the allowances out of the hands of the retail providers and into the hands of the first-sellers who would be the points of regulation, PG&E proposes that the allowances that would be administratively allocated to the retail providers should be auctioned “under the supervision of an independent entity” to the first-sellers, with the proceeds of the auction being returned to the retail providers “for the benefit of their customers.” *Ibid.*

Numerous parties opposed PG&E’s proposed auction. The Independent Energy Producers Association (“IEP”) response to the PG&E proposal was: “Emphatically, NO.” IEP Opening Comment at 11. In IEP’s view, allowing retail providers that own their own generation to have any involvement in either the administration of an auction or the allocation of auctioned revenues would “fundamentally undermine the commission’s goal of fostering a ‘competitive level playing field’ within the generation sector.” *Ibid* at 12. “Importantly, if retail service providers were allowed to control the administration of the auction and/or revenues from the sale of allowances, California would further exacerbate the barriers to generation investment in CA and, as a result, valuable IPP investment dollars, innovation, and experience would move to locations [and] more favorable investment environments out-of-state.” *Ibid.*

Other parties were equally emphatic. Calpine Corporation (“Calpine”) commented: “Retail providers should not, *under any circumstances*, be allocated allowances for subsequent auctioning to deliverers/first sellers.” Calpine Opening Comment at 23 (emphasis in original). Constellation NewEnergy, Inc., (“Constellation”) observed that “allocating allowances to a jurisdictional retail provider – when the jurisdictional retail provider also owns emitting resources – would create a significant conflict of interest for the retail provider:

Specifically, there would be a conflict between the retail provider’s objective of selling the allowances at the highest price so as to maximize the revenues from the auction, and the objective of

purchasing allowances for its owned and/or controlled generation at the lowest possible price to minimize its expenses.

Constellation Opening Comment at 23.

PG&E's proposal for an administrative allocation of allowances to retail providers on the basis of retail sales with a subsequent auction to first sellers as the points of regulation is a gerry-built scheme designed to accomplish two self-serving PG&E objectives simultaneously: (1) it allows PG&E to avoid being the GHG point of regulation (which appears to be an objective that is shared by all of the CPUC –jurisdictional retail providers, including SCE and SDG&E as well as PG&E), and (2) it permits PG&E to obtain the windfall profit shown in Figure 5 above in virtue of being allocated administrative allowances in excess of its actual need. Beyond allowing PG&E to escape being a GHG point of regulation while gaining the benefits of a wealth transfer, PG&E's scheme would accomplish nothing but harm to the purchasers of PG&E's excess allowances and, potentially, the generators that compete with PG&E. SCPPA joins the other parties that have urged the Commission to say “emphatically, NO” to PG&E's self-serving proposal.

C. Obstacles to Using Auction Proceeds to Remedy the Harm Caused by Auctions Make Auctioning a Poor Choice for Allocating Allowances.

Auctioning allowances would be likely to lead to adverse consequences. As shown on Figure 1 above, assuming that allowances are auctioned at \$25 per ton, the estimated cost of auctioned allowances would be over \$2 billion, assuming 2008 emission levels. At \$50 per ton, the cost would be over \$4 billion. If the allowances are auctioned to “first-sellers”, the first-sellers will pass the cost of allowances through in the form of increased wholesale prices for electricity. The increased wholesale prices will then be passed on to end-use consumers. Likewise, if the auction is to retail providers as the point of regulation, the retail providers will seek to pass through the cost to their ratepayers. The impact of high electricity prices would be regressive,

insofar as a larger percentage burden would be placed on lower income households than higher income households. *See* SCPPA Opening Comment at 12-13.

Another adverse consequence of auctioning is that the more carbon-intensive retail providers such as SCPPA members will be required to bear both the enormous capital cost of reconfiguring their resource mix to reduce GHG emissions *and* the cost of auction allowances. As discussed in SCPPA's Opening Comment (at 14-15), SCPPA members are going to be required to aggressively fund energy efficiency, new renewable resources, new transmission projects and other initiatives to reduce their current level of GHG emissions. Additionally, if auctioning were imposed as the allowance allocation methodology, SCPPA members would, as shown above, need to expend over **\$700 million** annually to buy emission allowances at \$25 per ton, assuming 2008 emissions. This would result in allowance-driven rate increases that would be *additional* to the rate increases that SCPPA would need to impose on their customers to pay for new energy efficiency programs, new resources, new transmission, and other initiatives.

Recognizing the rate burdens of auctioning allowances as well as the potential burdens on the southern California publicly owned utilities, advocates of auctioning have proposed several ameliorative measures. However, there are obstacles to those measures. The better course would be to avoid auctioning altogether so as to avoid both the adverse rate consequences and the unfair imposition of a double burden on particularly challenged carbon-intensive retail providers.

