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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 following its December 11th, 2009 conference call and December 15th, 2009 meeting in San Francisco. Sempra appreciates the openness and dedication that the members of the EAAC demonstrate as it finalizes its Allocation Report recommendations to the California Air Resources Board.

For the most part, Sempra supports the Committee's recommendations in the Allocation Report as it stands as modified in the December 11 and 15 meetings. Sempra wishes to provide the Committee with comments on several issues raised during the meeting presentations and discussions to consider as the Committee finishes its work in early January. These comments relate to recommendation numbers 9 and 14 and the overall allocation of allowance value. In addition, there are specific clarifying questions to make the Allocation Report as clear as possible.

Recommendations

Recommendation Number 9

Sempra would encourage the EAAC to retain recommendation number 9, though reworded.

9. If, for legal or other reasons, the ARB elects to allocate allowance value to electric consumers through local distribution companies, it should be phased out over time. In this case, ARB and its partner agencies should provide direction on the basis for allocation of allowance value and on how funds sent to the LDCs should be used to be consistent with the other recommendations of this report.

Sempra supports auctioning allowances as the best method for distribution. This is the most economically efficient method of distributing allowances to covered entities, will lead to more accurate carbon price signals, and will allow allowances to find their way to those activities where the value is greatest. Further, as was made clear in Committee discussion, the process to fund investments from allowance value mentioned in recommendation 13 does include providing allowance value to LDCs for AB 32 investments including funding of AB 32 complementary policies.¹ Recommendation 9 is

¹ The Committee has used local distribution company (LDC) interchangeably with load serving entity (LSE). Sempra would point out that they are different and have different responsibilities for implementing

a broader allocation of value to LDCs that may be necessary for legal or other reasons. In either case, however, allowance value should be provided to local distribution companies in proportion to their responsibility for implementing AB32 complementary measures, i.e., on the basis of sales. This would also serve to preserve the accurate carbon price signals that would be created under other EAAC recommendations.

As was raised in prior Committee meetings, there may be legal challenges to ARB collecting and dispersing the auction revenues. If allocation of allowances or allowance value to LDCs on the basis of their proportionate responsibility to implement AB32 complementary measures avoids the legal problems, ARB may decide on this course of action. Almost every consumer is also an electric consumer and the ratemaking structures, at least for the investor-owned LDCs, are flexible enough to provide allowance value to consumers without dampening the price signal (e.g., lump-sum consumer dividends). If ARB concludes that it is required to allocate allowances (rather than the revenues from an auction), ARB should also require the receiving entities to put the allowances into a central auction to encourage transparency and openness of market for allowances.

In fact, if there is a low level of revenue to disperse (as would be the case in a narrow program linked to the WCI with relatively low allowance prices), it may make more sense to distribute the funds from an auction through LDCs. It would make it easier to implement the Environmental Defense Fund idea of using consumer dividends for energy efficiency improvements (purchase of efficient appliances or lighting), with an

complementary policies. For example, the RPS is implemented through LSEs; each load serving entity has to acquire renewables in proportion to its load. On the other hand, a substantial portion of Energy Efficiency (EE) is funded by LSEs through a public goods surcharge, but LDCs implement the EE

opt-out provision to receive cash. This approach would tie the consumer dividends more closely to the purposes of AB 32.

A second reason ARB may want to allocate allowances to LDCs is to be compatible with Federal legislation. While it is too early now to forecast the final parameters of a Federal program, it may become more clear by the time the ARB finalizes the AB 32 cap-and-trade program. If, in fact, the Federal program allocates allowances to LDCs, it may make more sense to mimic that in the California program to strand fewer administrative structures in making the transition to a Federal program.

The last sentence of Recommendation 9 is important as well to assure that the Committee's recommendation 8 to provide correct price signals is maintained. Using auction revenues for the cost of implementation of ARB's proposed complementary measures (33% RPS and enhanced energy efficiency programs) is consistent with the Committee's recommendation that a "significant share of allowance value" be used to finance public and private investment to achieve emission reduction, adaptation and environmental remediation. Using auction revenues to finance low income energy efficiency and/or providing consumer dividends to households on a lump-sum basis would be consistent with other Committee recommendations. The use of the allowance revenue for these purposes would suggest allocation of allowance value based on retail sales (since RPS and EE spending are related to retail sales) or a combination of retail sales and population (related to lump-sum distributions).

Recommendation Number 14

programs. For clarity, these comments use the term "LDC" that is in the current EAAC Allocation Report while recognizing the term "LSE" may be more accurate.

Sempra is in agreement with the Union of Concerned Scientists' view that Recommendation Number 14 is unworkable and should be deleted. Currently, Recommendation 14 reads as follows:

14. The Committee recommends that a fraction of allowance value be allocated to a contingency fund for remediation to any vulnerable communities that experience increased exposure to co-pollutants as a result of AB 32 implementation.

