FILED
07-10-07
04:59 PM

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	Rulemaking 06-04-009 (Filed April 13, 2006)

California Energy Commission Docket #07-OIIP-01

JOINT REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL (NRDC) AND UNION OF CONCERNED SCIENTISTS (UCS) ON JOINT STAFF GHG REPORTING PROPOSAL

July 10, 2007

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1. Introduction and Summary

The Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) respectfully submit these reply comments in accordance with the "Administrative Law Judges' Ruling Regarding Comments on Staff Reporting Proposal" (ALJ Ruling), dated June 12, 2007, and in accordance with Rules 1.9 and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure. We also concurrently submit these comments to the California Energy Commission (CEC) in Docket #07-OIIP-01, the CEC's sister proceeding to this CPUC proceeding.

NRDC is a non-profit membership organization with a long-standing interest in minimizing the societal costs of the reliable energy services that a healthy California economy needs. In this proceeding, we focus on representing our more than 124,000 California members' interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. UCS is a leading science-based non-profit working for a healthy environment and a safer world. Its Clean Energy Program examines the benefits and costs of the country's energy use and promotes energy solutions that are sustainable both environmentally and economically.

NRDC and UCS commend the two Commissions for their leadership in addressing global warming and reducing greenhouse gas (GHG) emissions through their decisions and actions over the past several years. In these comments, NRDC and UCS

respond to the comments submitted by various parties on July 2, 2007 on the "Joint California Public Utilities Commission and California Energy Commission Staff Proposal for an Electricity Retail Provider GHG Reporting Protocol" (staff proposal). NRDC/UCS appreciate the joint Commission staff's hard work in developing a well-researched proposal for a near-term reporting protocol for retail providers. These reply comments are summarized as follows:

- NRDC/UCS agree with numerous parties' recommendations that Joint Staff should work toward a west-wide tracking system to aid future reporting.
- The design and implementation of GHG reporting should be driven primarily by long-term emissions reductions rather than short-term dispatch considerations.
- The potential benefits and drawbacks of the "first seller" approach are beyond the scope of the reporting protocol and should be considered at a later point in this proceeding.
- Contrary to PG&E's claims, retail providers must report their emissions under a load-based cap. AB 32 also requires retail providers to report emissions, without reference to the point of regulation.
- The concerns of possible gaming of default emission factors raised by multiple parties reinforce the importance of using ex post, rather than ex ante, emissions factors. NRDC/UCS suggest that Joint Staff catalogue examples of possible gaming and explain how their proposal would minimize "unintended consequences."
- NRDC/UCS support the recommendations of CRS and SMUD to avoid double-counting of the greenhouse gas emission attributes of renewable energy.
- NRDC/UCS agree with Calpine on the need for high default emissions factors.
- NRDC/UCS disagree with CMUA's assertion that CARB and the Joint Staff should not address contract shuffling through the reporting protocols.

2. **NRDC/UCS agree with numerous parties' recommendations that Joint Staff should work toward a west-wide tracking system to aid future reporting.**

Several parties (including AReM, DRA, GPI, and SDG&E/SCG)[1] joined NRDC/UCS in commenting on the need for the Joint Staff to be working toward a west-wide tracking system for future reporting. As SDG&E/SCG note, the staff proposal "may satisfy reporting necessary during the interim period prior to the implementation of AB 32," but "should provide more discussion of the path to a comprehensive measurement system required under AB 32." (p. 3) NRDC/UCS support DRA's recommendation that "Joint Staff and ARB continue to work with other states within the Western Electricity Coordinating Council (WECC) region to promote the need and pursue the development of a regional GHG tracking system for all electricity generation resources." (p. 7) The staff proposal should include significantly more discussion about the process for developing a more robust future reporting system to use in the long-term.

NRDC/UCS support PG&E's recommendation for Joint Staff to coordinate their near-term reporting proposal for regional emissions factors with other states "to ensure consistency and equity with reporting proposals in other Western states." (p. 5) DRA astutely observes that "establishing mandatory compliance with a regional emissions reporting system…may be the largest obstacle to overcome in the deployment of a complete regional emissions tracking and reporting system." (p. 7) NRDC/UCS agree, and anticipate the diplomatic and political exercise of engaging with other states to develop a regionally consistent reporting protocol will prove much more challenging than developing the tracking system itself. Accordingly, the staff proposal should suggest a public process for regional coordination and participation to begin as soon as possible to develop a set of multi-state GHG reporting guidelines for the electric sector.

