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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)

ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of AB 32 Implementation: Greenhouse Gases.	)	Docket 07-OIIP-01

SACRAMENTO MUNICIPAL UTILITY DISTRICT'S COMMENTS ON THE ALLOWANCE ALLOCATION ISSUES

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SACRAMENTO MUNICIPAL UTILITY DISTRICT'S COMMENTS ON THE ALLOWANCE ALLOCATION ISSUES

The Sacramento Municipal Utility District (SMUD) herein responds to the Administrative Law Judge's Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues ("ALJ Ruling"). This filing conforms with the California Energy Commission's (CEC) regulations and the Rules of Practice and Procedure of the California Public Utilities Commission (CPUC) and is being filed with both agencies.

SMUD stands on its record and reputation for supplying high quality electricity service to its Sacramento customers provided from a resource portfolio that demonstrates care for the environment and the economic well being of the population we serve. Electric utility greenhouse gas (Ghg) emissions are only a tenth of the Ghg emissions within California and only a fifth of California's total when imports are included in the total. Nonetheless, the electric industry is taking a leading role in reducing Ghg emissions in California. This leadership position speaks volumes about the depth of concern for the environment and effectiveness of the present regulatory structure of the electric industry in California. SMUD's locally elected regulatory Board is exemplary in this regard. Despite significant load growth SMUD has maintained its carbon emissions at or near its 1990 level.

It is from this perspective that SMUD offers its comments included here. Further, SMUD believes that to preserve the qualities that underpin our present successful efforts, the scope of actions considered here should no longer consider the First Seller point of regulation as viable. Our answers to the questions posed assume that the point of regulation will continue to be the retail electric service provider. The reasons for this also give context to our belief that Ghg emission allowances should be administratively allocated to the Retail Provider.

For publicly owned electric utilities in particular and for all Retail Providers even those with regulated resource oversight, SMUD believes the Retail Provider is in the best position to make knowledgeable decisions on electricity supply portfolios that:

- Minimize costs of Ghg reductions to the customers in their service territories,
- Retain a reliable and nonvolatile supply of power for all hours of the year, and
- Make decisions affecting large capital energy infrastructure in sufficient time to minimize costs and operational difficulties during a change in infrastructure character.

A second major reason for placing the point of regulation at the LSE in California is that the greatest reductions in utility Ghg emissions are driven by policy command regulations; e.g., demand reductions through energy efficiency, prohibition on investments in high carbon emission baseload generation, and addition of new renewable energy generation to the utility resource mix. Each of these major thrusts is regulated at the Retail Provider.

Third, placing the point of regulation at the Retail Provider will reduce overlapping regulatory requirements and process. To assure a "ton is a ton of CO2 equivalent" in Ghg reduction regions linked to California, energy efficiency based reductions of Ghg , including recognition of some early actions, will clearly need to be based on Retail Provider emission rates. Even if the electricity sector cap were placed at the "First Seller", a state recognized load-based emissions rate for Retail Providers would still be required.

Within the bounds stated above, SMUD's comments below respond to the questions in the ALJ Ruling and can be summarized in the following bullets.

- ***The point of regulations should be the Retail Provider.***
- ***Allowances should be allocated administratively based initially on "grandfathering" emissions.***
- ***Allowances should be transitioned along a smooth line from "grandfathering" emissions based in 2012 to "an updated benchmark" or electricity share by 2020.***

- *Allowances should be allocated annually with a compliance period of three or four years.*

- *No auction should be used, but if one is used: a) start very small and phase in based upon experience; b)auction proceeds should benefit ratepayers through use by Retail Providers; c)regulatory structure should specify uses of proceeds to minimizing the cost of regulatory Ghg programs such as energy efficiency, research and development, demand side management, carbon capture and storage, and reducing the impacts of global warming; d) trading of allowances with bilateral agreements should be allowed (i.e. a secondary market); e) limit purchasers and sellers to Retail Providers and any others required to obtain allowances; f) schedule multiple auctions held annually auctioning a portion of the allowances at each auction; g) require public disclosure of all auction and trading amounts and prices, and h) use a centralized statewide auction that can transition into a wider western or national system.*

- *Early action credit required in Assembly Bill (AB) 32 should be reflected in the cap set for each Retail Provider and phased in during the period of 2012 through 2020.*

SMUD notes that the questions presented will only be answered from the confines of the electric and natural gas industries. Nonetheless, the issues presented were originally suggested by the Market Advisory Committee (MAC) who focused on the impacts and market structures for the broader California economy. Therefore, SMUD cautions using the structures from the MAC on the energy industry alone when the MAC clearly intended the system to apply to all sectors.

