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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions.	R.11-03-012

REPLY COMMENTS OF THE CALIFORNIA LARGE ENERGY CONSUMERS ASSOCIATION ON THE ALLOCATION OF UTILITY ALLOWANCE VALUE UNDER CAP-AND-TRADE

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OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions.	R.11-03-012 (Filed March 24, 2011)

REPLY COMMENTS OF THE CALIFORNIA LARGE ENERGY CONSUMERS ASSOCIATION ON THE ALLOCATION OF UTILITY ALLOWANCE VALUE UNDER CAP-AND-TRADE

Pursuant to the Assigned Commission and Administrative Law Judges' Joint Scoping Memo and Ruling dated September 1, 2011 (Ruling), the California Large Energy Consumers Association (CLECA), submits these Reply Comments regarding the allocation and transfer of cap-and-trade (C/T) allowance value received by the utilities from the California Air Resources Board (CARB) to their customers.

I. INTRODUCTION

CLECA will use this Reply Comment opportunity to discuss what appears to be a relatively strong consensus among the parties that the best way for the Commission to meet the CARB's mandate to use allowance value for the "benefit of ratepayers" is to return that value directly to customers. In the main, the parties reject the idea of using the allowance value for the funding of new energy efficiency (EE) programs, incremental funding of RPS procurement, or grants to local community organizations. To be sure, the Joint Parties remain an outlier - advocating for the diversion of a very substantial

portion of the overall allowance value to as yet undefined EE or RPS programs.[1] However, the vast majority of the active parties understand the need to return allowance value to ratepayers to offset the higher rates they will have to pay as a result of C/T.

The joint utilities clearly wish to see all of the allowance value returned to their customers, even if such value exceeds in a given year the C/T costs they incur and place in rates. They argue forcefully that their customers currently pay very substantial amounts for GHG-related programs, creating an already strong carbon price signal in retail rates. TURN is also a strong advocate for the return of all the allowance value to ratepayers, making the very important point that EE and RPS programs should be funded based on the merit of those programs and in proceedings devoted to a proper review of such programs. TURN would like the Commission to avoid the sort of "feeding frenzy"[2] that the comments of parties such as the Green Power Institute evoke.[3] TURN, and CLECA, urges the Commission to resist calls for earmarking funding first and finding suitable programs later.

The Agricultural Parties (AG) advocate for the full return of allowance value to ratepayers, differing from the utilities only with respect to the possibility that excess allowance value in a particular year might be used for worthy but as yet unfunded GHG-related programs. As is the case with the Joint Parties, these AG programs are not yet identified or defined. Finally, the DRA also wants to assure ratepayers that all of their C/T costs are offset through a return of allowance value. DRA's proposal differs

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[1] One of the problems with the Joint Parties' proposal is that it is impossible to know in advance just how much of the total allowance value they would have the Commission keep from ratepayers, in part because the percentage is a function of carbon prices each year, and in part, it appears, because they are unable to decide the proportion among themselves. See, Jt. Parties' Comments at p. 5 and FN 7. CLECA is concerned that they could be talking about fully half of the allowance value in a given year.

[2] TURN Opening Comments, at p. 2. *"[T]hese revenues do not represent 'free money' that must be thrown at a variety of feel-good endeavors. Ratepayer money is fungible and any new spending program should be subject to a high level of scrutiny regardless of the proceeding in which it is proposed."*

[3] The only other party in this "spend the money" camp is the Green Power Institute who sees the allowance value funds as providing a unique opportunity to increase spending on RPS procurement.

somewhat in that it projects a relatively significant surplus of allowance value over C/T costs and would have the Commission use such surplus for a new public/private financing entity to support low-income EE.

While there are differences in the proposals of these parties, differences which we will explore, the overriding fact is their common view that the primary use of utility allowance value must be to return it to ratepayers to offset higher C/T costs. CLECA is aligned with these groups, and with the views of the Energy Producers and Users Coalition and the California Manufacturers and Technology Association, and strongly urges the Commission to follow their lead. Adopting any of these parties' proposals would be a vastly superior result to the adoption of the ill-defined spending proposal of the Joint Parties.