1. There are Legal Obstacles to Using Auction Revenues for Rate Relief.

Various parties that support auctioning are, nevertheless, concerned about the potential impact of auctioning on rates. For example, if first sellers are the point of regulation under the ultimately adopted California GHG regulatory scheme, The Utility Reform Network ("TURN"), supports 100 percent auctioning of allowances, provided there is "distribution of the revenues to

mitigate adverse impacts on consumers, including lower-income people in particular.” TURN Opening Comment at 10. (If retail providers are the point of regulation rather than first sellers, TURN advocates an administrative allocation of allowances. *Ibid* at 11.) TURN urges the Commissions to “insure that auction proceeds are either returned to ratepayers, used to subsidize rates for vulnerable low-income customers, and/or used to offset the costs of existing programs designed to lower GHG emissions....” *Ibid* at 6.

SCPPA shares TURN’s concern about the rate impact of auctioning, absent ameliorative measures. However, SCPPA is concerned that rate relief would not be an available option for the use of auction proceeds.

First, auction proceeds cannot be used for any purpose without restriction as though the auction proceeds were tax revenues. A valid tax can be imposed on California citizens only when the authorizing legislation is passed by a two-thirds majority of the Legislature or a vote of the people. Cal. Const. Art. XIII. AB 32 was passed by majority vote. Thus, AB 32 does not provide authority to impose a tax. Accordingly, revenues recovered under authority of AB 32 must be construed to be regulatory fees rather than taxes.

California law imposes restrictions on the use of revenues derived through regulatory fees. The fees must be used “to mitigate the actual or anticipated adverse effects of the fee payers’ operations....” *Sinclair Paint Company v. State Board of Equalization*, 15 Cal. 4th 866, 869; 937 P. 2nd 1350, 1351 (1997) (*Sinclair Paint*). Under *Sinclair Paint*, “the State must use the funds it collects [through the regulatory fee] *exclusively* for mitigating the adverse effects [of the fee payers’ activities], and not for general revenue purposes.” *Ibid* at 881; 456 (emphasis in original.) *See also San Diego Gas and Electric Co., v. San Diego county Air Pollution Control District*, 203 Cal.App.3d 1132 (1988); *Beaumont Investors v. Beaumont-Cherry Valley Water*

District, 165 Cal.App.3d 227 (1985). The purpose of AB 32 is to reduce GHG emissions, not to provide rate relief. Thus, while auctioning revenues may be used for various GHG emission reduction activities, the revenues may not be used for rate relief under *Sinclair Paint*.

Second as pointed out in various responses to Ruling Question 22, there is a potential for Commerce Clause violations if auction proceeds are obtained from all deliverers/first sellers and spent solely for the benefit of California ratepayers. Where a state government regulates local aspects of interstate commerce, the regulation is generally valid if it (1) does not facially, or in its practical effect or purpose, discriminate against out-of-state competition to benefit local economic interests *and* (2) is not unduly burdensome, *i.e.*, the incidental burden on interstate commerce does not outweigh the legitimate local benefits produced by the legislation. *See, e.g., Pike v. Bruce Church, Inc.*, 397 U.S. 137, at 142 (1970).

If the revenues derived from auctioning allowances to first-sellers are dedicated to providing rate relief to California retail ratepayers, there could be clear discrimination against out-of-state ratepayers and a benefit to in-state ratepayers. Under the first-seller approach, all first sellers including importers of electricity would be required to buy allowances. As a result, the marginal price charged for electricity in the wholesale market would be increased. Intra-marginal generators may shift from selling to wholesale buyers in other states in order to sell to California to take advantage of the higher California market clearing price. That shift by intra-marginal wholesale sellers of electricity could, in turn, cause an increase in wholesale prices paid for electricity in other states. That would tend to result in higher retail prices being charged to consumers in other states. The rate relief that would be provided through use of auctioned revenues would go to California consumers, but not to adversely affected consumers in other states. Accordingly, as SCPPA explained in its Opening Comment (at 41), dedicating auction

revenues to providing rate relief for California consumers could result in a challenge under the Commerce Clause.

Third, if the Commission decides to pursue the “first-seller” approach to establishing the GHG regulatory point of regulation, it is likely that there will be a legal challenge on the basis that the direct impact of regulation under the “first-seller” approach affects the electricity wholesale market which is subject to the jurisdiction of the Federal Energy Regulatory Commission (“FERC”) and is, accordingly, preempted. As observed by EPUC/CAC, “where a regulation could be perceived to be directed to rate reduction, the likelihood of preemption is higher.” EPUC/CAC Opening Comment at 37 *citing Northern Natural Gas Co. v. State Corp. Comm’n of Kansas*, 372 U.S. 84, 92 (1963).

Fourth, it is not up to the Commissions or CARB to decide how auction revenues shall be spent. The only provision in AB 32 about the disposition of revenues is contained in the new Cal. H & S Code §38597. That section provides: “The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division.” Cal. H & S Code §38597. If the Commissions or CARB were to attempt to use auction revenues for rate relief without depositing the funds in the Air Pollution Control Fund for appropriation by the Legislature, the use of the funds for rate relief would be unlawful.

Thus, there are multiple legal issues that will arise if the Commissions or CARB attempt to use revenues derived through auctioning of allowances for rate relief. There would be more legal issues if there were auctioning of allowances under the “first seller” approach than if there were auctioning to retail providers as the point of regulation. However, legal issues arise if auction revenues are used for rate relief regardless of the point of regulation.

