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FPL Energy Project Management, Inc's Response to California Air Resources Board Draft Scoping Plan and Appendices

FPL Energy Project Management, Inc ("FPLE") is submitting the following comments in response to the California Air Resources Board (CARB) release of their Climate Change Draft Scoping Plan and Appendices (dated June 2008). FPLE[1] is a leading clean energy provider with over 13,000 MW of natural gas, wind, solar, hydroelectric and nuclear power plants in operation in 25 states. More than 90 percent of FPL Energy's electricity is generated by clean fuels. In addition, FPL Energy is the nation's leader in wind energy generation and operates the two largest solar thermal fields in the world. Furthermore, FPLE is an affiliate of a regulated utility, Florida Power & Light Company located in southern Florida.

After reviewing the CARB Draft Scoping Plan and Appendices, FPLE would ask that CARB consider the following comments which focus on the avoidance of disproportionate impacts and program cost mitigation. The specific topics covered in this submission include:

1. CARB should avoid disproportionate economic burden on the electricity sector.
   The electricity sector does not emit the majority of California's GHGs into the atmosphere and should therefore not be over burdened with the lion's share of the emissions reductions.

2. CARB should allow the use of unlimited offsets for compliance and not restrict offset projects geographically.
   If offset projects are real and verified GHG reductions and these reductions can be achieved at a lower cost than other reduction measures, their development should be encouraged regardless of project location. In addition, real reductions in GHG emissions should not be limited in use. If offsets are real and can accomplish the California's GHG reductions goals at a lower cost than facility modifications, CARB should not limit a facilities ability to maximize their investment in offset projects and should address other air quality issues through programs with the authority to regulate those other pollutants.

[1] FPL Energy, LLC and its affiliates FPL Group, Inc., Florida Power & Light Company, FPL Group Capital, Inc, each have subsidiaries and other affiliates with names that include FPL, FPL Energy, FPLE and similar references. For convenience and simplicity, FPL Energy, FPL Group, FPL and FPL Group Capital, as well as terms like Corporation, Company, our, we and its, are sometimes used as abbreviated references to specific subsidiaries, affiliates or groups of subsidiaries or affiliates. The precise meaning depends on the context.

3. Linking California's GHG program with another regional, national, or international GHG program needs to be one of CARB's top priorities.
   A stand-alone California program is not a desirable situation (economically) and CARB must not only design their program to seamlessly integrate with other programs but also actively seek those opportunities.

4. CARB must avoid creating a program that penalizes cleaner generation sources.
   Customers and owners of clean generation sources have already incurred the cost of cleaning up their emissions and should not have to subsidize the cost to clean up additional sources. Additionally, CARB must protect Californians from shouldering the a disproportionate percentage of the burden to reduce emissions from sources in other states.

I. Introduction

In California, FPLE affiliates own and/or operate 700 MWs of wind, 310 MWs of concentrated solar thermal, 500 MW of combined cycle natural gas, and 44 MWs of coal generating capacity. Our company brings a unique perspective to the climate change discussion. We have looked at this issue from both the regulated and unregulated perspective as well as from the view of merchant and contracted assets. We operate in all major regions of the country. Our corporation is committed to advancing climate change policies and has actively participated in the development of the Regional Greenhouse Gas Initiative (RGGI) protocols in the Northeast. Also FPLE is actively participating in the Western Climate Initiative (WCI), Midwest Governors GHG Reduction Program as well as federal GHG reduction efforts.

FPLE supports CARB's "first deliver" point of regulation under a cap and GHG trade program. As we have expressed in our previous correspondence to CARB on GHG reduction, FPLE believes the most efficient mechanism for including a cost for carbon in the economy is through a carbon fee. A comprehensive upstream carbon fee would effectively spread the cost of GHG's across all emitting sectors evenly; however, a properly structured cap and trade program can also effectively accomplish the goals set forth under AB32. The details of how to properly and effectively institute the "first deliverer" program must be hammered out; however, this process should not sidetrack the development of the program. Within the cap and trade program there are many varied opinions on how to distribute allowances and the roll of offsets. Since the inception of AB32 issues like fairness, wealth transfer, environmental justice, and windfall profits have been discussed at great length. In order to avoid these pitfalls and other potential legal complications, FPLE recommends CARB pay close attention to parallel regulatory actions taking place across the U.S. For instance, the D.C District Appeals Court decision to vacate the EPA's Clean Air Interstate Rule[2] should be considered when