For ease of review of SMUD's responses, the questions are shown in bold text, and the responses directly follow the questions.

Please comment on each of the criteria listed by the MAC.

a. Reduces the cost of the program to consumers, especially low-income consumers,

b. Avoids windfall profits where such profits could occur,

c. Promotes investment in low-GHG technologies and fuels (including energy efficiency),

d. Advances the state's broader environmental goals by ensuring that environmental benefits accrue to overburdened communities,

e. Mitigates economic dislocation caused by competition from firms in uncapped jurisdictions,

f. Avoids perverse incentives that discourage or penalize investments in low-GHG technologies and fuels (including energy efficiency),

g. Provides transition assistance to displaced workers, and

h. Helps to ensure market liquidity.

1. **Are these criteria consistent with AB 32? Should other criteria be added, such as criteria specific to the electricity and/or natural gas sectors? In making trade-offs among the criteria, which criteria should receive the most weight and which the least weight?**

One criteria that is missing from the list is rewarding or at the very least not penalizing early leadership in carbon reduction. As SMUD's public record attests, our entity wide Ghg emissions while variable year to year, have remained essentially flat since 1990; this despite a one third increase in electricity demand within our service territory. AB 32 in Section 38562(b)(3) specifically recognizes that entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of regulatory greenhouse gas limits and reductions receive appropriate credit for early voluntary reductions.

SMUD has expended considerable funds to promote energy efficiency, to purchase and build renewable generation, and to develop from their infancy solar technologies just now blossoming in California's economy. Furthermore, SMUD has focused on developing efficient, relatively low polluting, gas fired resources. The costs for these low carbon activities and investments have been born by SMUD's ratepayers. It is imperative in setting criteria for allocation of allowances that early actors not be penalized for reducing carbon emissions prior to enactment of the regulations. Acting otherwise would be contrary to the statutory language of AB 32.

In addition, because of the long lead times in effecting infrastructure change in the energy industry, additional items to be included for consideration on the list are:

- Early development of currently uncertain, advanced energy supply and demand technologies that are clearly compatible with Executive Order S-3-05 and the acknowledged need to reduce Ghg emissions from all of society to less than a quarter of present levels. This is similar to listed item 'c.', promotes investment, but in our opinion beyond the ability of incremental market forces to efficiently provide within the response time required.

- Availability of capital in quantity and with longterm dependability to facilitate large infrastructure change. This is similar to listed item 'h.', liquidity of market funds, but more specific to the highly regulated electricity industry.

Other important considerations that should be included in this list are foreseeable but currently difficult to quantify changes to electricity demand from energy exchanges with other economic sectors. Two specific examples in particular must be considered and both are named as important Ghg reduction policy thrusts. They are illustrative of the potential for unintended consequences if un-restrained market forces or poorly designed regulatory structure were imposed on only the highly regulated electricity industry. These are:

- Substitution of low carbon electricity for petroleum in the transportation sector, and

- Substitution of natural gas fueled, locally generated electricity for grid supplied electricity where apparent net Ghg emissions reductions can be achieved relative to grid supplied electricity.

Clearly both of these technology options could potentially reduce the total California Ghg emissions inventory. Unfortunately, they do not fit into the criteria referenced above. Furthermore, the incremental effects of unintended market drivers may not match longterm goals for California.

As for which of the items on the MAC list that are of lesser applicability, SMUD notes that they all are seemingly of interest for a cap and trade program scope as expansive as that envisaged by some on the MAC. However, for a scope within the bounds of this regulatory arena, some items, for instance listed item 'g.', assistance to displaced workers, may be beyond the reach of this effort.