The Morgan Stanley Capital Group, Inc. (“Morgan Stanley”) advocates assigning auction revenues through an assignment of “Auction Revenue Rights” (“ARRs”). Morgan Stanley Opening Comment at 2, 14. However, the legal issues that would arise are the same.

Instead of having an auctioning of allowances that results in a dramatic increase in electricity prices and a responsive attempt to provide rate relief by channeling auction revenues back to rate payers, the better course would be to avoid the problem altogether by rejecting auctioning. The problems caused by auctioning would be fully avoided by adopting the program envisioned by the CPUC in D.06-02-032 and as supported by SCPPA.

2. There Is a Practical Obstacle to Using Auction Revenues to Assist Overburdened Carbon-Intensive Communities.

Southern California publicly owned utilities that have carbon-intensive resource mix are going to be particularly challenged if they are going to be required both to fund GHG reduction efforts and to buy auctioned allowances. *See* Figures 1 and 2 above. As a palliative, NRDC/UCS propose “to allow utilities to keep a portion of the amount they spend in the auction to invest in specified ways, subject to oversight and verification that the investments meet appropriate criteria.” NRDC/UCS Opening Comment at 10.

A return of 100 percent of the revenues spent for auctioned allowances would eliminate the problem of requiring retail providers such as the southern California publicly owned utilities from being required both to fund GHG reduction efforts and to purchase of allowances. In the case of the southern California publicly owned utilities, the return of auction revenues would meet the *Sinclair Paint* criteria insofar as the revenues would be directed to GHG reduction efforts, consistent with the purpose of AB 32.

However, under Cal. H & S Code §38597 as promulgated in AB 32, the revenues received through an auction are to be deposited in an Air Pollution Control Fund to be

appropriated by the Legislature for the purposes of carrying out AB 32. Given the many potential uses for auction revenues, all of which may be consistent with *Sinclair Paint*, it is highly unlikely that 100 percent of the revenues or even some lesser but nevertheless substantial percentage of the revenues that are derived from retail providers such as the southern California publicly owned utilities would actually be returned to those utilities for GHG reduction efforts. Thus, the adverse consequences of adopting the auction approach cannot be dismissed by suggesting that the double burden that would be experienced by the southern California publicly owned utilities would be mitigated by a return of auction revenues to the utilities.

EPUC/CAC make a suggestion that is similar to NRDC's proposal to return auctioned revenues to retail providers such as the southern California publicly owned utilities. EPUC/CAC suggest "auction revenue retention." EPUC/CAC Opening Comments at 30. However, Cal. H & S Code §38597 requires that revenues "shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division." Insofar as auction revenues must be deposited in the Air Pollution Control Fund, the suggested "revenue retention" would be contrary to AB 32.

IV. AN ADMINISTRATIVE ALLOCATION OF ALLOWANCES ON THE BASIS OF "OUT PUT" OR ANY OTHER MEASURE THAT IGNORES ACTUAL EMISSIONS WOULD RESULT IN A WEALTH TRANSFER AND WINDFALL PROFITS FOR THOSE THAT RECEIVE ALLOWANCES IN EXCESS OF THEIR NEED.

PG&E and NCPA propose that allowances should be administratively allocated to retail providers and that the allocation should be based on retail sales. As shown by Figures 3, 4, and 5 above, an allocation of allowances on the basis of retail sales would result in an enormous wealth transfer from the southern California publicly owned utilities and their customers to other California utilities.

Emission allowances should not be allocated on the basis of retail sales, “benchmarked” lbs. CO₂ /kWh of output, population, or any other factor that does not bear a direct one-to-one correlation to a retail provider’s actual historical emissions. Any allocation on a basis that is not correlated to emissions and the actual need of regulated entities for allowances would result in cross-subsidies and wealth transfers among retail providers. The allocation would be inequitable and would degrade the integrity of the GHG regulatory program.

A. Allowances are a Regulatory Tool, Not Rewards for Past Behavior.

A variety of parties contend that allowances should be allocated on the basis of “output” measured as retail sales or on the basis of retail sales multiplied by a statewide benchmark stated in lbs. CO₂/kWh. Either way, allowances would be allocated among the regulated entities without regard to the actual emissions associated with the regulated entities’ output.

The common refrain of the parties that seek to have an output-based allocation of allowances among regulated entities is that it “rewards” the regulated entities that have a “cleaner” resource mix: “This approach rewards the retail providers that already have a clean resource mix, and recognizes early action they have already taken.” NRDC/UCS Opening Comment at 12. Conversely, they argue against allocating allowances on the basis of actual experienced emissions or “grandfathering” because that would “reward” regulated entities that have higher emissions such as the southern California publicly owned utilities: “[G]randfathering fails to recognize and reward those entities that have taken early action to reduce GHG emissions, and at the same time, grandfathering rewards entities with high historic emissions.” *Ibid* at 11-12.