3. **The design and implementation of GHG reporting should be driven primarily by long-term emissions reductions rather than short-term dispatch considerations.**

Some parties, such as Southern California Edison Company (SCE) contend that the staff proposal would interfere with the efficient dispatch and operation of the

[1] Alliance for Retail Energy Markets (AReM), Division of Ratepayer Advocates (DRA), Green Power Institute (GPI), and San Diego Gas and Electric Company/Southern California Gas Company (SDG&E/SCG)

California Independent System Operator (CAISO) Market Redesign and Technology Upgrade (MRTU) market. Other parties (Western Power Trading Forum, Morgan Stanley, SCE) also assert that GHG costs should be reflected in dispatch decisions. NRDC/UCS agree that the reporting protocol should carefully account for potential impacts on dispatch and on the overall functioning of the MRTU market.

However, the design of the reporting protocol, and of GHG regulation more broadly, should not be predicated on day-to-day dispatch considerations and compatibility with MRTU. While AB 32 regulations should be designed to incorporate be GHG reduction principles into short-term electricity markets, the larger and overriding policy goal of the State should be to fundamentally affect *long-term* investments and resource allocation decisions in the electricity sector. The policy-making presumption should be that GHG regulations will significantly influence the nature of the market, rather than merely fitting in with an existing structure that may not be conducive to achieving cost-effective GHG emissions reductions. NRDC/UCS strongly agree with the Green Power Institute's (GPI) comment that the "core purpose of AB 32 is to change electricity and energy markets generally in fundamental ways that transition the mix of energy sources used by society to lower-carbon resources, and to more efficient energy use." (GPI, p. 5) A myopic focus on how GHG emissions reporting might affect short-term dispatch decisions without serious consideration of the core investment changes that are needed to achieve significant and sustained long-term emissions reductions would undermine the fundamental purpose of AB 32. The reductions demanded by AB 32 will require long-term investments in emission reduction strategies; changes in short-term dispatch will not achieve the AB 32 goals. Achieving appropriate long-term policy signals should be the top priority and optimizing short-term dispatch should be a lower priority.

Rather than heed SCE and other parties' comments that the staff proposal is inherently incompatible with the proper functioning of the short-term CAISO market and thus should be overhauled, the Commissions should, jointly with the Air Resources Board (ARB) and CAISO, explore potential changes to the CAISO Integrated Forward Market that may be necessary under MRTU to facilitate accurate GHG emissions reporting and to provide proper market signals. NRDC/UCS agree with the Division of

Ratepayer Advocates' recommendation that the Commissions and the ARB "continue to work closely with the CAISO" to "incorporate some form of GHG emissions tracking and/or optimization in the IFM in a subsequent release of MRTU." (DRA p.12)

4. The potential benefits and drawbacks of the "first seller" approach are beyond the scope of the reporting protocol and should be considered at a later point in this proceeding.

The ALJ Ruling on June 12, 2007, which sought comments on the staff proposal, asked parties to address whether "modifications to the Staff proposal would be needed to support implementation of…the 'first seller' structure." (June 12, 2007 ALJ Ruling p.2) Several parties interpreted this as an opportunity to advance their arguments in support of the first seller (or a generic source-based) approach, and both Southern California Edison (SCE) and Pacific Gas & Electric (PG&E) devoted the majority of their comments to touting the advantages of the first seller approach over the load-based approach that the Public Utilities Commission has favored to date.

The comments of these parties clearly stray beyond the issues presented in the both the June 12 ALJ Ruling and the staff proposal. The staff proposal clearly stated that "the issue of whether a load-based cap is the appropriate approach will be addressed elsewhere in this proceeding." (Staff proposal p.1) Accordingly, the Commissions should not consider the arguments in favor of either the first seller or load-based approach at this time, but should defer any issues that are not specifically related to reporting for subsequent discussion in this proceeding. This will allow all parties to address the complete universe of issues that arise from the different points of regulation that are contemplated by the first seller and load-based approaches. NRDC/UCS welcome the opportunity to engage in an informed discussion on the relative advantages and disadvantages of the first seller and load-based structures at that later point in time.

NRDC/UCS recognize that some changes to the staff proposal will be necessary in the event that the State chooses to adopt the first seller approach. At the same time, NRDC/UCS also emphasize that regardless of whether the first seller or load-based approach is ultimately selected, the State still faces immensely challenging and highly complex issues related to reporting and tracking of GHG emissions. NRDC/UCS are not

persuaded by parties' arguments that the use of the first seller approach would inherently resolve the majority of these reporting and tracking issues. NRDC/UCS continue to urge the Commissions and their staff to work with their counterparts in other states in the west to develop and implement a robust reporting and tracking system that is accurate and consistent across all states in the region. Such a system is critically necessary, independent of whether the State regulates electric sector emissions at the first seller or retail provider level.

5. Contrary to PG&E's claims, retail providers must report their emissions under a load-based cap. AB 32 also requires retail providers to report emissions, without reference to the point of regulation.