3.2 Basic Options

2. Broadly speaking, should emission allowances be auctioned or allocated administratively, or some combination?

SMUD believes that for the highly regulated electric utility industry greenhouse gas emission allowances should be administratively allocated to the rate setting authority of retail service providers. As the options grow and grow for all of the things that revenue generated from monetized value of allowances could be used for, the more it is obvious that the value should be vested with those authorities that carry fiduciary responsibility

for setting the rates that the affected consumers must pay to generate those monetized values. While it is possible in theory to monetize the allowance value through an auction and then vest those monies back to the rate setting authority for the protection of the consumer, the process so created at least adds inefficiency, and at its worst exposes the consumer's money to an untried market mechanism - an exposure that the electricity consumers of California are loath to re-experience.

SMUD does recognize the need for Retail Providers to sell and purchase allowances at various times. These transactions are necessary regardless of whether the allowances are administratively allocated or auctioned. A system similar to the oasis system used for transmission access should be developed to allow for secondary trades between Retail Providers.

3. **If you recommend partial auctioning, which proportion should be auctioned? Should the percentage of auctioning change over time? If so, what factors should be used to design the transition toward more auctioning?**

As stated above, SMUD does not advise development of an allowance auction. Also it is clear that the overwhelming majority of Ghg emissions reductions from the electric utility industry will come from regulatory bounds already in place to decrease consumer demand for energy and to increase the quantities of renewable energy used by generators. However, should the California Air Resources Board adopt an overall Ghg program that includes an auction, SMUD recommends that the auction begin as a very small portion of the overall allocation amount. Two or three percent of the total electricity sector allowance allocation available in year one would be sufficient to "try out" an auction scheme. The approximately two million tonnes of allowances available through auction in that first year monetized at an as yet undetermined price variously estimated at $10 per tonne, $50 per tonne or more would yield sufficient potential reductions to begin a market while limiting the expense to California electricity consumers. Recall that the expenses would come on top of Retail Providers' commitments to renewable energy and demand side reductions.

Over time and if the auction is functioning efficiently, the percentage of allocations purchased through the auction could be increased. The allowances available through the auction should be limited to a maximum of those allowances that could be needed to be exchanged to effect the Ghg emission reductions expected from the electricity sector.

SMUD notes that to the extent that auction proceeds are not returned to the consumer (as we suggest through the rate setting authorities), the cost of the allocations simply become a cost adder to utilities that then become additional ratepayer costs.

4. **How should new market entrants, such as energy service providers, community choice aggregators, or (deliverer/first seller system only) new importers, obtain emission allowances, i.e., through auctioning, administrative allocation, or some combination?**

A means of updating prior allocated amounts to reflect changes needs to be incorporated.

Such updating should provide for new entrants as well as demographic shifts and progress in reducing Ghg emissions. The updating method should preserve stability for investors while rewarding good progress towards a low carbon future. Updating the allocations should occur no less than each compliance period.

5. **What are the important policy considerations in the design of an auction?**

One of the most important questions is how the proceeds from the auction will be spent. SMUD recommends that these proceeds be returned to the rate setting authority of the Retail Providers (e.g., the public Boards for publicly owned utilities) to be used to reduce the costs faced by ratepayers. The rate setting authority is in the best decision making position to understand all of the rate increasing demands to be borne by the retail customer in meeting Ghg reduction requirements, and to balance resources to meet them.

A second important policy consideration is avoiding unintended impacts on the electric market and ratepayer costs. To address these issues, SMUD recommends that any auction begin with a small percentage of the allowance market to allow the market to develop and function without the potential for large impacts to any market participant or retail service provider. Let the market work out its kinks prior to moving into a larger auction.

Finally, the allowance auction should not be a money making opportunity for those who do not need the allowances as these would indeed be "windfall" profits. The auction should be limited to those entities that need the allowances. Trading among those who need the allowances after the initial auction will be necessary and should be available to all participants needing allowances. Nonetheless, the auction itself should not be a speculative or profit generating activity. Experience with newly devised energy markets in California have shown that the costs of speculation and profit taken for unproductive reasons will be born by the ratepayers.

6. **How often should emission allowances be auctioned? How does the timing and frequency of auctions relate to the determination of a mandatory compliance period, if at all?**

Auction schemes which could promote liquidity and stability for investors have been suggested in Federal legislation. One such scheme which might be considered would (in conjunction with a three or four year compliance period) offer a significant portion of the allowances to be auctioned (maybe half) well in advance of their need, say three or four years before the allowance validity year with the balance offered in the compliance year. Multiple auctions held periodically through any year, quarterly for instance, would add to public scrutiny of the process and perhaps enhance confidence.