It would be bad public policy to allocate allowances to some regulated entities as a reward for past actions while denying an allocation of allowances to other entities as a penalty for past actions. Allocating allowances to reward some regulated entities and to penalize others

would require the regulatory agency to investigate the appropriateness of the reward or penalty. For example, in deciding whether to reward or penalize the SCPPA members, the regulatory agency would need to investigate the circumstances that led to the reliance by SCPPA members on coal resources, primarily the Intermountain Power Project in Utah and the San Juan Project in New Mexico.

The SCPPA members' reliance on coal is a legacy of the 1970s. In 1978, Congress adopted the Powerplant and Industrial Fuel Use Act ("PIFUA"). This Act prohibited development of new gas-fired baseload resources. The national policy was to encourage the use of coal, a domestic resource. When confronted by the need to add capacity, state and public resistance to developing nuclear facilities, and the unavailability of hydroelectric options in the region, SCPPA and its members resorted to coal-fired facilities located in nearby western states, consistent with PIFUA and national policy. The addition of the coal-based resources was driven by a combination of legal, geographical, and economic circumstances. The global warming consequences of such resources were not understood at the time. It would be unjust to either reward or penalize the southern California publicly owned utilities for actions they took in the past on bases that were entirely valid at the time and were unrelated to concerns about carbon emissions.

Similarly, it would be unjust to either reward or penalize low-carbon retail providers for actions they took in the past. For example, just as the southern California publicly owned utilities acquired resources such as the Intermountain Power Project for reasons that were valid at the time and were unrelated to concerns about carbon emissions, PG&E constructed the Diablo Canyon nuclear facility and the Helms pumped storage project for reasons other than concerns about carbon emissions. Just as the southern California publicly owned utilities do not deserve

to be either rewarded or penalized for their decision to participate in the Intermountain Power Project in the 1970s, PG&E should not be either rewarded or penalized for its decision to construct the Diablo Canyon nuclear facility or the Helms pumped storage project.

The allocation of allowances should not be regarded as being an opportunity to grant rewards or levy penalties. Instead, as correctly conceived by the CPUC in D.06-02-032 and in traditional air quality regulation under the Clean Air Act, allowances are a feature of a regulatory structure that can add flexibility to the structure. Under the program as conceived by the CPUC as well as under Clean Air Act regulations, entities are required to reduce their emissions from a base level to lower levels at a prescribed rate over time. Progressively fewer allowances are made available during each successive compliance period as the regulated entities progress toward their ultimate emission reduction goals. If trading of allowances is permitted as it is under the SCAQMD's RECLAIM Program or under the GHG regulatory program envisioned by the CPUC in D.06-02-032, an element of flexibility is introduced. Entities that have surplus allowances can trade the allowances to others that have a deficit in exchange for monetary consideration.

It would be a major policy mistake to transmute allowances from being a feature in a regulatory program that adds an element of flexibility to being a mechanism for rewarding or punishing past behavior. If the Commission were to adopt the view of NRDC/UCS and others that allowances should be used to reward or punish past actions, the Commission or CARB would be obligated by fundamental precepts of justice to inquire on a case-by-case basis whether a reward or a punishment was warranted. A case-specific analysis would have to be performed for each and every regulated entity to determine whether it merited a reward or a punishment for its past actions. Clearly, intent associated with past actions would need to be ascertained.

The Commissions and CARB should avoid getting into the business of rewarding or punishing regulated entities for past actions that bear, one way or another, on their current carbon footprint. The Commissions and CARB should categorically reject the notion proffered by NRDC/UCS and others that allowances should be allocated as rewards or punishments for past actions.

B. Retail Providers That Currently Have a Less Carbon Intensive Resource Mix Should Not Be Permitted to Escape Making a Contribution to the Attainment of AB 32 GHG Reduction Goals.

Retail providers that currently have a resource mix with a lower carbon intensity should not be permitted to escape making some contribution, albeit smaller in absolute terms than the contribution of others, to achieving AB 32 GHG reduction goals.

As NRDC/UCS correctly observed, allocating allowances on the basis of emissions “essentially obligates each regulated entity to reduce its emissions by the same percentage.” NRDC/UCS Opening Comment at 11. That is what happens under Clear Air Act regulation, that is what would happen under the program envisioned by the CPUC in D.06-02-032, and that is what SCPPA recommends. It would be fair. The more carbon-intensive regulated entity would be required to do more than a less carbon intensive regulated entity insofar as a percentage of a larger number results in a larger number while the same percentage multiplied by a smaller number results in a smaller number. Yet, each regulated entity would have to make some contribution.

PG&E argues, however, that it should *not* be required to make a contribution to attaining GHG reduction goals. It claims that “low emitting utilities will have fewer low cost GHG reduction opportunities because they already have taken advantage of those opportunities.” PG&E Opening Comment at 17-18. PG&E is effectively claiming that it has done all it can do and should not be called upon to do more.