II. CONCERNS REGARDING THE DRA'S PROPOSAL.

The DRA proposes that utility allowance value should be used first to offset 100% of the anticipated cost increase in retail rates occasioned by implementation of C/T. The DRA differs from the utilities with respect to the mechanism for return of allowance value to ratepayers; DRA would have the utilities mail a rebate check to each customer once a year in contrast to the utilities' proposal to reflect allowances as an offset to higher C/T costs in monthly bills. DRA's rationale for the annual rebate check is its view that such a mechanism would create "distance" between the customers' payment of higher retail rates and the receipt of an offsetting rebate check.[4] By creating this visual and temporal distance, the DRA believes that the carbon price signal created by the new C/T costs would be preserved.

CLECA urges the Commission not to adopt this annual off-bill rebate. We are

[4] DRA Comments, at pp. 3-4.

concerned that the DRA proposal may prove to be unworkable as a result of the customer tracking issues identified by the utilities. Further, it clearly would be more costly and cumbersome than the utilities' idea of simply offsetting C/T costs (or TURN's idea of a quarterly bill credit). There is value in simplicity here; a process which might confuse customers or cause them to question the source, purpose or amount of their "rebate" should be avoided.

Further, while CLECA acknowledges the role of a carbon price signal in electric rates, we also agree with the utilities that the primary work of the C/T scheme will occur at the wholesale level where compliance will require generators to acquire allowances and to reflect such allowance costs in the prices they charge utilities for wholesale power. This pricing will affect the order in which generation resources are purchased and dispatched, and will thereby impact the emission of GHG associated with electricity consumption in the State. Also, the utilities make a forceful argument that the price elasticity of demand for retail electricity has been shown to be relatively low and that the use of price in retail rates as a tool to reduce carbon emissions is a very expensive option. The goal should be to reduce GHG, not to punish ratepayers.

CLECA is perplexed by the fact that the DRA Comments strongly endorses the concept of a carbon price signal in retail rates, because one of the DRA's primary missions in rate proceedings is to assure that large segments of residential customers and residential load are exempted from the very price signals created by higher costs associated with a variety of programs designed to reduce GHG. Roughly 2/3's of residential load falls with usage tiers 1 and 2, either CARE or non-CARE, and thus is largely if not completely protected from such costs. This group of small-use residential customers is DRA's primary constituency and DRA has been quite effective in blunting

any attempts to recover increasing utility costs, GHG-related or otherwise, from such customers and usage. This fact alone makes the DRA's carbon price signal rationale for annual off-bill rebates somewhat suspect. On balance, CLECA believes that the added cost, complexity and potential for mistakes are not worth any potential benefit of visual and temporal "distance" between the monthly bill and the rebate check.

CLECA is also concerned with DRA's assumption that there will be ample utility allowance value each year to both fully offset higher C/T costs and to fund a new program for financing of energy efficiency programs. We share the utilities' concerns about the DRA's assumptions regarding the aggregate level of annual allowance value. The timing of the auction of allowances and the tools generators use to achieve compliance will affect both allowance value and C/T costs, and there is no assurance that they will match up in a particular year. We fear that the DRA's new financing program, like many programs, will become embedded in the complex fabric of utility regulation and require assured funding each year without respect to the availability of surplus allowance value or the value and efficiency of the program. The program does not appear to be well-defined at this stage and it raises concerns about who will be liable for revenue shortfalls or loan defaults. By leveraging these funds would the DRA program increase the risk for ratepayers in the future?

On balance, CLECA concludes that the DRA proposal to utilize 10% of allowance value for the funding of a new EE financing program is not well thought-out and that the Commission should reject it.