[2] *State of North Carolina v EPA*, D C Circuit Court of Appeals, 2008, No. 05-1244

discussing the legal viability of applying any fuel adjustment factors under a free allocation methodology. The DC District Appeals Court found that the adjustments to states NOx allowance budgets would result in "subsidized reductions" from states with cleaner emissions sources to states with higher emitting sources.[3] CARB must avoid duplicating EPA's mistake by avoiding any requirements that would cause cleaner emissions sources within the state to subsidize the cleanup of larger emitting sources. FPLE recommends that CARB avoid potential accusations of bias or fairness issues by instituting a GHG program that either auctions 100% of the allowances at the inception or transitions to 100% rapidly without implementing any type of adjustment factor based on fuel usage. CARB needs to keep the GHG reduction program simple and require entities to pay in proportion to their emissions. An added benefit to auctioning a large portion or all of the allowances is the generation of a revenue stream that can be used to provide the infrastructure needed for a low carbon economy. For instance, the revenues from an auction could be used to attack hurdles preventing the commercial scale development of new lower emitting technologies, to provide funding for low income consumer relief initiatives, and/or funding for other relevant solution oriented programs.

II. Avoid Disproportionate Burden to Electricity Sector

As observed in the prior stakeholder responses to both CARB and CPUC requests for written and oral comment, a large portion of the program stakeholders feel the scope of the CA GHG program should encompass as many emitting sources as relevant and feasible. The inclusion of a larger portion of emitters will in effect spread the cost of GHG reductions over a larger swath of the economy. Extreme impacts on one sector should be avoided. The impact resulting from GHG regulation should be shared evenly by all sources of GHG emissions. An additional benefit of regulating more sectors is the creation of a larger opportunity to locate least cost reduction options. CARB has recommended a multi-sector program which covers 85% of the emitting sources in the state[4]. However, CARB suggests the cap and trade portion of the program phase in the transportation and natural gas sectors in either the 2nd or 3rd compliance periods. We feel this is a mistake. FPLE urges CARB to include all applicable sources into the cap and trade in the initial compliance period rather than delaying their inclusion. Any delay in including these sectors will delay potential reductions that could be achieved in these sectors.

FPLE urges the CARB to take into account the proportional contribution of the sectors when they make their final recommendations for required reductions from specific sectors. The projected "Business As Usual"(BAU) emissions in 2020 are 596 MMTCO2E from all sectors listed in Table 1 and Figure 1 of the Draft Scoping Plan.[5] These sectors account for 85% of the GHG emissions in the state of California.[6] The

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[3] *Ibid*, p41

[4] *Climate Change Draft Scoping Plan*, California Air Resource Board. June 2008. Appendices. pC-12

[5] *Climate Change Draft Scoping Plan*, California Air Resources Board, June 2008, Discussion Draft p7-8.

[6] *Ibid*, p17

projected emissions reductions in 2020 with the implementation of the "Other Recommended Measures" prescribe a 40% emissions reduction in the electricity sector (ES) (Table A, below). In addition CARB is recommending additional 35 MMTCO2E reduction under the cap and trade program. If the responsibility for this reduction under the cap and trade program were the sole responsibility of the electric sector, the result would be 54% of the reductions occurring in the electricity sector which accounts for only 23% of the GHG emissions.[7] FPLE does not feel sufficient justification has been given to justify this disproportionate burden on the electricity sector. It is essential that the CARB not delay the inclusion of the other sectors responsible for the remaining 62% of the capped emissions into the trading program.

Table A

	Average Emissions 2002-2004 (MMTCO2E)	Projected BAU Emissions 2020 (MMTCO2E)	Projected Emissions Reductions After Implementation of Other Recommended Measures (MMTCO2E)	Preliminary 2020 Emissions Reductions w/ Cap and Trade of ES only (MMTCO2E)
Electric Sector	109	139	45	80
Total	469	596	112	147
Percentage	23%	23%	40%	54%

In order for the cap and trade program to effectively produce the least cost reductions, the market must be free to function. If a large portion of the reductions are proscribed through command and control methods, the resulting cost to consumers and industry could be unnecessarily inflated. Cap and trade programs are utilized in order to provide the market participants the flexibility to find the least cost reduction option. Restricting the pool of reduction opportunities in the cap and trade through the regulation of GHGs through command and control methods will limit the flexibility for regulated entities to seek out least cost emissions reductions. This limited flexibility could increase the cost of GHG reductions. FPLE urges CARB to define the balance between command and control measures and the cap and trade program and evaluate the potential negative impacts of command and control measures will have on cap and trade flexibility options. Also, CARB must avoid the potential piling on of multiple levels of GHG reduction requirements onto one source. If a source is held to a GHG requirement under the cap and trade program, they should not have additional command and control requirements as well. CARB needs to maximize the effectiveness of the cap and trade program by avoiding the restriction compliance options through prescribing reduction measures under a command and control program.

