FILED
12-03-07
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)

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 TYPE AND POINT OF REGULATION ISSUES FOR THE ELECTRIC SECTOR

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December 3, 2007

SACRAMENTO MUNICIPAL UTILITY DISTRICT'S COMMENTS ON TYPE AND POINT OF REGULATION ISSUES FOR THE ELECTRIC SECTOR

In accordance with the California Energy Commission's (CEC) regulations and the Rules of Practice and Procedure of the California Public Utilities Commission (CPUC) the Sacramento Municipal Utility District (SMUD) provides the following comments on the Administrative Law Judges' Ruling Requesting Comments on Type and Point of Regulation Issues ("Ruling"). These comments are being provided to both the CEC and the CPUC. The comments below respond to the questions in the Ruling. The questions are shown in bold text, and the responses directly follow the questions.

General

1. **What do you view as the incremental benefits of a market-based system for GHG compliance, in the current California context?**

The market based system allows trading within the utility sector to give options for entities to meet hard caps given operational and demand fluctuations as well as manage the blocky nature of reductions. SMUD has and continues to advocate for a secondary market to allow entities that have allowances to trade amongst themselves to provide some flexibility and to recognize the inherent difficulty in predicting the weather and resulting demand. Since utilities do not control demand, the weather, and other environmental factors, they cannot exactly predict the level of generation (MWh) required for any specific year. Therefore, the secondary market allows for trading to adjust for these fluctuations as well as recognizes the blocky nature of changes in generation sources where an early change can yield extra allowances or long-lead time capital investments may take years to come on line.

On the other hand, an auction is unnecessary and potentially counterproductive because the auction will require managing volatile new revenue flows in addition to the cost of reducing carbon in the energy provided to utility customers. As we've found out in California, it also lays open the possibility of manipulation or market speculation.

2. **Can a market-based system provide additional emissions reductions beyond existing policies and/or programs? If so, at what level? How much of such additional emission reductions could be achieved through expansion of existing policies and/or programs?**

At this point and for at least the first several years of this program, we do not know if markets will provide additional reductions or reductions at a lower cost. Because this is a new program and a new method of achieving these results, we propose beginning the market structure slowly so that any problems will be confined to a small section of the program and can be fixed before they are applied to the entire program. As SMUD

recommended in its comments on allowance allocation, SMUD recommends allowing the development of a secondary market for allowances and holding off on a full scale auction of all allowances at this time.

Principles or Objectives to be Considered in Evaluating Design Options

3. **Do you agree with this set of objectives? Are there other objectives or principles that you wish to see included? If so, please include your recommendations and reasoning. Finally, please rank the objectives above, and any additional factors you propose, in order of importance.**

The following additional objectives should be included in the evaluation of greenhouse gas (GhG) programs.

Maintain/Enhance Reliability. Does the approach being considered compromise the efficient and reliable operation of the electric grid? Does the approach provide incentives that would encourage the location of generation outside of California further pressuring transmission capabilities? Does the approach discourage location of generation in load centers?

None of the stated objectives recognize the inherent requirement to maintain the operation and balance on the transmission grid. With the increase in intermittent renewable development, balancing the grid will present additional challenges that need to be considered when setting environmental policy. Public support for GhG reductions will decrease quickly if the reliable supply of electric power is compromised. Therefore, in order to achieve the goals of AB 32, the electric industry must also be cognizant of its primary requirement, to supply reliable energy to Californians. No policy as sweeping as that contained in AB 32 should be implemented without consideration of this underlying requirement to keep the lights on for California.

Foster Compliance Options. Would the approach allow entities the opportunity to select the most cost effective method of reducing emissions?

In order to meet the statutory requirement to develop cost effective regulations, the regulations should provide for utility options for compliance. Flexibility that allows entities to find the most cost effective carbon reduction strategies to meet the GhG goals, while complying with existing and likely future additional legislative directives such as mandatory increases in renewable generation.

Facilitate Infrastructure Changes. Would the approach support long lead time capital intensive investments in infrastructure necessary to support the transition to a low carbon future?

SMUD is concerned that the incremental price signals provided by market based systems will not provide the incentives for long lead time capital intensive infrastructure additions in transmission and generation. Changes that are needed to reduce the carbon content of

the generation mix serving California. Without these infrastructure additions, California will not meet the 2020 targets, nor set us on the path for further reductions by 2050.