III. CONCERNS REGADING THE JOINT PARTIES' COMMENTS

CLECA is opposed to the Joint Parties' proposal to use a very large portion of the allowance value each year for funding of new EE, RPS and community programs. First,

the amount of money they propose to siphon off for these new programs is really quite large - these funds would not be available to offset C/T costs which we know customers will incur. They propose to use nearly $500 million of allowance value in the first year of the program for these incremental programs and that figure would grow each year with increases in the CARB's Floor Price for allowances.[5] While the Joint Parties have asserted that, on average over the life of the program, approximately 70% of allowance value would be returned to customers to offset higher bills, this percentage is a function of market prices for carbon each year of the program and certainly is not guaranteed. Indeed, if market prices do not increase in the manner that the Joint Parties suggest, more than 50% of the allowance value could be taken "off the top" for their new programs. We also note that individual members of the Joint Parties advocate for a much larger percentage of allowance value to go to the new programs.[6] In view of the fact that the ratepayers of PG&E, SCE and SDG&E currently pay more than $1 billion each year for EE programs, several hundred millions dollars each year for the CA Solar Initiative and hundreds of millions, perhaps a billion, dollars each year for RPS compliance costs, this new proposal seems excessive; it amounts to "piling on".

Second, the cornerstone for the Joint Parties' proposal is their assertion that maintaining and enhancing the carbon price signal is paramount among the objectives under consideration.[7] CLECA disagrees. Raising retail electric rates is not the best and certainly not the most efficient way to achieve the State's goal of reducing GHG emissions associated with electricity use. As the utilities have pointed out, retail electricity use has a rather low price elasticity of demand; it takes really big rate and bill

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[5] The Joint Parties included a table in their Revised Proposal (January 6, 2012) at p.15 which displays how the amount would be determined each year. The utilities' allowances would be multiplied by the floor price for the year times a factor of 75%. In 2013, that would amount to $483 million.

[6] Ibid., see FN 14 at p. 15.

[7] Joint Parties Comments, at pp. 5, 7.

increases to induce customers to reduce their use of electricity. Further, as we have discussed, a very large proportion of residential usage in California is highly insulated from these or other cost increases. Nearly 70% of residential usage will not see any significant rate increases as a result of the implementation of C/T. The price signal argument is simply misguided and the Commission should keep its eye on the ball of the real aim of the exercise, namely reducing GHG emissions by increasing the cost of fossil-based wholesale power.

Third, the Joint Parties, despite numerous opportunities and gentle nudging by the ALJs, have failed entirely to provide specificity regarding the new or enhanced programs they would fund with the $500 million or more of allowance value each year. What are these programs? How would they work? What are their precise aims? How would the Commission assure they are cost-effective? The Joint Parties are asking the Commission to commit the money in advance and they promise that they will come up with programs on which to spend the funds later. As TURN so clearly notes, this is a bad way to fund programs and it leads to waste and inefficiency. CLECA agrees. If parties believe that more needs to be done for EE or RPS programs, they should raise those concerns directly in the proceedings in which those programs are under discussion and review.

Fourth, the Joint Parties proposal would return some of the allowance value to residential ratepayers and to EITE customers, but it would not provide funds to agricultural, commercial and industrial (C&I) customers generally. They blithely assert that C&I customers can readily pass through any cost increases associated with their use of electricity, but they offer no proof that such is the case, either generally or in the case of specific customers. Further, under their proposal, allowance value would go to

residential customers, many of whom will not incur any of the C/T cost increases. Their proposal is highly discriminatory and its adoption would violate the provisions of the Public Utilities Code which for decades have required this Commission to assure that rates for electric service are just, reasonable and non-discriminatory. It simply is not right, fair or just for the Commission to adopt a proposal which would increase overall electric rates roughly $1 billion per year, assure that a large portion of residential load pays none of the increase and provide offsetting allowance value only to residential and EITE customers.

IV. CONCERNS WITH THE JOINT PARTIES' APPROACH TO EITE CUSTOMERS

While CLECA is gratified to learn that the Joint Parties now recognize the need to provide allowance value to EITE customers to offset their increased electric costs associated with the C/T program, their specific formula would improperly limit the return of allowance value to such customers.[8] The Joint Parties suggest a formula for determining allowance value to EITE customers reflecting the following: the customer's historic usage, the utility's C/T compliance cost per MWh, the CARB's "assistance factor" and the relationship of the customer's current usage to its base period usage. Thus allowance value would equal:

> customer's base period usage * utility base period compliance cost in $ * 0.9 * ratio of historic to current usage.

