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Dr. Lawrence Goulder
Chair, Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Sempra Energy's Comments to the Economic and Allocation Advisory Committee

Dear Dr. Goulder and Committee Members:

Sempra Energy (Sempra) submits these comments to the Economic and Allocation Advisory Committee (EAAC) following its October 7, 2009 meeting in San Francisco. Sempra appreciates your dedication to advising the California Air Resources Board on implementing a Cap and Trade program and other aspects of the AB 32 Scoping Plan. AB 32 and its implementation through the Scoping Plan are critically important to California and the EAAC's determination of key economic effects is essential.

Sempra wishes to provide the Committee with comments on several issues raised during the meeting presentations and discussions to consider as the Committee develops its outline and report over the next month. These comments relate to: allowance allocation methods, distribution of allowance value, treatment of non-CO₂-pollutants, and economic analysis/modeling.

Allowance Allocation Methods

Sempra is encouraged by the EAAC's general support for auctioning allowances. Auctioning is economically efficient and creates a transparent price signal allowing market participants to evaluate alternatives and to choose economically viable strategies. Sempra agrees there may be a limited need for free allocation in some sectors to incent activities and to address competitiveness and leakage,¹ but we are convinced that for the great majority of allowances an auction is the best method for distributing them.

The Committee rightly recognizes there are differences between the allocation of free allowances, even with a requirement that the those allowances be auctioned by the entity receiving the free allocation and a centralized auction of these allowances, with an allocation of the auction revenues to LSEs. To the extent that the Committee decides to freely allocate allowances, Sempra suggests that those given allowances should be required to auction those allowances. However, it should be recognized that a centralized auction of these allowances would greatly increase transparency in the market because it would eliminate the possibility of non-market transfers from LSEs to themselves. Nevertheless, a free allocation of these allowances, even with a required auction by those granted an allocation of allowances, is inferior to a public

¹ For example, in comments to the ARB, Sempra supported providing free allowances for the thermal load of new combined heat and power facilities prior to 2015 to avoid discouraging CHP prior to inclusion of the natural gas sector in the cap-and-trade.

auction followed by an allocation of auction revenues to LSEs because entities that have been given allowances to auction and also want to purchase them can bid high without regard to cost to the extent they know they will subsequently receive the same amount of revenue and realize a zero effective cost. This direct connection between the price bid in the auction and the revenue returned from the auction can reduce the incentives for those entities to reduce their emissions. If the allowances are to be allocated and a central auction held, with the entities receiving back revenue but not in proportion to their allocation of allowances, the initial allocation is merely a complication and serves no real purpose; the allocation should simply be based on the revenues from the auction. If entities receive the auction revenues, there is not the direct connection between what they bid (and pay) for the allowances and the revenue they receive; entities in this situation will have a much better incentive to determine their value for the allowances and bid accordingly.

Distribution of Allowance Value

Proposition 13

Sempra agrees with concerns that returning auction revenue to the state's general fund may be considered taxation. Proposition 13 requires a supermajority vote of the Legislature to adopt any new tax. More specifically, the California Constitution, Article XIII A, currently requires a vote for any changes in state taxes enacted for the purpose of increasing revenues, including by changes in methods of computation. In order to avoid being considered a tax, revenue from fees would have to be used for purposes that are reasonably related to the purposes of the statute.² In this case, auction revenues must be used to further the goals of AB 32.

Rate Design

Some members expressed concerns that returning allowance value to customers through the utilities would mitigate the carbon market price signal conveyed to the consumers. However, as Professor Bushnell points out, rate design can have a significant impact on whether the price signals are mitigated. California is somewhat unique in its rate design as a result of its conservation goals. Using revenue to reduce the average energy rate increases does not have to impact the price signals of the existing rate structure. For residential customers, California utility rates increase with usage, encouraging conservation. For other rate classes, the rate structure is weighted toward variable charges, providing conservation incentives. The most straightforward method of returning revenue to mitigate citizens' higher costs for electricity and natural gas is to refund any revenue as a fixed charge that will not change the current encouragement of energy conservation. Even though it is evident that there are many interests who prefer being allocated revenues from an auction, returning allowance value to utilities to benefit customers is the most simplistic mechanism to protect those financially impacted by AB 32.