[7] *Ibid* p 7

In addition, to providing a wider scope of sectors in the cap and trade program, CARB needs to limit the participants in the auction. Entities outside the capped sectors wanting to participate in the carbon market will be provided that opportunity through the secondary markets. Unless there is some other motivation we are unaware of, the most likely reason a third party would want to participate in the initial auction would be to profit off the re-sale of allowances. Not only would transaction fees be added to the cost of allowances each time an allowance changes hands, allowances would be potentially placed in higher demand further increasing their cost. There is no possible benefit to the cost of compliance by allowing these third parties entities access to the initial auction. In addition, any concerns about market liquidity can be address through the structure and frequency of auctions. GHG allowances must be made available to regulated entities first. The auctions should be held at least quarterly to provide a consistent stream of allowances into the market. In addition, the quantities of allowances available for purchase to each regulated entity can be limited in order to promote liquidity. These auction variables would enable regulated entities the flexibility to adjust their purchasing schedules in response to changes allowance prices and compliance obligations. In order to allow the market to function and reduce the potential unnecessary cost increase in allowance prices CARB must restrict participants in the allowance auctions.

Lastly, the CARB needs to consider the impact that certain sector reduction strategies will have on other regulated sectors. For instance, one strategy for GHG reductions in the transportation sector could be the electrification of transportation vehicles. A modern electric generation facility can produce power more efficiently and with lower emissions than most if not all currently manufactured vehicles. If moderate to large portion of California's vehicles are converted to or replaced with plug in hybrid technologies, the demand for electricity will increase at a rate greater than currently forecasted. This could negate the reductions projected under the proposed energy efficiency measures. Emissions would increase in the electricity sector while decreasing in other sectors. This may allow California to meet their reduction goals but the electric sector's budget could be grossly deficient. Several possible solutions to this imbalance include auctioning of 100% of allowances, distributing a portion of the auction revenues back to some portion of the electric sector, and/or increasing the scope of the cap and trade program to include a larger percentage of the emissions in California. CARB must keep their GHG program options flexible enough to respond to unforeseen market fluctuations.

III. Support Unlimited Use of Offsets for Compliance

The use of offsets has the potential to provide real reductions in GHG emissions at a lower cost. As long as offsets are real, verifiable, additional, and permanent FPLE feels they should not be limited. Specifically FPLE feels the use of offsets to meet compliance obligation should not be limited. First, CO_2 emissions reach the upper atmosphere in approximately 30 days and they do not cause any significant localized effects. As CARB is intimately aware, state and federal environmental agencies have

fully functioning air emissions programs to address the impacts of emissions on ambient air quality. CO2 is not recognized as a localized harmful air pollutant. Local air quality is a very important but entirely different issue and should not be allowed to cloud this debate. Arguments used against the utilization of offsets because of localized air quality should not be allowed to influence the GHG discussion. Next, FPL feels the use of offsets for compliance should not be limited because the technologies to reduce GHG emissions have yet to be developed on a commercial scale. In the early years of the program, emissions sources will have extremely limited options to significantly reduce GHG emissions. Two such options entail switching fuels and replacing older generation units with newer technologies. Both options have the potential to result in a significant cost increase to consumers. The use of offsets to meet compliance obligations will reduce (but not eliminate) the need to increase investment in new generation units and allow electric generators to schedule replacement of older units on a more palatable time frame. Finally, as more sources switch to cleaner burning fuels, those fuels will be in higher demand causing the price for these commodities to rise even higher. The use of cleaner burning fuel is already more costly than higher emitting fuels. A large spike in demand for cleaner burning fuels could in turn cause a larger than anticipated spike in costs to consumers. The unlimited use of offsets to meet compliance obligations is essential to keep the program cost as low as possible. Therefore FPLE feels the use of offsets for compliance should not be limited but encouraged.

FPLE feels offset projects should not be limited geographically. If an opportunity exists to develop an offset project it should be encourage regardless of the location. Climate change is a global issue. The more projects that are encouraged, the sooner we will bring our planet to the GHG steady state concentration needed to avert the predicted catastrophic effects of climate change. For instance if twice as many projects can be developed outside of California or even outside the United States that would result in real GHG reductions, why would CARB want to limit their development? These types of projects should be encouraged and developed sooner rather than later as long as the reductions are real and permanent. The focus should be the verifying real reductions claimed by these projects in stead of reason for limiting these potentially significant reductions. In addition, the development of more projects could potentially lower the cost of reductions for Californians. Lower cost reductions limits the potential impacts to consumers and industry. FPLE feels CARB should not limit offset projects geographically because doing so could limit the potential to significantly reduce GHG emissions on a global scale.