They assert that their approach is a version of "Option C" as proposed by CLECA. While it may appear to be similar, it is not the same. Further, it would appear to under compensate EITE customers as compared to our Option C.

[8] Ibid., at pp. 11-12. While the Joint Parties do not state a formula explicitly, this is appears to be what they describe.

Here is the Option C formula offered by CLECA:

$$Allowances_k = O_{k,j} * E_j * I_{x,k}$$

Where,

O = Product output of facility "k" in EITE sector "j" in the most recent year

E = Electricity efficiency benchmark, as measured by MWh of electricity consumed per unit of output in EITE sector "j" in 2009.

I = GHG intensity factor, as measured by emissions per MWh of electricity generated in 2009 by the local utility "x" that serves the area in which facility "k" is located.

The heart of the Option C formula is the electricity efficiency benchmark for each sector; MWH of electricity per unit of product output in a base period. That figure (E_j) is multiplied by the serving utility's GHG intensity in a base period, as measured by tons of CO_2 emissions per MWh of electricity provided ($I_{x,k}$). The result is tons of CO_2 associated with the electricity required to produce a ton of product output for the sector. And that figure can then be multiplied by current year product output to determine the allowances due a particular customer.

In contrast, the Joint Parties' formula does not use a sector efficiency factor. Rather, it begins with the individual customer's own usage for a base period and applies a 90% factor to that. The value of having a sector-wide efficiency factor is that it requires individual firms to make efforts to reach the sector efficiency level, which level already includes a stretch factor either through the use of a 90% factor or by adoption of the "best in class" firm's actual efficiency. In a given sector, a particular customer could have an efficiency better than the sector figure, although most would fall below it. Where best in class determines the sector, all but the best firm would fall below it. The Joint Parties' approach would penalize every customer in the sector by application of the 0.9 factor regardless of their current efficiency and the steps they have previously

taken to be more efficient.

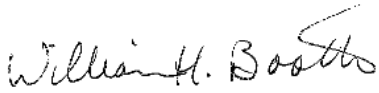
Further, the Joint Parties' use of a utility compliance cost figure for a base period rather than a tons of CO_2 per MWH of output GHG intensity figure for that base period locks in a compliance cost from the historic period when in fact compliance cost per ton of CO_2 will clearly change over time. By locking in a relatively low compliance cost from a base period, the Joint Parties' formula would assure that EITE customers under recover their actual indirect compliance costs over time. There is no need to state the formula in this way and, indeed, it does not meet the test of minimizing leakage. Furthermore, Option C, as CLECA has proposed it, states the award in terms of allowances which would be transferred to the customer which then could be used by the customer to cover then current compliance costs. The Joint Parties' proposal would not provide allowances to EITE customers, but rather would give them dollars.

While we appreciate the Joint Parties' acknowledgment that EITE customers' indirect C/T costs need to be covered in order to prevent leakage, their formula will not accomplish that task. CLECA urges the Commission to adopt its Option C formula instead. As we have stated, the data needed to perform the benchmarking calculations would be collected through CARB's GHG Market Reporting Requirement (MRR), which requires each facility to report the amount of electricity consumed and product output on an annual basis. To maximize consistency with CARB's approach for allocating allowances for direct emissions, electricity efficiency benchmarks should be based on 2009 MRR data. The data needed to calculate fixed utility GHG intensity factors and sector output for the most recent year is collected through the MRR as well.

IV. CONCLUSION

CLECA urges the Commission to adopt an approach to the return of utility allowance value which will assure that each customer's increased rates resulting from implementation of the C/T scheme are fully offset. For those customers who will not experience increased rates, there should be no explicit provision of allowance value. This should be done in the most efficient, simple manner possible; the Commission should reject the DRA's proposal for annual rebate checks. It should also reject the Joint Parties' proposal to siphon off a very large proportion of the overall allowance value for funding of new, ill-defined EE, RPS and community grant programs. Finally, the Commission should assure that EITE customers' increased electricity costs resulting from the C/T program are fully offset through the return of allowances under Option C.

Respectfully submitted,



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