Existing Programs

California's Investor Owned Utilities (IOU) customers have effectively been investing to control GHG growth and provide rate relief to low income consumers for years through existing CPUC programs. These programs, some of which are listed below, include energy efficiency, renewable electricity generation, and prohibitions on certain types of generation as well as low income assistance. Before agreeing to fund new institutions to provide similar services the Committee should consider whether the State's goals can be

² *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 881 (citing *San Diego Gas &*

Electric v. San Diego County Air Pollution Control District (1988) 203 Cal.App.3d 1132, 1146).

accomplished by augmenting existing programs which already have infrastructure and a proven record. At a minimum, before funding new programs the Committee should ensure that these new programs are not simply duplicating something the state's utility ratepayers are already funding.

Some California utility programs already in place include:

- **CARE** – the CPUC has approved \$2.6 billion in funding of the CARE program for 2009-2011. The CARE program provides a 20 percent bill reduction for eligible households.³
- **Low-Income Energy Efficiency** – the CPUC has approved nearly \$1 billion for low-income energy efficiency for 2009-2011.⁴
- **Energy Efficiency** - the CPUC previously approved Investor-owned Utility spending on energy efficiency of \$2.1 billion for the 2006-2008 period⁵ and \$3.1 billion for 2010-2012.⁶
- **Renewable Portfolio Standard** - Investor-owned Utilities have implemented programs to procure renewables to increase the percentage of renewables to 20 percent by 2010. Based on the Scoping Plan estimated cost of renewables, for SDG&E alone this represents a cost of \$95 million related to GHG reduction from 2004-2010.⁷ Future costs of expanding to a 33% Renewable Portfolio Standard included in the Scoping Plan will be similar.
- **California Solar Initiative (CSI)** - the CPUC has approved spending of \$908 million on the CSI in the hope of transforming the cost of photovoltaics (PV).⁸ In addition, SCE, PG&E, and SDG&E have applications pending to further fund the expansion of this GHG-reducing technology.
- **Self-Generation Incentive Program** - the CPUC has approved IOU spending of \$288 million on the Self Generation Incentive Program that supports the installation of small GHG-reducing technologies such as wind turbines and fuel cells.⁹
- **Public Interest Energy Research Program (PIER)** - the CPUC has approved collection of \$62.5 million for the PIER program R&D electric spending and \$21 million on natural gas public interest research, overseen by the Energy Commission through the public purpose program surcharge.¹⁰
- **Utility RD&D** - the CPUC has approved funding of utility RD&D programs which are \$12.8 million per year for SoCalGas and SDG&E alone to encourage innovation in GHG-reducing technologies in the energy industry.¹¹

³ CPUC 2008 Annual Report

⁴ *Ibid.*

⁵ *Ibid.*

⁶ CPUC news release, September 24, 2009.

⁷ ARB Scoping plan, Appendix C, Table 16, page C-130 applied to SDG&E renewable generation megawatts.

⁸ California Solar Initiative webpage, www.californiasolarstatistics.ca.gov/reports/10-14-2009/adminStats.html

⁹ CPUC Self-Generation Incentive Program (SGIP) Eighth-Year Impact Report, Evaluation Highlights, EH-1, and similar table from the Sixth-Year Report.

¹⁰ California Energy Commission website, www.energy.ca.gov/research/index.html

¹¹ D.08-07-046, Appendix 1 and D.08-07-046, Appendix 2.