7. **How should market power concerns be addressed in auction design? If emission allowances are auctioned, how would the administrators of such a program ensure that all market participants are participating in the program and acting in good faith?**

To address these and other concerns SMUD recommends that the auction portion of the

allocations be limited in the initial years to a small percentage of the overall allocations. By limiting the amount of allocations that are auctioned, the system can address potential concerns such as market power and windfall profits without threatening the entire program. An implementation period that only expands the auction portion of the allocations as the market develops and functions properly has the ability to avoid some of the problems experienced with the market function under AB 1890.

As a publicly owned entity, SMUD is comfortable working in the light of public disclosure. We believe it allows more and better ideas to be brought forward as well as increasing public confidence. Because of this, it is important that regardless of whether allowances are auctioned or administratively allocated, the owner of each allowance, the record of every allowance change of ownership and any price paid should be public record along with any promise of use for such allowance, if not for use by the registered owner at the point of regulation.

8. **What criteria should be used to designate the types of expenditures that could be made with auction revenues (including use to reduce end user rates), and the distribution of money within those categories?**

The auction revenues should be returned to the rate setting authority of the Retail Provider for use at their discretion in minimizing cost to consumers for the total response needed to fight global warming. Because each Retail Provider is in a different situation regarding current carbon content, magnitude of change needed for demand reduction, for owned assets or contracted assets to comply with the major carbon reduction regulations already imposed, and to meet needed changes yet unforeseen, each rate setting authority is in best position to determine the best use of these auction revenues. This program could be similar to the program used to select appropriate uses for public goods funds.

A note of caution should be considered regarding auctions. Use of auction revenue may be directed to relieve of the cost of compliance from regulatory driven reduction programs (e.g., efficiency technology research and development, demand side management incentives, carbon capture and storage research and development, etc.) However, at least for the first several compliance rounds, perhaps a decade, the cost of carbon as revealed by the markets will likely have substantial and unpredictable volatility. High quality programs cannot be effectively based on a volatile funding stream.

9. **What type of administrative structure should be used for the auction? Should the auction be run by the State or some other independent entity, such as the nonprofit organization being established by the Regional Greenhouse Gas Initiative?**

If an auction is used it should be a statewide auction. The auction should allow for a secondary market for bilateral or "oasis" type trades between Retail Providers.

3.4 Electricity Sector

a. <u>Grandfathering</u>: "A method by which emission allowances are

freely distributed to entities covered under an emissions trading program based on historic emissions." (MAC report, p. 93.)

b. <u>Benchmarking</u>: "An allowance or allocation method in which allowances are distributed by setting a level of permitted emissions per unit of input or output" (e.g., fuel used or sales to customers (pounds (lbs)/megawatt-hour or lbs/million British thermal units (MMBtu)). (MAC report, p. 90.)

c. <u>Updating</u>: "A form of allowance allocation in which allocations are reviewed and changed over time and/or awarded on the basis of changing circumstances (such as output) rather than historical data (such as emissions, input or output). For example, allowances might be distributed based on megawatt-hours generated or tons of a product manufactured." (MAC report, p. 96.)

d. <u>Others</u>: Such as population (lbs of carbon dioxide (CO_2/customer or lbs CO_2/capita) or cost of compliance (based on retail provide supply curves of emission reduction measures, or a comparable metric.

10. **If some or all allowances are allocated administratively, which of the above method or methods should be used for the initial allocations? If you prefer an option other than one of those listed above, describe your preferred method in detail. In addition to your recommendation, comment on the pros and cons of each method listed above, especially regarding the impact on market performance, prices, costs to customers, distributional consequences, and effect on new entrants.**