These three objectives need to be added to the list of objectives for the design of a GhG program. The top five goals should be Maintain/Enhance Reliability, Cost Minimization, Foster Compliance Options, Facilitate Infrastructure Changes and Goal Attainment. A program that fails to maintain the reliability of the electric system is doomed to fail. Similarly, a program that is prohibitively expensive cannot be sustained. Compliance options will help to reduce costs by not setting each reduction requirement in rigid command and control parameters. Meeting the 2020 goals as well as future reductions will require substantial investment in infrastructure that cannot be left to market mechanisms that may be unable to support long lead time capital intensive infrastructure. Finally, a program that fails to meet the goals will only encourage additional legislation and additional process which may further exacerbate the need for stability to build long lead time infrastructure.

Load-Based Cap-and-Trade System Design

4. **With a load-based cap-and-trade system, should exports from in-state generation sources be included and accounted for under the cap? Why or why not? If so, how? For example, exports could be captured in a cap-and-trade system by regulating in-state sources that export, or by counting the emissions associated with exported power, without any compliance obligation on the exporter. There may be other options as well.**

Exports should not be included under the cap. Under a load based approach all power consumed in California would be accounted for through the load serving entity. If power produced in California but consumed elsewhere is included, California would be double counting its emissions by counting emissions from power consumed elsewhere. Whichever system is adopted, the regulations should clearly only account for the emissions under one system or the other, not both. Since AB 32 explicitly requires accounting for "all emissions of greenhouse gases from generation of electricity delivered to and consumed in California", only the emissions from power consumed in California should be counted. (Cal. Health and Safety Code Section 38505[m].)

Removing the compliance obligation on the exporter of power would work as one solution. SMUD has no objection to reporting the emissions for wholesale sales but does not believe the seller should be held responsible under a load based system for the emissions associated with the sale. To do otherwise would double count the emissions.

Cross boarder relationships must be developed to avoid double counting. If Nevada uses a load based system and power imported to Nevada is counted by Nevada, it should not also be counted when exported from California. If source based systems are used, power accounted for at its source should not be counted in California when it is imported. Because California imports a significant amount of power from other states, it is imperative that California coordinate with surrounding states to account for GhG emissions only once.

5. **How extensive do you view the threat of contract-shuffling under a load-based program, given the accessibility of clean resources within the western interconnect? What mechanisms do you propose to combat this possibility? On what basis do you support your position?**

SMUD understands the general concerns about leakage including simply moving the carbon to a location out-of-state. This concern is not limited to, nor is it unique to, the energy sector. Other sectors can move production or fueling out-of-state to reduce instate emissions with no reduction in carbon. In order to truly address the concerns about shifting contracts from high carbon generation to low carbon generation and ultimately not reducing emissions from a west wide perspective, California needs to work with western states to develop a west wide program. Until such a west wide or national program is implemented, California must rely upon renewable portfolio standard (RPS) or GhG programs in other states.

The unstated premise for the concept of contract shuffling relies upon the view that surrounding states have no interest in reducing the carbon emitted from their facilities or those facilities that provide electricity for consumption in the surrounding states. For evidence to the contrary we need look no further than to the comment letter from the states of Washington and Oregon on the carbon to attribute to power exported to California. Washington and Oregon are clearly claiming their low carbon resources for serving native load and sending the high carbon resources elsewhere. In addition, surrounding states are implementing RPSs of their own. The general presumption that other states will simply take all of the high carbon resources and send lower carbon gas fired or renewable resources to California fails to acknowledge these programs and requirements. Therefore, SMUD feels this concern is really overstated and all of the extensive efforts made to ensure that AB 32 does not simply result in a carbon trade from one facility to another are unnecessary.

Furthermore, if the concerns about contract shuffling turn out to be real, the shuffling will be publicly identifiable. First, information about new development of high carbon resources is public once permitting begins regardless of the state where such permitting is initiated. Similarly, the capacity factors of power plants are reported each year and available for inspection and review. The emission performance standard adopted under Senate Bill (SB) 1368 will prevent Californians from underwriting the development of or furthering longterm continuation of high emitting carbon resources. Thus, over time these high carbon resources will either develop sequestration or other carbon capture strategies, or begin to reduce their level of operation. In the unlikely event this concern about contract shuffling becomes a reality, the regulators in California will be able to see the results of the transactions and make changes to respond to a real situation.

