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December 10, 2008
LEG 2008-0809

Mary Nichols, Chair
California Air Resources Board
1001 I Street
P.O. Box 2815
Sacramento, CA 95814

Re: Sacramento Municipal Utility District's Supplemental Comments on AB 32 Scoping Plan

Dear Chair Nichols:

SMUD, the Sacramento Municipal Utility District, is the publicly owned electricity provider for the Sacramento area. SMUD has been an early and continuous supporter of AB32. We enthusiastically support the goal of reducing greenhouse gas emissions and confirming California's leadership in creating a vigorous, low-carbon economy for the 21st Century confirming. SMUD appreciates the hard work that the ARB staff and other contributing State agencies have done to put together a comprehensive plan to meet AB 32 targets. SMUD submits the following written comments on the Proposed Scoping Plan (PSP), in addition to earlier oral comments submitted to the Board on November 20, 2008, and written comments on the Draft Scoping Plan. SMUD is grateful for the open and inclusive process followed by the ARB in constructing the AB 32 Scoping Plan.

In general, SMUD supports the Electric Sector programmatic measures, the 33% RPS, the energy efficiency targets, the California Solar Initiative, and the need for carbon allowance trading. The Scoping Plan forms an adequate basis upon which to begin development of specific regulations needed to assure the greenhouse gas reductions needed to meet AB 32 goals.

There is, however, much work still to do. SMUD believes that to successfully fulfill the reductions asked of the Electricity Sector, serious consideration of our recommendations is necessary. Setting policy now to remedy these issues will be easier than confronting them in the regulatory development phase.

In summary, SMUD makes the following recommendations to augment the Scoping Plan:

- The Transportation Sector must be included in the emissions cap from the outset in order to preclude a significant and inequitable burden on the Electricity Sector, as well as granting unwarranted benefit for the largest carbon emitting sector.

- No timeline for the reductions is stated or implied in the Scoping Plan. The ARB should not be lulled into casual acceptance of a linear reduction target that becomes a hard cap, as is implied by Scoping Plan Appendix C, Figure 1. The cap trajectory should instead be set by evaluation of the likely timing of the reductions due to specific measures found in the Scoping Plan.

- Electricity reliability must be identified as a paramount consideration in the design of a cap and trade program.

- Voluntary GhG emission reduction programs should be accommodated to expressly recognize their contribution and without giving unwarranted advantage to capped entities.

- High value emission offset projects in California are in a nascent condition, but need new rules to officially credit reductions. Accelerated adoption of regulations under Section 38571 of the Health and Safety Code must be a priority to stimulate development of these projects within California.

SMUD's Detailed Comments

The Transportation Sector Must be Included under the Emissions Cap from the Outset

The PSP states that sectors representing 85% of California's greenhouse gas emissions should participate in a cap and trade program. This includes the Transportation Sector, which by itself accounts for almost half of the emissions in the cap and trade program. We agree with the ARB recommendation to include this very important sector. However, the PSP recommends, without substantial evidence, that the Transportation and Natural Gas Sectors not be included in the cap and trade program until 2015, while the electricity and industrial sectors must be subject to it in 2012. The PSP offers no adequate justification for delaying inclusion of these sectors.

This is fundamentally an equity issue that would unfairly burden the Electricity and Industrial Sectors, provide unwarranted benefit for the Transportation Sector, and introduce significant opportunity for unintended increase in fossil fueled energy uses. As the PSP notes, and as the ARB has noted throughout, there is a strong desire to maintain equity and fairness between the sectors when allocating the emissions reduction liability under AB 32. In effect, by delaying their inclusion, these sectors are being given free allocations to cover all of their compliance needs in the first compliance period. This amounts to the ARB granting hundreds of millions, if not billions, of dollars of value to these sectors before equity in allowance allocation is even discussed. This also has the unintended effect of introducing economic bias that favors additional fossil fuel use.

Such a decision might be understood if it were based on a thorough and publicly vetted analysis of why it is appropriate to exclude these sectors at the outset of the program. However, the Scoping Plan process did not include this analysis, nor are sufficient reasons offered in the PSP as to why these sectors should receive 100% free allocations for the first compliance period of cap and trade. The ARB has identified a suitable point of regulation for both sectors, and should pursue their inclusion in cap and trade at the outset of the program.

If there remain unstated reasons that preclude inclusion of the Transportation and Natural Gas Sectors within the cap and trade program at its outset, perhaps there are acceptable alternatives. For instance, allowance value based fuel carbon fees or similar mechanisms might be used to ensure that these sectors include the price of carbon in their business decisions.

Linear Reduction of Emissions from 2012 to 2020 is Not Supported by Analysis

As required, the Scoping Plan identifies sufficient GhG emission reductions to enable California to meet its reductions goals by the year 2020. Figure 1 of Appendix C shows significant mandatory reductions are expected to occur even in the earliest years of the program and continue evenly throughout the period. However, we are unaware of specific information to show how the Scoping Plan programs will produce this linear reduction of emissions with time. Such investigations will be needed before setting interim emission caps. Simply assuming that a linear reduction in emissions is achievable is insufficient, and could well increase costs unnecessarily. Certainly for the Electricity Sector, the record is clear that significant lead times on the order of years are needed to accomplish sustainable changes in energy use or even relatively minor infrastructure modifications. It is highly unlikely that the bold supply and demand side changes embedded in the Scoping Plan's programs will be realized in equal, year-over-year reductions beginning in 2012, even though we have already begun those quests in earnest.