SMUD has held the carbon content of its generation to approximately its 1990 level despite significant load growth. SMUD ratepayers have paid for the investments that made this achievement possible. Nonetheless, SMUD recognizes the need to craft a carbon reduction solution that works for the entire state. Therefore, SMUD proposes an administrative allocation that recognizes the real costs faced by high carbon Retail Providers through initial allocations based on historic emission rates (i.e., grandfathering). But, to avoid penalizing entities like SMUD that have expended considerable funds to achieve a relatively low carbon footprint, the administrative allocation should transition to a form of updated benchmarking by 2020. The short transition time is necessary to recognize early actors. Under this balanced approach, the

allowances should be allocated to Retail Providers based upon a combination of need i.e. current carbon burden identified as "grandfathering" above and the percent of electrical energy they serve in California, "electricity share," a form of updated benchmarking. This system creates a balance between the burden faced by high carbon entities with significant need to reduce the carbon content of their generation and recognition of those whose carbon content is lower so as not to punish low carbon leaders. The system should follow a smooth transition over the time period between 2012 and 2020 from an initial focus on reducing the increased cost of regulatory compliance due to high emissions assets, to a focus on allocation based upon electricity share so as to recognize the efforts of early carbon reductions. Thus, except to the extent that a minimal auction is warranted, allowances should be allocated to retail service providers at the outset in proportion to the Ghg quantity represented in their retail electricity and shifting smoothly to allocation by 2020 based upon the retail provider's California retail sales electricity share.

SMUD has considered potential advantages offered by allocation based upon per capita consumption of electricity, but believe that the complexities needed to accommodate widely divergent climactic regions across California would be too great a challenge.

The above scheme encourages early reductions in high carbon resources, rewards early leaders and provides an early advantage to high carbon entities that need to make the most significant reductions. Furthermore, while a system based on benchmarking may appear to reduce incentives for energy efficiency, any marginal effects on energy efficiency should be clearly outweighed by the lower overall cost of carbon reduction achieved by energy efficiency measures.

11. **Should the method for allocating emission allowances remain consistent from one year to the next, or should it change as the program is implemented?**

As stated above, the system should be updated with due regard for stability of investor interests and reward for early action.

12. **If new market entrants receive emission allowance allocations, how would the proper level of allocations be determined for them?**

By placing the point of regulation at the provider of retail electricity, the number of new entrants is reduced and stability and predictability are greatly enhanced. The updating allowance allocation recommended above would accommodate new retail service providers at each compliance period.

13. **If emission allowances are allocated based on load/sales, population, or other factors that change over time, how often should the allowance allocations be updated?**

As indicated in answers above, the allowance allocations should be updated annually to reflect load growth and new entrants.

14. **If emission allowances are allocated based on historical emissions ("grandfathering") or benchmarking, what base year(s) should be used as the basis for those allocations?**

Because SMUD's Ghg emissions have remained relatively constant when averaged over the last decade and a half, we are somewhat indifferent to the time of setting the benchmark. However, as is public record for SMUD through our entity-wide emissions disclosures, and for the electricity sector in California as a whole, considerable variation in year to year emissions of Ghg are the norm. This is easily correlated with variations in hydro-based resources, but likely has other common modes as well. For this reason multiple years of emissions need to be considered in setting a baseline. Three or four years of consecutive data would provide a minimum baseline period.

Furthermore, the compliance period for the renewable portfolio standard (RPS) is going into place at the same time as these Ghg requirements. The base years should be selected carefully to ensure early RPS compliant entities are not punished for meeting RPS requirements in advance of the deadline.

15. **If emission allowances are allocated based initially on historical emissions ("grandfathering"), should the importance of historical emissions in the calculation of allowances be reduced in subsequent years as providers respond to the need to reduce GHGs? If so, how should this be accomplished? By 2020, should all allocations be independent of pre-2012 historical emissions?**

SMUD's response to this issue is contained in the response to question 10 above.

16. **Should a two-track system be created, with different emission allowances for deliverers/first sellers or retail providers with legacy coal-fueled power plants or legacy coal contracts? What are the factors and trade-offs in making this decision? How would the two tracks be determined, e.g., using an historical system emissions factor as the cut-off? How should the allocations differ between the tracks, both initially and over time? What would be the market impact and cost consequences to consumers if a two-track method were used?**

Providing the holders of legacy coal projects or contracts with different allowances would be an attempt to recognize the inherent costs upon these utilities of transitioning their generation resources from coal to another generation source that could very well be higher cost energy than their current contracts. Nonetheless, allowances have value that could become a windfall profit if not managed properly. Therefore, any system providing these allowances to entities holding these legacy contracts should be designed so that these allowances do not become an area of profit, sending a signal to industry that those with the highest exposure will be rewarded.