PG&E's attempt to avoid making a contribution to attaining AB 32 GHG reduction goals should be rejected. PG&E *can* do more. That has been demonstrated by the modeling that has been done by the CPUC's modeling consultant, Energy and Environmental Economics, Inc. ("E3"). Under both E3's business-as-usual model and E3's aggressive policy model, PG&E, like all other California retail providers, is shown as achieving substantial reductions in CO₂ intensity between 2008 and 2020. Under the business-as-usual model, PG&E's CO₂ intensity is shown by E3 as declining by roughly *half* between 2008 and 2020. Modeling Ruling, Attachment B at 172.

More generally, E3's modeling shows that *all* California retail providers can make a contribution by 2020 to reducing electric sector GHG emissions under both the business-as-usual model and the aggressive policy model. E3's modeling shows that there is no basis for PG&E's claim that it "cannot do more" that it has already done to reduce GHG emissions. Thus, E3's modeling shows that there is no factual basis for requiring that the full burden for meeting AB 32 electric sector GHG reduction goals for 2020 should fall entirely on the retail providers that have a more carbon-intensive resource mix currently.

C. Allocating Emission Allowances on the Basis of Output Would Result in Unjust and Unacceptable Wealth Transfers Among Retail Providers.

Allocating GHG emission allowances on the basis of output without regard to each regulated entities' actual emission levels would "simply create wealth transfers related to the overall goal of achieving new, additional GHG emission reductions." PacifiCorp Opening Comment at 19. As shown by Figure 5 above, if allowances were valued at \$25/ton, an allocation of allowances based upon 2008 sample year emissions would result in a wealth transfer of over **\$250 million** for just one year from southern California publicly owned utilities to other California utilities. The wealth transfer would swell to over **\$500 million** for just one

year if allowances were valued at \$50/ton. This wealth transfer would be a cost for the southern California publicly owned utility ratepayers that would be *additional* to the enormous cost that those ratepayers are going to have to incur to wean themselves from the carboniferous resources that were added decades ago in compliance with state and national policies that existed at the time.

TURN says it agrees with PG&E's proposal to allocate allowances on an output basis. TURN Opening Comment at 21. However, TURN appears to be unaware of the wealth transfer consequences of the PG&E proposal. An output-based allocation of allowances would be unjust, unfair, and unreasonable. Proposals for allocation based on output should be rejected.

D. An Allocation of Allowances on the Basis of Output to Generators Would Result in Windfall Profits.

In addition to proposals for an allocation of allowances to retail providers on the basis of output, there have been proposals for an allocation of allowances to generators on the basis of output. Constellation says: "The point of regulation should be the emitting resources – a source-based approach." Constellation Opening Comment at 3. To the extent to which allowances are administratively allocated, Constellation says "allowances should be allocated using an 'output' based methodology." *Ibid.* Similarly, Calpine recommends "administratively allocating allowances rather than auctioning them, regardless of whether a load-based or deliverer/first seller approach is adopted." Calpine Opening Comment at 6. Calpine advocates that the administrative allocation should be based on a "output-based allocation methodology...." *Ibid.*

EPUC/CAC go even further. Not only do they propose that there should be an administrative allocation of allowances to co-generators on the basis of output. EPUC/CAC propose that there be "double benchmarking" calculated "on the basis of the emissions of a typical, and often 'best available technology' ('BAT'), plant for a given energy output."

EPUC/CAC Opening Comment at 19. Under the “double benchmarking” approach, a co-generator would receive an administrative allocation of allowances on the basis of both its electrical output and its heat output. *Ibid* at 20.

These pleas by generators and co-generators for an administrative allocation of allowances on the basis of output should be categorically rejected. First, generators and co-generators should not be a point of regulation at all. Retail providers should be the point of regulation and should be the ones to receive administratively allocated allowances.

Second, to the extent to which the generators and co-generators are designated as being points of regulation and are able to pass most of their cost on to consumers, they should not receive a free allocation of allowances. As the MAC correctly observed: “The free distribution of allowances can result in a substantial transfer of wealth from consumers to those entities that receive allowances.” MAC Recommendations at 56. Accordingly, the MAC appropriately recommended that “California avoid windfall profits, where they would occur, by limiting the free allocation of allowances.” *Ibid*. Specifically: “There should be no free allocation to firms under the cap that are able to pass most of their costs on to consumers.”

However, there should be some degree of flexibility to accommodate situations in which the generators or co-generators operate under long term fixed price contracts so as to not be able to pass through costs of allowances until those contracts expire. *Ibid*. SCPPA agrees with the MAC that “whether these producers should receive a free allocation in the interim should be evaluated carefully” if a first-seller regulatory scheme were adopted. *Ibid*.

E. Administratively Allocating Allowances on the Basis of Output Cannot Be Justified as an Accommodation for Load Growth.

The advocates for an administrative allowance on the basis of output advocate using a recent base period to establish allowances, and they urge regular updating of base period data.

See e.g., FPL Opening Comment at 11. They claim that this feature is a strength of their proposal. They claim that, as a result of frequent updating, load growth can be accommodated.

