

January 11, 2010



Mr. Kevin Kennedy, Ph.D.
Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 94814

Re: California Air Resources Board’s “Preliminary Draft Regulation for a California Cap-and-Trade Program”

Dear Mr. Kennedy:

The State Water Contractors (SWC) thank the California Air Resources Board (ARB) for seeking comments on the “Preliminary Draft Regulations for the Cap-and-Trade Program” (Proposed Regulations). The SWC¹ is a non-profit, mutual benefit corporation organized under the laws of the State of California, comprised of 27 public agencies holding contracts to purchase water delivered by the State Water Resources Development System, otherwise known as the State Water Project (SWP), which is owned and operated by the California Department of Water Resources (DWR). SWC’s public agency members are the beneficial users of the SWP, which provides water for drinking, commercial, industrial, and agricultural purposes to a population of more than 25 million people and to over 750,000 acres of farmland throughout the San Francisco Bay-Area, the Central Valley of California, and Southern California. The primary purpose of the SWP is to store and deliver water to the SWP contractors, who pay all of the costs incurred by the SWP.

DWR manages a power resource portfolio solely for the purpose of delivering water to SWP contractors. There are no electricity customers served by the SWP. The SWP contractors’ ability to reliably and economically serve their customers is in jeopardy due to reduced snowpack, prolonged drought and

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Terry Erlewine

¹The SWC members are: Alameda County Flood Control & Water Conservation District, Zone 7; Alameda County Water District; Antelope Valley-East Kern Water Agency; Casitas Municipal Water District on behalf of the Ventura County Flood Control District; Castaic Lake Water Agency; Central Coast Water Authority on behalf of the Santa Barbara County Flood Control & Water Conservation District; City of Yuba City; Coachella Valley Water District; County of Kings; Crestline-Lake Arrowhead Water Agency; Desert Water Agency; Dudley Ridge Water District; Empire-West Side Irrigation District; Kern County Water Agency; Littlerock Creek Irrigation District; The Metropolitan Water District of Southern California; Mojave Water Agency; Napa County Flood Control & Water Conservation District; Oak Flat Water District; Palmdale Water District; San Bernardino Valley Municipal Water District; San Gabriel Valley Municipal Water District; San Geronio Pass Water Agency; San Luis Obispo Co. Flood Control & Water Conservation District; Santa Clara Valley Water District; Solano County Water Agency; and Tulare Lake Basin Water Storage District.

other conditions attributed to GHG. That is why the SWC have supported the efforts of DWR to reduce carbon emissions. More than 50% of the energy used to deliver water is produced from clean, carbon free hydroelectric generation. With the support of the SWP contractors, DWR has already taken steps to significantly reduce the SWP carbon footprint. That action will reduce SWP GHG emissions below 1990 levels and will provide a significant contribution toward achieving California's AB32 goals. The SWP contractors further support a DWR emission reduction policy that combines additional renewable energy and energy efficiency to achieve further GHG reductions. We view the Proposed Regulation program as complementary to the measures DWR has already initiated to reduce SWP GHG emissions. However, we are concerned that, as proposed, the program will create inequities and have unintended consequences.

ARB's consultants, the Economic and Allocation Advisory Committee (EAAC), estimate the value of the emission allowances at between \$2.5 billion to 7.5 billion in 2012. EAAC expects those cost to increase to between \$7.5 billion and \$22 billion in 2020.² These estimates are based on an EAAC assumption that all emission allowances are auctioned. The SWC suggests instead that ARB provide free allowances to carbon emitters and auction only those allowances needed to fund "Additional Reductions Necessary to Achieve the Cap." This approach reduces to 34.4 MMTCO₂ of emission allowances auctioned in 2020 instead of 365 MMTCO₂ assumed by EAAC.³ Limiting the number of allowances auctioned will help avoid the significant inequities that will likely be imposed on the SWP customers by the Proposed Regulation. Alternatively, the proposal by the Joint Utilities may also help avoid inequities, if it is properly structured and allocates allowances to all covered entities having a surrender obligation for electricity used to serve electric and water customers.⁴ However even a modified Joint Utilities proposal will lead to unintended consequences because of the amount of dollars this program will collect and redistribute.

To underscore our concern regarding unintended consequences of the Proposed Regulation we refer ARB to the effort to redesign the California electricity markets. That effort was born of good intentions, involved the allocation of a scarce resource through an auction, and transferred significant dollars between participants. In 2000 and 2001, "California was rocked by energy shortages and skyrocketing electricity prices."⁵ State and federal policy makers and regulators were ill-equipped to deal with manipulation of the poor market design. Our first lesson from that catastrophe is "policy makers must respect market forces."⁶ The customers of the SWP continue to pay for the unintended consequences of the attempt to restructure the California electricity market. The SWC is disturbed to find minimal consideration in the tone or substance of the

² Recommendations to the California Air Resources Board from the Economic and Allocation Advisory. Untitled Table 3, "Allocating Emissions Allowances Under California's Cap-and-Trade Program." <http://climatechange.ca.gov/eaac/documents/eaac_reports/2010-01-07_EAAC_Allocation_Report_Draft.pdf> (January 7, 2010)

³ California Air Resources Board. Table 2: Recommended Greenhouse Gas Reduction Measures, "Climate Change Scoping Plan." <<http://www.arb.ca.gov/cc/scopingplan/document/scopingplandocument.htm>>. (December 2008)

⁴ THE JOINT UTILITIES. Letter to EAAC. January 6, 2010.

⁵ Susan P. Kennedy. "The Oh Decade: California's electricity crisis stung – but made us stronger." Special to The Sacramento Bee. January 1, 2010.

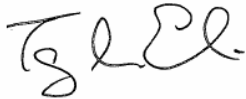
⁶ *ibid*

Proposed Regulation that ARB will apply the lessons learned from the California Electricity Crisis.

Another aspect of the Proposed Regulation that will lead to unintended consequences is that it permits parties that do not have surrender obligations to “opt in” to the auction process. Such parties will participate in the auction solely for their financial gain. These speculators will increase the volatility of the price of emissions, bid up the price of allowances and create the highest possible cost for those with a surrender obligation. Allowing speculators to opt-in that have no vested interest in containing the cost of emissions will likely lead to higher costs to California’s families and businesses and achieve no reduction in GHG emissions.

As currently contemplated, the Cap-and-Trade program will have a far greater impact on the California economy and the costs to the SWP customers than we had expected. Our comments are intended to avoid the inequities and unintended consequences that the Proposed Regulation will likely create. The SWC appreciates this opportunity to comment on the Proposed Regulation. We look forward to meeting with ARB staff if you would like to discuss our comments.

Sincerely,

A handwritten signature in black ink, appearing to read 'Terry Erlewine', written in a cursive style.

Terry Erlewine
General Manager