17. **If emission allowances are allocated administratively to retail providers, would other adjustments be made to reflect a retail provider's unique circumstances? Comment on the following examples, and add others as appropriate:**

    a. Climate zone weighting to account for higher energy use by customers in inclement climates, and

    b. Increased emission allowances if there is a greater-than-average proportion of economically disadvantaged customers in a retail provider's area.

SMUD believes that the complexities in adjusting allocation schemes to accommodate the two listed concerns are beyond the reasonable expectation for this rulemaking. However, by vesting allocation of allowances with rate setting authorities who regularly balance these issues and more as they pertain to customers in their service territory, these concerns will be balanced as appropriate for all of California.

18. **Should differing levels of regulatory mandates among retail providers (e.g., for renewable portfolio standards, energy efficiency investment, etc.) be taken into account in determining entity-specific emission allowance allocations going forward? For example, should emission allowance allocations be adjusted for retail providers with high historical investments in energy efficiency or renewables due to regulatory mandates? If those differential mandates persist in the future, should they continue to affect emission allowance allocations?**

Differences in initial utility conditions should be afforded in setting the cap(s), not in the allocation schemes. Any adjustments in allocation of allowances based upon RPS and energy efficiency investments should be made upon the actual amount of energy efficiency or renewable energy investments achieved by a retail service provider not on regulatory mandates. Just because an entity has a regulatory mandate does not mean that entity has achieved all of the goals set by the regulatory mandate. Similarly, just because an entity does not have a regulatory mandate does not mean the entity is not committed and has not expended substantial funds for energy efficiency, renewable energy sources or research and development for low carbon resources. Therefore, if differing levels of investments in low carbon strategies are to be considered, they should be based upon goals achieved not mandates.

Despite SMUD's concerns, should the CPUC and CEC decide to take regulatory mandates into account, they need to treat common publicly owned utility (POU) board actions like regulatory mandates. Common POU board actions include adopted budgets with specific energy efficiency goals, board resolutions, and strategic directives to name a few examples.

19. **How often should the allowance allocation process occur? How far in advance of the compliance period.**

The allowance allocation process should be set on an annual basis even with longer compliance periods. To the extent that unpredictable changes to allocations could occur, those changes should be set with due regard for confidence in the process and stability of funding. In any case, at least prior to the beginning of the compliance year to allow entities to plan for the following year.

20. **What are the distributional consequences of your recommended emission allowance allocation approach? For example, how would your method affect customers of retail providers with widely differing average emission rates? Or differing rates of population growth?**

Administrative allocation of all allowances to the Retail Provider, the recommended point of regulation, will best preserve ability of the highly regulated electricity industry to maximize balancing opportunities as needed. By beginning the allocation process with a focus on historical emissions, the impact to ratepayers served by high carbon retail service providers will have some relief.

The ratepayers from high carbon retail service providers will be facing the highest potential immediate costs for carbon reduction. Nonetheless, ratepayers of lower carbon retail service providers have in some instances already paid for low carbon resources. For example, SMUD has expended considerable funds to encourage energy efficiency improvements for its ratepayers. Furthermore, those same ratepayers have paid for the development of early utility scale solar, investments in hydrogen fueling station and advancements in hydrogen vehicles, and higher cost gas fired generation in comparison to coal. Therefore, these comparisons of ratepayer costs when focused only on the current situation fail to fully recognize the costs already included in rates of some retail service providers to support existing low carbon strategies. These costs are just as real as the current costs faced by the ratepayers of high carbon retail service providers.

21. **Would a deliver/first seller point of regulation necessitate auctioning of emission allowances to the deliverers/first sellers?**

SMUD believes that it would, and to considerable total of all the allowances. The great risk in initiating such a scheme is yet another reason to refrain from the First Seller model.

22. **Are there interstate commerce concerns if auction proceeds are obtain from all deliverers/first sellers and spent solely for the benefit of California ratepayers? IF there are legal considerations, include a detailed analysis and appropriate legal citations.**

SMUD has no comment.