Accommodating load growth is not a sufficient selling point for adopting the terribly unfair output-based methodology for administratively allocating allowances. There is a question about the degree to which load growth should be explicitly accommodated. Other measures such as revisions of land use practices or building codes may be a better way to accommodate load growth. Furthermore, under the regulatory approach proposed by the CPUC in D.06-02-032 and supported by SCPPA, there is provision for trading of allowances through a secondary market. That would be an avenue for obtaining allowances beyond those initially allocated on the basis of base year emissions.

F. LADWP’s Proposal to Move from Allocating Allowances on the Basis of “Current Emissions” to Allocating Allowances on the Basis of “An Emission Level that Reflects Best Industry Practices”.

In its October 31, 2007 Opening Comment as well as at the November 5, 2007 workshop, LADWP appeared to take a position on the allocating allowances that differs from SCPPA’s view that allowances should be allocated on the basis of emissions associated with a retail provider’s service to load, with the amount of allocated allowances declining over time.

Like SCPPA, LADWP supports an administrative allocation of allowances to retail providers as a point of regulation in the electric sector. LADWP Opening Comment at 2, 6. Also like SCPPA, LADWP supports an initial allocation of allowances that would be based upon emissions rather than some other factor such as retail sales, population, or a statewide “benchmark” stated in lbs.CO₂/MWh. LADWP Opening Comment at 14-15.

However, in both its Opening Comment and in its oral presentation at the November 5, 2007 workshop, LADWP said that it would support an administrative allocation of allowances that would start with an initial allocation of allowances based upon emissions but move over

time to a point at which “each regulated entity in the electric sector” reaches “an emission level that reflects best industry practices” by 2020. LADWP stated in its Opening Comment:

LADWP supports an administrative allocation of allowances at the program inception date (2012) based on current and accurate emissions levels, with an annual declining cap that ultimately brings each regulated entity in the electric sector to an emission level that reflects best industry practices.

LADWP Opening Comment at 2. This was reiterated by LADWP spokesperson at the November 5, 2007 workshop: “LADWP’s proposal is to support an administrative allocation of allowances at the program’s inception in 2012, based on current and accurate emission levels, with an annual declining cap that ultimately brings each regulated entity in the electric sector to an emission level that reflects best industry practices in 2020.” Transcript (“Tr.”) at 13-14.

The key phase in LADWP’s statement of its position is the one that describes the end points that “each regulated entity in the electric sector” would be required to achieve by 2020: “an emission level that reflects best industry practices.” This would *not* be a statewide “benchmark” stated in lbs.CO₂/MWh that would be common to all retail providers. Instead, “each regulated entity in the electric sector” would be required to reach an emission level by 2020 that is consistent with “best industry practices.”

LADWP did not proffer a definition of “best industry practices” in its Opening Comment. However, E3 has provided a workable definition. E3 provides a description of an “Aggressive Policy Reference Case” in its CPUC GHG Modeling Stage 1 Documentation that was Attachment B to the Administrative Law Judges’ Ruling Requesting Comments on Modeling-Related Issues (“Modeling Ruling”) issued on November 9, 2007, in this proceeding.

Under E3’s Aggressive Policy Reference Case, each retail provider (which E3 assumes to be a point of regulation) is assumed to reach an energy efficiency level at 100 percent of “net economic potential” as described in a separate report by E3. Modeling Ruling, Att. B at 24.

Additionally, each retail provider is assumed to achieve a Renewables Portfolio Standard (“RPS”) of 33 percent. *Id.*

The E3 Aggressive Policy Reference Case also incorporates a number of assumptions that are included in the E3 Business-as-Usual Reference Case. As a result, the Aggressive Policy Reference Case assumes, among other things, that existing California Solar Initiative (“CSI”) installation rates are maintained through 2020, existing Self Generation Incentive Program (“SGIP”) installation rates continue through 2020, the default emissions standard of 1100 lbs. CO₂/MWh is assigned to unspecified resources of retail providers, and, importantly, “[a]ll existing coal plant ownership [is] maintained [and] long-term contracts end if known to expire before 2020 (Reid Gardner, Boardman, Bonanza-1, Hunter-2).” *Ibid.*

E3’s Aggressive Policy Reference Case is, at this point, the best available description of “best industry practices” as used but as undefined by LADWP. With the understanding that E3’s Aggressive Policy Reference Case is what LADWP means by the phrase “best industry practices”, SCPPA can support the proposal by LADWP as a workable alternative to SCPPA’s primary proposal, namely, that allowances be administratively allocated to regulated retail providers as the electric sector points of regulation on the basis of recent pre-AB 32 experience emissions with the amount of allocated allowances decreasing over time proportionally for each retail provider as necessary for the retail providers to achieve their AB 32 GHG reduction goals by 2020.