The primary problem is determining whether increased exposure is the result of AB 32. Under the business as usual case underlying AB 32, GHG and co-pollutants increase due to increased economic and population growth. While monitoring ambient levels of co-pollutants may show an increase, it is unclear how that increase would be associated with AB 32 and not due to weather, economic growth, or population growth.

Especially in the first compliance period, where mobile sources are not covered by the cap-and-trade, it would be questionable to conclude any increase was associated with stationary sources subject to the cap-and-trade. As Table A of the PG&E letter of November 16, 2009 to the Committee showed, the vast majority of co-pollutants are associated with the mobile sector. It is much preferred to make sure the complementary policies in the transportation sector are producing sufficient reductions in co-pollutants across California such that recommendation 14 is not necessary.

Table A: Percentage share of California emissions derived from production and use of fossil fuels

	ROG	NOX	PM2.5
Electric Powerplants and Cogeneration	0.3%	1.5%	1.6%
Other Fuel Combustion (Stationary Non-Residential)	1.2%	6.8%	3.9%
Petroleum Production and Marketing	6.2%	0.3%	0.6%
Subtotal: Sectors in First Compliance Period	7.7%	8.5%	6.1%
Fuel Combustion (Residential)	0.2%	1.8%	0.9%
Mobile Sources	52.4%	85.8%	23.2%
Subtotal: Sectors in Second Compliance Period	52.6%	87.6%	24.1%
Total	60.3%	96.1%	30.2%

In addition, this recommendation seems to ignore the role of local air quality management districts. Standard air quality permits cannot be issued if ambient standards are violated or if a toxic health risk assessment shows a significant impact. Air quality offsets are already required to address increases in a non attainment area. Air quality attainment planning administered by air pollution control districts contemplates that there will be economic growth and that new sources of emissions will be built. If there were disproportionate impacts on certain communities, the air quality districts can take appropriate actions to mitigate increases in criteria pollutants.

Allocation of Allowance Value

Sempra supports the EAAC recommendations 7, 11, 15, and 16, related to the allocation of allowance value. Another important issue discussed by the Committee that is not yet in the recommendations was how to allocate allowance revenue across different uses of

the funds: to low income households for disproportionate impacts (Recommendation 7); toward financing public and private investments oriented toward achieving GHG reductions (Recommendation 11); return of allowance value to households (Recommendation 15); and, investment channeled to disadvantaged communities to support climate change mitigation (Recommendation 16). Sempra supports the view of several Committee members that funding of recommendations 7, 11, and 16 should be considered before a return of funds directly to households (#15).

There is considerable uncertainty regarding how much allowance revenue there will be. If the ARB adopts a narrow program for the first compliance period, the WCI is in place, and the allowance price is low, the amount of revenue to allocate may be smaller than shown in the Committee report. On the other hand, the broad program, with no WCI in place, and high allowance prices create a much different scenario consistent with the high values in the Allocation Report. Given a wide variability, the activities directly related to the accomplishing the goals of AB 32 should be funded first to avoid lost opportunities, to advance new low emission technologies, and to assure California reaches its AB 32 goals.

Further, Sempra supports the generalized statements in recommendation 13. However, the process described in recommendation 13 should rationalize and coordinate funding of GHG reduction activities across state agencies and the private sector. If Community Benefit Funds, local governments, or LDCs are chosen to deliver low income energy efficiency; the process should rationalize funding across agencies. Community Benefit Funds and local governments should not be competing with LDCs to deliver the same low income energy efficiency services. California's electricity and natural gas consumers are currently paying for ARB Complementary policies through actions of the

California Public Utilities Commission (CPUC). Funding of the following programs should be adjusted if the ARB chooses to implement recommendations 7, 11, and 16 though non-utility vehicles.

- **Financing public and private investments oriented toward achieving GHG reductions (Recommendation #11)**
 - **Energy Efficiency** - the CPUC has approved Investor-owned Utility spending on energy efficiency of \$3.1 billion for 2010-2012 (\$1 billion per year).²
 - **Renewable Portfolio Standard** - Investor-owned Utilities have implemented programs to procure renewables to increase the percentage of renewables to 20 percent. Future costs of expanding to a 33% Renewable Portfolio Standard included in the Scoping Plan are estimated to cost \$133 per metric ton of reduction. Based on the Scoping Plan estimated reductions, this complementary policy (21.2 MMT) translates to \$2.8 billion in annual added costs by 2020.³
 - **California Solar Initiative** - the CPUC has approved spending of \$908 million on distributed photovoltaics (PV) over the past 3 years.⁴ In addition, SCE, PG&E, and SDG&E have applications pending to further fund the expansion of this GHG-reducing technology. Based on Scoping Plan

² CPUC news release, September 24, 2009.