IV. Linking to other Programs

CARB must proceed with the development of California GHG reduction program with the intension of linking with other programs. The program must be design so it can be easily merged with existing or developing programs. The latest released CARB cost modeling shows no significant changes in the dispatch of electric generation until carbon

allowances approach $160/tonne of CO2E.[8] This number could be dramatically reduced as the options for reduction are increased. One way to accomplish this goal would be through linking the CA GHG program with another GHG reduction program. Increasing the options for finding reductions will foster a larger more competitive market for reduction opportunities and therefore reduce the cost of compliance. A reduction in the cost of compliance will in turn reduce the costs to consumers and industry. CARB must design the California GHG reduction program so it is easily linked with these other programs. For instance the majority of RGGI members are choosing to distribute allowance through 100% auction. A California program that adopts the same methodology would more easily link with RGGI. As WCI develops their program, California must continue to monitor their program structure. At points were it is appropriate California should be prompting WCI to also structure their program to enable a seamless transition to a larger merged program. Overall, the simpler CARB makes their program the easier it will be to link with other programs. FPLE urges CARB to actively pursue option that would prevent a California only cap and trade program.

V. Avoid penalizing already clean generation

CARB must consider the pollution reduction initiatives that have been instituted in the state of California. Over the past two decades a large portion of California electric customers have invested in the modernization of their electric generation fleet. When linking with other programs, CARB must be careful not to burden their citizens with the cost of modernizing other states generation fleet. It would be inappropriate to those sources that have already installed more efficient generation technologies to in turn have to subsidize another regions cleanup.[9] In order to keep the program simple and avoid any references to fairness, CARB should require polluters to pay only for what they emit. Cleaner burning units with lower carbon intensity source should have to purchase fewer allowances than higher emitting sources per the unit of output. Have each source pay the cost for the carbon they are emitting by requiring each emitter to buy their allowances. In addition, any sort of adjustment of a metric according to fuel types is unnecessary and presents a bias in favor of higher emitting fuels. The recent vacation of EPA's Clean Air Interstate Rule emphasizes the presence of a bias when a fuel adjustment factor is employed. The D.C. Circuit Court ruled the net result of EPA's "*ad hoc*" fuel adjustment factors would result in "subsidized reductions" by oil- and gas-fired units to clean up coal-fired generation units.[10]. The Court went on to call the EPA's state use of fuel adjustment factor "arbitrary and capricious."[11] CARB should not repeat the EPA's mistakes. While any free allocation of allowances presents a case for a bias, the use of fuel adjustment factors only multiplies the magnitude of the bias exponentially. CARB should not determine the economic winners and losers in a carbon reduction program. Force the sources that emit more pollutants pay for their own reductions and do not create

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[8] *Economic Impact Modeling*, California Air Resources Board, April 2008

[9] *State of North Carolina v. EPA*, D.C. Circuit Court of Appeals, 2008, No. 05-1244 p41

[10] *Ibid*, p41

[11] *Ibid* p42

subsidized reduction scheme. CARB should force all emitters to pay for what they emit. No more and no less.

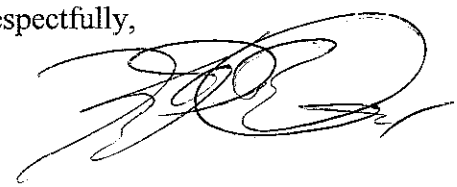
VI. Conclusion

CARB will be forced to make some very difficult decisions over the next several months that will shape the direction of California's GHG program. In addition, CABR has a responsibility to look beyond California's boarders. The structure of the California program has the potential to influence regional and national policy. CARB must consider the impact their program would have if of a similarly structured program were adopted on a regional and/or national scale. FPLE would like to re-emphasize that CARB should:

- Avoid disproportionately burdening the electricity sector
- Not limit the use of offsets
- Structure their program so it can easily be linked to other programs
- Discourage the subsidization higher emitting source cleanup

The decisions made by CARB will most likely affect the development of other programs in the US. CARB has a responsibility to develop a program devoid of any bias that will most effectively and efficiently achieve the goals set forth in AB32. We feel some basic elements needed to achieve this are 100% auctioning of allowances, restricting auction participation, and use of flexible compliance and cost control mechanisms.

Respectfully,



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