6. **Which of these systems best accounts for all imports? What are the advantages and disadvantages of each potential tracking system in terms of accuracy, cost of development and administration of tracking systems, costs of administration to the parties, and overall costs to ratepayers? Are there alternative tracking approaches that you would recommend and for what reasons?**

SMUD proposes using a contract and settlement approach to tracking. This approach follows existing monthly accounting, true-ups, and reporting to the Energy Information Administration (EIA) on Form 906. SMUD would propose to use existing reporting frequencies and forms to the greatest extent possible to reduce the regulatory burden while also providing the information needed to track emissions. Monthly information on emissions would provide the information needed by utilities to make conscious, emissions informed, decisions on future purchases and allow utilities to plan for expected emission responsibilities connected with those purchases.

Under a partial Western Electricity Coordinating Council (WECC) GhG cap, with only California or a few states participating, SMUD prefers a combination of the first and second options described in this decision. This monthly accounting true-up method is superior to both the development of an improved tracking system that matches contracted sources to loads, and much better than a NERC e-Tag based contract and settlement approach or a tradable emission attribute certificates (TEAC) approach. The TEAC approach only works if all of the WECC states, provinces and the northern portion of Baja California are participating in the program, and while this might be worth pursuing, it must be evaluated in discussion with other WECC states and provinces. The contract and settlement approach, if it relies on NERC e-tag data, is forcing an emissions tracking system on a reliability instrument. Furthermore, the NERC e-tag system is shown to be unreliable in the Attachment A to the Ruling.

A contract and settlement approach that recognizes the physical limitations of the electricity grid, and the intent of long and medium term contracts in providing some level of certainty around costs, provides the best basis for tracking emissions from the generation purchased source to sink. This will necessarily require a tracking system to which participants report transactions, at a level of frequency that provides useful information for market participants, but at the same time one that is not overly burdensome.

Recognizing that the WREGIS system uses monthly reporting of generation to track renewable generation, that relevant filings on all generation in the WECC are made to the EIA each month, and that energy settlements are done on a monthly basis, it would make sense to implement a tracking system that relies on monthly aggregation of generation and purchases, and which leverages the existing reporting from form EIA 906 that could allow WECC-wide monthly generation and emissions profiles. Reporting frequency would depend on how quickly the state could receive results from the EIA, with more frequent reporting allowing an improved estimation of the carbon content in short term market purchases.

The accuracy of such a system would be very high for specified contracts, and for unspecified purchases, would improve as additional states and/or utilities opted into the tracking system. The advantages to such a system would be that it leverages existing reporting information and timelines to enable a low cost easily automated tracking system. The disadvantage of such a system is that it would still rely on estimation of a residual mix. The accuracy would arguably be reasonably high at the outset, but would be

dependent on the percentage of load in the WECC that had opted into the tracking system, and the diversity of resources remaining in the residual mix.

7. **If a load-based approach is pursued, would the potential benefits of a full TEAC system be great enough to warrant the start-up and administrative costs?**

The costs of instituting any WECC wide tracking system will not be small in absolute terms. However the benefits relative to protection of carbon assets valued in the billions of dollars each year is the proposition to be weighed. Because our suggested tracking system would piggyback on the monthly EIA reporting and the bilateral contract settlement process common to Western utilities, it's ongoing reporting would seem a reasonable additional operational burden.

However, specific reporting protocols and timetables for introducing this system would need broad utility working group participation to estimate initial and ongoing reporting costs.

Pure Source-based (GHG Regulation of In-state Generation Only)

8. **Do you view this approach as compliant with Assembly Bill (AB) 32? Please support your answer.**

The majority of reductions in emissions can and most likely will be achieved by expansion of existing programs to increase the level of renewable resources in the overall California resource mix, expand investment in energy efficiency and comply with the requirements in SB 1368 (setting the emission performance standard "EPS"). Various modeling efforts have shown that increasing the level of investment in these programs can meet the 2020 GhG goal. Therefore, the state can meet the GhG goals in 2020 without direct regulation of imports beyond the programs mentioned above. But, the program runs the risk of becoming extremely expensive if it sets hard numbers on specific programs to be obtained by all utilities. Since retail service providers in California have great variation in their generation mix and existing carbon reduction strategies, a one-size-fits-all solution will create significant additional costs. Instead, each utility must be given the flexibility to select the most cost effective reduction strategies for each utility.