PG&E states that a first seller "direct reporting approach should apply regardless of whether the ultimate point of regulation under AB 32 is chosen to be the retail provider under a 'load-based cap' or the 'first seller' under the approach recommended by the Market Advisory Committee." (p. 4) In so stating, PG&E implies that even under a load-based cap, the retail providers would not be required to report their emissions. The Commissions should reject this proposal. Under a load-based cap, the retail providers are the regulated entities, and therefore must report their emissions. The regulatory principle that applies in this instance is incontrovertible: the entity that is the point of regulation and is responsible for its emissions *must* report those emissions *on which its compliance depends*.

PG&E also claims that holding retail providers responsible for reporting "may be inconsistent with the statutory requirements of AB 32, which apply to 'sources' of emissions, not to third parties who are not the sources of emissions." (p. 11) On the contrary, reporting by retail providers is entirely consistent with statute; AB 32 states that "This [reporting] requirement [accounting for greenhouse gas emissions from all electricity consumed in the state] *applies to all retail sellers of electricity*, including load-serving entities…and local publicly owned electric utilities."[2] (emphasis added)

[2] Health and Safety Code, Section 38530(b)(2).

6. **The concerns of possible gaming of default emission factors raised by multiple parties reinforce the importance of using ex post, rather than ex ante, emissions factors. NRDC/UCS suggest that Joint Staff catalogue examples of possible gaming and explain how their proposal would minimize "unintended consequences."**

SCE states that "under the Staff Proposal there are many options (and large economic incentives) to disguise the true GHG emissions of the California generator," and provides several examples of the potential gaming that might occur under the staff proposal. (p. 8) In addition, the California Independent System Operator (CAISO), along with other parties, comments on the need for consistency between the default emission rates for the real-time market (RTM) and the integrated forward market (IFM), since "assigning different values for the two markets may create an incentive for parties to select one market over the other." (p. 4) NRDC/UCS remain seriously concerned about the possibilities for gaming, as these practices could undermine the key reporting protocol criteria "minimization of unintended consequences" and "setting appropriate policy signals." NRDC/UCS believe that ex post emissions factors will help shed light on some of these gaming activities and result in better reporting accuracy.

NRDC/UCS support DRA's recommendation to expand the staff proposal's "minimization of unintended consequences" criterion to "cast a wider net by addressing other risks and consequences." (p. 5) Unintended consequences could encompass a far broader set of events than the market distortions that are described in the staff proposal, including the various examples of gaming identified by several parties. NRDC/UCS strongly recommend that Joint Staff catalogue examples of possible gaming, make appropriate changes to the proposal, and explain how the reporting proposal would minimize unintended consequences.

7. **NRDC/UCS support the recommendations of CRS and SMUD to avoid double-counting of the greenhouse gas emission attributes of renewable energy.**

Several parties note that the staff proposal fails to address how the emissions of null power should be reported. NRDC/UCS agree with the Center for Resource Solution (CRS) and the Sacramento Municipal Utility District's (SMUD) comments that the

emission benefits of renewable energy resources should not be double counted. NRDC/UCS support CRS' recommendation to only allow reporting entities (or sellers) to report (or claim) the "net-zero emissions from the renewable energy facility if the RECs associated with the electricity generation are owned by the reporting entity [or seller] and have been retired in their appropriate WREGIS account." (p. 3-4) Null power whose RECs have been sold separately to another buyer should be attributed a non-zero GHG emissions value. NRDC/UCS believe that SMUD's proposal to assign null power with the "emission attribution of the region from which the renewable energy was generated" (SMUD, p. 8) represents a good starting point for further discussion.

8. NRDC/UCS agree with Calpine on the need for high default emissions factors.

NRDC/UCS agree with Calpine that default emissions factors should be set high; otherwise, "the default emissions factors that would be adopted in the Staff Proposal…would encourage high emitting sources, such as [conventional] coal fired generation, to market themselves as unspecified sources." (p. 4) Emissions proxies that are set too low will provide perverse incentives for high-emitting resources to mask themselves as unspecified sources, thereby inaccurately representing actual emissions and compromising the integrity of any GHG emissions market.

9. NRDC/UCS disagree with CMUA's assertion that CARB and the Joint Staff should not address contract shuffling through the reporting protocols.

The California Municipal Utilities Association (CMUA) and other municipal utility representatives assert that the staff proposal's discussion and proposal to address contract shuffling concerns are excessive and unwarranted. (CMUA, pp. 3, 5-6, 8) However, as CMUA itself notes, AB 32 requires that CARB ensure that emission reductions are real. (p. 8) The Joint Staff's proposal to address contract shuffling concerns is entirely consistent with CARB's obligation to ensure the integrity of emission reductions.

10. Conclusion

NRDC/UCS commend the Joint Staff for their hard work in developing the draft reporting proposal, and urge the Commissions to adopt the recommendations described herein. NRDC/UCS look forward to continuing to work with the Commissions and other parties to refine and further develop the electricity sector reporting proposal.

Dated: July 10, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"Joint Reply Comments of the Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) on the Joint Staff GHG Reporting Proposal" in the matter of R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on July 10, 2007 at San Francisco, California.

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