Given SCPPA’s understanding that “best industry practices” is equivalent to E3’s Aggressive Policy Reference Case, adoption of LADWP’s proposed benchmark for 2020 would mean that any retail provider that follows “best industry practices” as defined by E3’s Aggressive Policy Reference Case would not be a net buyer of allowances in 2020. Also, it

would mean that no retail provider would be required to abrogate or cease performance under an existing contract until the contract expires in accordance with its current terms.⁵

G. Emission Allowances Should Not Be Allocated on the Basis of Population.

NRDC/UCS propose: “Another allocation approach that should be considered is per-capita or per-customer allocation.” NRDC/UCS Opening Comment at 13. Their reasoning is as follows: “A per-customer allocation would implicitly allow each customer to emit an equal quantity of GHGs....” *Ibid.* That rationale is nonsense. To the extent that “customers” are

⁵ LADWP also says in its Opening Comment:

The LADWP can support a transition to an electric sector average benchmark as the 2020 emissions reduction goal. LADWP recognizes that this would result in an overall greater burden for those retail providers that have high carbon footprints in comparison to those that are relatively cleaner. They would be required to reduce a greater percentage in comparison to retail service providers with low carbon footprints.

LADWP Opening Comment at 13. If this statement is taken out of context and in isolation, it appears to commit LADWP to supporting a transition from allocating allowances among retail providers on the basis of emissions to allocating allowances on the basis of a statewide benchmark stated in lbs. CO₂/MWh by 2020. However, LADWP qualifies the statement by explaining that if there were to be an initial allocation of allowances on the basis of emissions with a transition to an allocation on the basis of a benchmark by 2020, there would need to “accommodations”:

[If] such approach is adopted, the LADWP believes that other accommodations are necessary, and must be included in order for such a methodology to be feasible. These include a reasonable glide path for high carbon retail service providers in the early years to provide an adequate planning horizon for new investments in renewable generation and related transmission. This would be followed by a steeper curve in later years until reaching the required reduction levels in 2020.

LADWP Opening Comment at 13-14. Another “accommodation” would be that the benchmark would be based on “best industry practices”. LADWP Opening Comment at 2.

Statewide “benchmarking” is infeasible insofar as California retail providers are so diverse in the structure of their existing and potential resource portfolios. Northern California retail providers are geographically situated so as to be able to take advantage of hydroelectric resources that have zero emissions and simultaneously provide flexibility to integrate additional renewable resources into their systems without generating GHG emissions. Such retail providers do not have to burn fossil fuel to provide spinning or operating reserves insofar as hydroelectric resources serve those functions.

By contrast, entities in southern California that have substantially less access to hydroelectric resources than northern California retail providers require fossil fuel generation to “firm” intermittent renewable resources such as wind generation. Thus, in general, even with equivalent levels of renewable resources, the southern California retail providers will tend to have higher average emissions per kilowatt hour than northern California retail providers. As a result, statewide “benchmarking” is unworkable. If the Commissions or CARB were to desire

people customers do not emit greenhouse gases except to the extent to which they breathe air. (A person emits approximately 2.5 lbs./ CO₂ per day.) Customers are not generators of electricity. Allocating allowances on the basis of the number of a retail providers' customers or the population in a retail provider's service territory would have no rational relationship whatsoever to the retail providers' emissions associated with service to electrical load.

Furthermore, aside from having no rational relation to emissions associated with service to load, allocating allowances on the basis of the number of customers or population in a service territory would fail to accommodate the "widely divergent climatic regions across California...." SMUD Opening Comment at 10. For that reason, as well, allocating allowances on the basis of number of customers or population on a service territory fails to be rational allocation methodology for California.

H. The SCE Proposal to Allocate Emission Allowances on the Basis of Economic Harm Is Too Complex.

SCE advocates allocating allowances "to entities suffering economic dislocation (i.e., harm) because of imposition of GHG regulations." SCE Opening Comment at 14. SCE would allocate allowances to both generators and retail providers. SCE Opening Comment, Appendix at 11-12. SCE proposes, similar to PG&E, that there be an auction *subsequent* to the allocation of auctions to permit the entities that are the points of regulation to obtain allowances. SCE Opening Comment at 13-14. The auction would be independently administered: "An independently administered auction is the appropriate method for redistribution of allowances after their initial assignment." *Ibid* at 25. The value received from the auction would flow "back to the original allowance holders." *Ibid* at 26.

to pursue statewide benchmarking for retail providers, some accommodation would be required as proposed by LADWP or as proposed by SCPPA in its Opening Comment. See SCPPA Opening Comment at 28-30.

Insofar as the SCE proposal involves an allocation of allowances to parties with a subsequent auction and a return of revenues to the parties, the SCE proposal may be legally suspect for some of the reasons discussed above in connection with other proposals. For example, it appears that SCE proposes that there would be a return of funds to “the original allowance holders” without revenues from an auction being deposited in the Air Pollution Control Fund for appropriation by the Legislature as required by the Cal. H & S Code §38597.

More generally, however, while SCPPA is generally sympathetic to SCE’s proposal to allocate allowances initially on the basis of economic harm, SCPPA is concerned that SCE’s proposal is overly complex. The determination of who suffers economic harm would be administratively difficult. Furthermore, the multiple step process of administratively allocating allowances to the sufferers of economic harm, subsequently auctioning the allowances by an independent agent, and then returning auction revenues to the original recipients of the allowances appears to be unduly complex.