A potent example is the 33% RPS, intended to meet about 12% of the total reductions under the cap. Currently, the three large investor owned utilities are unlikely to meet their targets of 20% renewables by 2010[1] due at least in part to delays in permitting and construction of transmission lines. These obstacles have delayed new

[1] *2007 Integrated Energy Policy Report* – California Energy Commission, November 2007 pp. 158-163

IOU capacity since the inception of the RPS. It seems unlikely that by 2012, a sudden breakthrough in transmission permitting and construction will occur that will allow the Electric Sector to be on a surer track towards achieving the 33% RPS than it has been in attaining the 20% goal. As a result, a significant portion of the reductions needed to achieve a linearly reducing cap will not be in place by 2012. Will other sectors under the cap have enough early reductions to achieve a linearly reducing cap starting in 2012? The record is bereft of evidence. To our knowledge, the only time-dependent analysis undertaken thus far addresses whether a program could produce needed reductions by 2020. Again, this does not speak to the issue of straight line reductions. The ARB should not be lulled into casual acceptance of a linear reduction target that becomes a hard cap.

At a minimum for the Electricity Sector, ARB staff should review recent progress by the IOU's in accomplishing their RPS targets, and revise the expected cap trajectory to account for a more realistic rate of progress. Analysis also needs to be done of how fast energy efficiency programs, including the CHP programs, can be brought on line, and the rate of reductions from those programs. A linearly reducing cap leaves little room for error or for making necessary adjustments in the programmatic approaches to ensure the cap is met.

Reliability of the Electricity Grid Should be Identified as a Paramount Consideration in Design of a Cap and Trade Program

The ARB is proposing that the Electricity Sector embark on the biggest change to the sector since deregulation. It is important that the ARB acknowledge the potential risks to electricity reliability associated with allowance shortages, and identify ways to address this potential, both in the PSP and the eventual cap and trade design. Electricity is a vital commodity, necessary for sustaining life. Further, it has a real time element that few other commodities have. Considerable utility resource and regulatory oversight is warranted on a continuous basis to ensure that this vital balance of supply and demand is not disrupted.

At the heart of our concern for the potential of a market-based allowance model to become a significant problem for maintaining grid reliability is the fact that the entity responsible for acquiring allowances is different than the entity responsible to assure grid reliability. While the generator is proposed as the point of regulation for allowances, the point of regulation for assuring adequate resources to meet demand remains the load serving entity (as checked and cleared continuously by the Balancing Authority). The generator must meet its responsibility to obtain emission permits, but not to assure grid reliability. Serious threats to grid reliability due to potential lack of liquidity in allowance markets have been posited. Accommodation for acute shortage of allowance availability needed to operate the grid needs to be paramount when designing any emissions cap and trade system for the Electricity Sector. Substantive differences in mitigation options for removal of SOx, NOx, Hg, and other pollutants compared to CO2 mean that experience with the federal SOx reduction cap and trade program cannot be used as a basis for GhG caps.

Accommodation of an acute shortage of allowances without unduly challenging grid reliability may well be possible, but not if consideration of that possibility is absent from design of the cap and trade system.

Voluntary Emissions Reduction Programs Should be Accommodated

Voluntary greenhouse gas reduction programs such as voluntary green pricing programs, or energy efficiency programs that are funded through voluntary contributions, should be accommodated by the ARB in a way that expressly recognizes their contribution and without giving unwarranted advantage to capped entities. These programs provide an opportunity to bring in outside revenue to finance reductions that would not have otherwise occurred as a result of ARB programs. However, if the ARB does not adjust the cap to reflect the presence of these programs, their usefulness will be eliminated. A contribution to a voluntary green pricing program will not result in a reduction in greenhouse gas emissions if the reduction trajectory remains unchanged by the ARB. Instead, it will merely mean that those entities subject to the cap would have to pay a little less for compliance. However if the ARB recognizes this contribution by lowering the cap accordingly, a voluntary investment in renewable energy can reduce emissions and help the state achieve its climate goals faster than it would have otherwise.

Greenhouse gas emission reductions achieved through voluntary efforts are real. Failure to recognize the validity of those reductions and credit them would unjustly disenfranchise the volunteer's efforts and reward entities under the cap.

High Quality Emissions Offsets that Could Begin Development Today Need Process Certainty

The Scoping Plan makes the case that inclusion of emissions offsets will help mitigate allowance prices under cap and trade. SMUD, as a potential buyer of offsets, sees a number of projects poised for development. However, the rules for qualifying voluntary offsets remain uncertain. ARB can incentivize early development of high quality offsets by accelerating adoption of protocols for quantifying voluntary GhG emission reductions pursuant to Health & Safety Code § 38571. Fast-tracking these regulations, and allowing verified offsets to be banked early and used for compliance in 2012, would jump-start the nascent emissions offset industry in California and afford it time to ramp up for 2012 and beyond. A new industry, with *green jobs* for project developers, verifiers, brokers, and emissions reductions technology providers could begin *sooner* if ARB provides more certainty. SMUD and other entities needing to achieve reductions under a cap could then be more aggressive in backing these fledgling projects. Each entrepreneur will need time and process certainty in order to identify opportunities, develop technologies, train appropriate staff, work through local permitting issues, and invest in and develop verifiable projects. By acting quickly, the ARB can reduce uncertainty and foster availability of offsets to serve the purpose of reducing volatility of allowance prices under cap and trade. Delaying action on identifying compliance offset project types risks causing unnecessary increases in compliance costs, and could send scarce development capital out of the state, thereby reducing co-benefits of these projects to California.

SMUD commends the Air Resources Board and the other State agencies that have worked with ARB Staff for drafting a Scoping Plan of unprecedented breadth that fulfills a standard set out in AB32 to identify methods and programs capable of achieving economy-wide greenhouse reductions that will return California to its 1990 emission levels and to begin the change needed to achieve even much greater reductions.

Respectfully submitted

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