- **CPUC Order Instituting Rulemaking** - the CPUC has recently opened an OIR to consider funding of electric vehicle infrastructure and is planning to open an OIR to consider a program for the development of GHG-reducing combined heat and power technologies

Non-CO2-pollutants

It has been suggested that AB32 mandates the market-based compliance mechanism be designed to help reduce “non-CO2-pollutants” and provide special treatment for localized areas. The Legislative Intent in AB 32, section 38501¹² seems to emphasize somewhat contradictory roles. The statute itself requires ARB to “consider overall societal benefits, including reductions in other air pollutants, diversification of energy sources, and other benefits to the economy, environment, and public health.” ARB is further directed to “Design any market-based compliance mechanism to prevent any increase in the emissions of toxic air contaminants or criteria air pollutants.” This language when taken out of context creates stumbling blocks for comprehensive decision-making.

Sempra believes that the directives contained in AB32 should not require that other goals be pursued at the expense of cost-effective GHG reductions. Sempra believes that these directives merely instruct the ARB to ensure that it does not ignore these concerns or make existing problems worse. However, if the AB32 implementation plan tries to accomplish too many different goals, its effectiveness at reducing GHG will be greatly diminished. All environmental and social problems, however deserving of attention, cannot be solved by a single program. Programmatic inefficiency may require increasing the number of measures to achieve the mandated level of GHG reductions, with likely additional costs and unintended consequences. In addition, by their very nature, many GHG reductions will inevitably lead to reductions in other air pollutants.

The preferred way to deal with non-CO2-pollutants with significant local impact is for local air quality agencies to use existing criteria pollutant authority. Implicitly including non-CO2-pollutants currently subject to trading programs will lead to complex interactions between markets and potential double counting of the benefits of reducing those pollutants. Further, an over-emphasis on non-CO2 pollutants, or double-counting of the benefits of reducing these, may exacerbate leakage as businesses relocate to other regions which might have GHG regulations, but do not attach additional implicit costs for non-CO2 pollutants.

Zonal Trading

The suggestion raised at the workshop for a zonal trading scheme creates concerns that any type of zonal trading or one-way trading for identified communities will add a significant layer of complexity and reduce the efficiency of the GHG cap-and-trade mechanism. Additionally, since the effects of GHG emissions do not occur on a local level, but on a global level, such a zonal system will create a disparity in costs for the same product.

Further, it is unclear how such restrictions would work with respect to the transportation sector.

¹² (h) It is the intent of the Legislature that the State Air Resources Board design emissions reduction measures to meet the statewide emissions limits for greenhouse gases established pursuant to this division in a manner that minimizes costs and maximizes benefits for California’s economy, improves and modernizes California’s energy infrastructure and maintains electric system reliability, maximizes additional environmental and economic co-benefits for California, and complements the state’s efforts to improve air quality.

Economic Modeling

Sempra supports the use of multiple models that have different structures to assess the sensitivity of results to the model structure with consistent and transparent inputs. It was encouraging that those conducting the modeling indicated that they were focused on using the same inputs so that differences will result from the models and not just the starting points. Sempra agrees with the Economic Analysis/Modeling committee about the limitations of the modeling, especially using both industry specific and then general equilibrium models. There are many potential pitfalls from the combined use of these models in ways they weren't specifically designed for. Sempra would like to also make the following comments:

- Any look at CA-only sources would lead to misleading results because of the nature of the electricity market - as natural gas in-state replaces coal from out-of-state, in-state GHG will appear to increase when in fact overall GHG is decreasing.
- As noted in the EPA analysis of the Waxman-Markey bill, the most important elements are the assumptions about offsets and the change in technology costs. It doesn't appear that the committee will opine on these issues directly, but their impacts will be huge. As the Committee indicated, the modeling should use various input assumptions to produce a range of costs and allow a range of scenarios to be analyzed.
- Sempra agrees with the Committee discussion that the value of allowances is dependant on mandatory measures as opposed to reductions that could occur under cap and trade. Mandated GHG reductions clearly diminish demand for allowances.

Sempra Energy appreciates the opportunity to comment on these activities and looks forward to continued collaboration.

Sincerely,



c: Ms. Lucille Van Ommering
Mr. James Goldstene