It seems that one of the primary motivations for SCE’s complex multiple step proposal is to avoid having SCE become a point of regulation. The stated objective of SCE’s proposal allocation of allowances on the basis of economic harm would seem to be more directly attained if SCE would acquiesce to having retail providers become the point of regulation and to having an allocation among the retail providers on the basis of emissions associated with serving.

V. THE BASE YEAR FOR ADMINISTRATIVELY ALLOCATED ALLOWANCES SHOULD BE A RECENT PRE-AB 32 MULTIPLE YEAR PERIOD.

Various proposals for defining the base year for administratively allocating allowances based on emissions were proffered in opening comments. SCPPA proposed a three year period 2004-2006. That would be long enough (three years) to normalize any anomalies that might have occurred during any particular year. Additionally, insofar as the three years 2004-2006

precede enactment of AB 32, retail providers would get the full benefit of GHG reduction efforts that they might undertake after enactment of AB 32. That would provide an appropriate incentive for retail providers to undertake “early actions” to achieve GHG reductions prior to AB 32 regulations becoming effective on January 1, 2012. SCPPA Opening Comment at 33.

The Modesto Irrigation District (“MID”) proposed using the single year 2006 as the base period. MID Opening Comment at 6. Although 2006 was immediately prior to enactment of AB 32, one year would not be sufficient to eliminate inter-year anomalies.

LADWP proposed a three to five year period “as close to the base period as possible.” LADWP Opening Comment at 17. However, that would fail to give credit for “early actions” that retail providers might undertake after enactment of AB 32 but prior to AB 32 regulations becoming effective on January 1, 2012.

PacifiCorp proposes a five year period “prior to the rule’s effective start date.” PacifiCorp Opening Comment at 15. PacifiCorp proposes, further, that California should “drop data from the years with the highest and lowest emissions for each load serving entity.” PacifiCorp’s proposed base period suffers from the defect of following the enactment of AB 32, in which case the methodology would not give full credit for “early actions” undertaken after AB 32 enactment but prior to AB 32 regulations become effective on January 1, 2012. However, PacifiCorp’s proposal for a five year period with the years of highest and lowest emissions appears to have merit. The PacifiCorp approach would take advantage of the practice typically used by appraisers.

After reviewing the suggestions in the opening comments, SCPPA continues to believe that allowances should be administratively allocated on the basis of emissions data from an

immediate pre-AB 32 period so as to give full credit for post-AB 32 but pre-implementation “early action”. As for the number of years that should be used for the base period, SCPPA believes PacifiCorp’s suggestion should be considered.

A. Base Period Allowances Should Not Be Disturbed Except for Periodic Downward Adjustments to Meet AB 32 Goals.

Once a retail provider’s allowance on the basis of emissions is established, the allowance should not be disturbed and except to be adjusted downward periodically. As PacifiCorp proposes:

For planning purposes, the individual regulated entity’s emission allowance allocation methodology (i.e., its ratio of the GHG baseline and subsequent caps compared to other regulated entities), should never be changed, but the forecasted cap available for grandfathered GHG emission allowances could be adjusted periodically.

PacifiCorp Opening Comment at 19.

B. If There Is a Reserve for New Entrants, the Reserve Should Be Small.

Advocates of an administrative allocation of allowances generally suggested that there be a small reserve for new entrants. PacifiCorp proposed a “set aside” of less than three percent for new entrants. PacifiCorp Opening Comment at 9. FPL proposed ten percent. FPL Opening Comment at 12. SCPPA is unsure there is any need for a set aside if retail providers are the point of regulation. The entry of new providers is currently chilled by the freeze on any expansion of direct access in California. Furthermore, allowances would be available through a secondary market under the regulatory approach contemplated by the CPUC in D.06-02-032. However, it seems the sentiment is running in the direction of having some set-aside for new entrants. The PacifiCorp proposal appears to SCPPA to be the most reasonable.

VI. CONCLUSION.

SCPPA recommends that the Commissions adopt a GHG emission allowance allocation methodology which would simultaneously accomplish the twin objectives of *achieving the GHG reduction goal of AB 32* while *minimizing GHG reduction costs for California electricity consumers*. To that end, SCPPA recommends that the Commissions build upon the foundation laid by the CPUC in D.06-02-032 and the Scoping Memo. GHG emission allowances should be administratively allocated to regulated retail providers as the points of regulation in the electric sector for the benefit of the retail providers' customers. The allocation should be based upon recent pre-AB 32 actually experienced emissions, with the amount of allowances that are allocated to each retail provider for each successive compliance period being reduced proportionally over time as necessary to achieve the AB 32 GHG reduction goals for the electric sector and for each retail provider by 2020.

Respectfully submitted,

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Attorney for the **SOUTHERN CALIFORNIA
PUBLIC POWER AUTHORITY**

Dated: November 14, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY REPLY COMMENT ON ALLOWANCE ALLOCATION ISSUES** on the service list for CPUC Docket No. R.06-04-009 and CEC Docket No. 07-OIIP-01 by serving a copy to each party by electronic mail and/or by mailing a properly addressed copy by first-class mail with postage prepaid.

Executed on November 14, 2007, at Los Angeles, California.

/s/ Sylvia Cantos

Sylvia Cantos