³ ARB, Scoping Plan, Table G-I-2, page G-I-7.

⁴ California Solar Initiative webpage, www.californiasolarstatistics.ca.gov/reports/10-14-2009/adminStats.html

projection of 2.1 MMT, and a cost of \$900 per MT, this cost increases over time to \$1.9 billion per year in 2020.⁵

- **CPUC Order Instituting Rulemaking on CHP** - the CPUC is planning to open an OIR to consider a program for the development of GHG-reducing combined heat and power technologies that is contained in the Scoping Plan. Based on Scoping Plan projection of a 6.7 MMT reduction, and a cost of \$200 per MT, this is a cost increasing to \$1.3 billion per year in above market costs in 2020.⁶
- **Public Interest Energy Research Program** - the CPUC has approved collection of \$62.5 million annually 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.⁷
- **Avoiding disproportionate impacts on low income households**
(Recommendation #7)
 - **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 income eligible households.⁸
 - **Low Income Energy Efficiency** – the CPUC has approved nearly \$1 billion for low-income energy efficiency for 2009-2011 (\$300 million per year).⁹

⁵ ARB, Scoping Plan, Table G-I-2, page G-I-7; and Energy and Environmental Economics, Greenhouse Gas Modeling of California's Electric Sector to 2020, October, 2009, Table 5, page 34. The cost is the expected cost from a total resource cost perspective.

⁶ ARB, Scoping Plan, Table G-I-2, page G-I-7; and Energy and Environmental Economics, Greenhouse Gas Modeling of California's Electric Sector to 2020, October, 2009, Table 5, page 34. The cost is the expected cost from a total resource cost perspective.

⁷ California Energy Commission website, www.energy.ca.gov/research/index.html

⁸ CPUC 2008 Annual Report

- **SB 695** – limits price increases for income eligible households and low usage electric customers, protecting them from GHG costs embedded in electric prices in excess of 3-5 percent.

As noted above, customers of California’s utilities are already being asked to absorb increases in electricity costs for complementary policies aimed at reducing carbon levels. While a Cap and Trade in lieu of these complementary policies is designed to allow the least cost methods of reducing carbon, a cap and trade on top of these complementary policies will further increase costs to California utility customers. If Cap and Trade auction revenues flow back to electricity customers through the electricity providers that are being required to implement these measures to compensate them for the costs, they have and will continue to incur to implement these complementary measures (e.g., on the basis of sales, or load), accurate carbon price signals will be maintained in California's cap and trade program.

Clarifications

Free Allocation to Local Distribution Companies (Page 14)

A paragraph should be added here to mention the other reason to provide free allocation to LDCs – to fund AB 32 complementary policies: energy efficiency programs, CHP programs, and 33% RPS overcome market barriers. The 33% RPS and the California Solar Initiative are also designed to advance technology development.

Other Features of the Auction (page 16)

⁹ *Ibid.*

Sempra agrees with the Independent Energy Producers that any allowances allocated to LDCs should be required to be placed in the auction, with an independent auctioneer, so that there is no competitive advantage conferred on LDC-owned generation. This fact should be mentioned at least in a footnote to clarify the case where the ARB would allocate allowances to LDCs.

Allowance Value Range (page 28)

While the analysis covers a range of alternatives, it does not consider the case of linkage with the WCI. While the effect on the allowance price is probably outside the scope of what can be done, the reduction in coverage of electric sector emissions should be considered. That is, imported electricity generated in WCI states would not generate allowance revenue. Since half of electric sector emissions are from generation located outside California, the allowance budget in the first compliance period may be substantially smaller than what is shown in Table 2.

Prevention of and Compensation for Adverse Impacts (page 33)

The text in sections 5.1.1 and 5.1.2 should be adjusted to reflect the realities of the California electric sector. The information from the presentation of Mr. Rostow of the CPUC should find its way into this chapter. Likewise, section 5.1.5 should be adjusted to reflect low likelihood of adverse impacts on communities given the low contribution of the stationary sources to co-pollutants and the mobile source complementary policies.

Rationale for Investments (page 38)

The references to complementary policies should be eliminated in this section. Indeed, complementary policies are investment in activities that overcome market barriers (e.g. energy efficiency and CHP programs). The reference should just say “the price signal is not sufficient to trigger all of the cost-effective and socially beneficial investments...”

At page 40, it states that external benefits are not addressed. However, the rationale for most complementary policies includes the other external benefits. And to the extent that criteria pollutants are subject to regulation, those benefits are included in decisions to adopt new technology.

Sempra Energy appreciates the opportunity to comment before the Committee finalizes its report.

Sincerely,

A handwritten signature in black ink, appearing to be "M. Kelly", with a long horizontal flourish extending to the right.