23. **If you believe 100% auctioning to deliverers/first sellers is not required, explain how emission allowances would be allocated to deliverers/first sellers. In doing so, answer the following:**

a. How would the amount of emission allowances given to deliverers/first sellers be determined during any particular compliance period?

b. How would importers that are marketers be treated, e.g., would they receive emission allowance allocations or be required to purchase all their needed emission allowances through auctions? If allocated, using what method?

c. How would electric service providers be treated?

d. How would new deliverers/first sellers obtain emission allowances?

e. Would zero-carbon generators receive emission allowance allocations?

f. What would be the impact on market performance, prices, and costs to consumers of allocating emission allowances to deliverers/first sellers?

g. What would be the likelihood of windfall profits if some or all emission allowances are allocated to deliverers/first sellers?

h. How could such a system prevent windfall profits?

SMUD recommends against further consideration of the First Seller model. It is unviable in several dimensions as California's response to AB 32. Proceeding with load-based point of regulation obviates the need to consider the many complexities presented by this question.

24. **With a deliverer/first seller point of regulation, should administrative allocations of emission allowances be made to retail providers for subsequent auctioning to deliverers/first sellers? If so, using what allocation method? Refer to your answers in Section 3.4.1, as appropriate.**

SMUD supports putting the retail service provider as the point of regulation. These types of concerns present the difficulties of using a first seller system. If the regulations adopt a first seller system, the real focus needs to be on the auction revenues and using those revenues to reduce the cost impacts to ratepayers. The auction revenues need to be provided to the retail service providers to offset some of the costs on ratepayers of compliance with the new regulations.

25. **If you recommend allocation of emission allowances to retail providers followed by an auction to deliverers/first sellers, how would such an auction be administered? What kinds of issues would such a system raise? What would be the impact on market performance, prices, and costs to customers?**

SMUD has no comment.

26. **Answer each of the questions in Section 3.4.1, except Q16, but for the natural gas sector and with reference to natural gas distribution companies (investor – or publicly-owned), interstate pipeline companies, or natural gas storage companies as appropriate. Explain if your answer differs among these types of natural gas entities. Explain any differences between your answers for the electricity sector and the natural gas sector.**

SMUD only supplies natural gas to some of its owned electrical generation assets. It is SMUD's position that its natural gas transmission facilities would therefore, only be subject to regulation as a part of the electric utility sector in regards AB 32. This approach would avoid double counting the emissions from SMUD's gas transmission and distribution system.

27. **Are there any other factors unique to the natural gas sector that have not been captured in the questions above? If so, describe the issues and your recommendations.**

As noted in our answer to question 1, allowance allocation process needs to consider the potential for changing consumer use of energy supplies for their needs. Of interest regarding natural gas and electricity changes is the potential for development of onsite generation of electricity that displaces grid supplied electricity.

28. **Considering your responses above, summarize your primary recommendations for how the State should design a system whereby electricity and natural gas entities obtain emission allowances if a cap and trade system is adopted.**

SMUD has in our answers above recommended a fair and reasonable approach to allowance allocation as pertains to the electric service industry. In summary, SMUD advocates for the Retail Provider as the point of regulation. Allowances should be administratively allocated beginning initially in 2012 based on grandfathered emissions (100 percent) with a short transition to updated benchmarking (100 percent) by 2020. Allowances should be provided annually and updated annually to allow for load growth, new entrants and other changes. The compliance period should be a three or four year period. A secondary market for trading allowances must be established to allow bilateral trades among Retail Providers and could follow a system similar to the Oasis system used for transmission. Early action credit should be reflected in the cap set for each Retail Provider and should be phased in over the 2012 to 2020 timeframe.

SMUD does not recommend using an auction, but if one is used it should begin initially with a very small (2 to 3 percent) portion of the market and phase in only after the

auction has proved successful. Auction proceeds should be returned to the Retail Providers for use in minimizing the costs in fighting global warming. Only Retail Providers should be allowed to participate in the auction to avoid creating a pure profit opportunity since those profits are simply additional costs to the ratepayers. Any auction should occur multiple times during a year with the results public. Any auction should be statewide with the ability to transition to a regional or national system.

Dated: October 31, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the attached:

SACRAMENTO MUNICIPAL UTILITY DISTRICT'S COMMENTS ON THE ALLOWANCE ALLOCATION ISSUES

on all known parties to R. 06-04-009 and CEC Docket No. 07-OIIP-01 by transmitting an e-mail message with the document attached to each party named in the official service list. I served a copy of the document on those without e-mail addresses by mailing the document by first-class mail addressed as follows:

See attached service list

Executed this 31st day of October 2007, at Sacramento, California.

Lois Navarrot

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