If a source based regulatory system is used instead of existing RPS, EPS and energy efficiency programs, which SMUD sees as highly unlikely, that source based system needs to be west wide or nation wide to obtain real results. Until such a national or west wide system is adopted, simply regulating resources in California drives generation outside California. Because California is a net importer of electricity now, an instate system alone would fail to recognize emissions driven by consumption in California and would further drive generation out of the state.

9. **In light of the relatively high capacity factors of carbon-intensive facilities outside the state, how extensive do you expect the short-term threat of substituting higher-carbon imports for in-state generation to be? Might this**

possibility be dealt with through specific program design (e.g., allocations, limiting conditions, etc.)?

SMUD believes the assumptions built into this question are flawed as described in our response to Question 5. The question assumes that California entities can obtain limited existing renewable resources that are in great demand due to the efforts by other states to require investment in renewable resources or can simply shift from coal fired generation to natural gas fired generation. This question assumes that others would be willing to exchange their renewable or gas fired generation for coal fired generation. Other than hydroelectric power, renewable generation is more expensive than coal fired generation. Based upon SMUD's experience in the energy markets, renewable generation will not simply be substituted for coal generation. Those purchasing renewable generation now are doing so for other than cost reasons and will not be willing to simply exchange their renewable power for coal generation.

Natural gas fired generation is also generally more expensive than coal fired generation. Will there be some entities willing to obtain coal fired generation in place of gas fired generation? Potentially, but increasing the demand for low carbon resources is the very point of these regulations and should not be seen as a negative result. California's buying power should be focused on low carbon resources going forward. The high carbon resources will need to advance sequestration or another solution to their high carbon emissions to sell to California in the future.

10. **Given existing procurement oversight and the prospect for a regional or federal GHG program in the foreseeable future, how extensive do you expect the threat to be of a longer-term shift of production to regions beyond the reach of a California source-based cap-and-trade regime?**

Certainly, the potential for large out-of-state growth of renewable generation is clearly foreseeable to satisfy both the demand of California and requirements of surrounding states. In addition to the growth of renewable generation, coal generation will also receive substantial support from outside of and from California to investigate and develop carbon capture solutions. These shifts are already occurring as demonstrated by the efforts of high coal utilities to invest in renewable generation. Unless California is willing to finance, permit and construct all generation needed to support California load, California must embrace these changes to production of electricity in regions outside the state. It is unrealistic to expect California to be able to regulate outside its borders but instead, should focus on creating incentives to electric producers to provide low carbon energy to California.

11. **If emissions associated with imported power are excluded from a cap-and-trade program, what policies beyond the existing suite of program including energy efficiency, California Solar Initiative, RPS, and Emission Performance Standard (EPS) do you recommend that California employ to achieve the necessary reductions from the electricity sector.**

As stated above, AB 32 will not allow a complete disregard for imports. Therefore, if a cap and trade program is developed it should include imported as well as locally generated power. Treating imports differently from local generation may create an incentive to locate and purchase power from outside the state. Pushing generation outside of the state further stresses the transmission system and reduces local reliability. SMUD does not see creating an incentive to locate generation outside the state as a solution.

12. **As the Public Utilities Commission does not currently have authority to oversee all energy efficiency and renewable procurement programs for all kinds of retail providers (investor owned utilities (IOUs), community choice aggregators (CCAs), electric service providers (ESPs), and publicly owned utilities (POUs) which agency(ies) should fill in any gaps? Would the California Air Resources Board (ARB) have the authority to require certain energy efficiency and renewable targets be met by POUs?**

Publicly owned utilities (POU) all have publicly elected governing boards that face the ultimate judge, the people of California. It is these governing boards that have the responsibility to see that their utility meets the standards set by adopted regulations or statutes. POUs adopt resource plans and make resource procurement decisions in public and in compliance with laws like the Brown Act. Unlike investor owned utilities (IOU), the POU procurement decisions are already subject to a public review and approval process because these decisions are brought to the POU governing boards. Furthermore, general principles of law require that government agencies and special districts comply with the law.[1] Many governing boards have explicit policies requiring that they act in compliance with the law. Therefore, POU governing boards follow and comply with laws and regulations and do not need to have the California Air Resources Board (CARB) or the CEC serve as a second and in some cases third level of review to be sure POUs follow the law.

This very important distinction is often lost when simply looking at the different regulatory structure between POUs and IOUs. The POU governing boards act in much the same manner as the CPUC in overseeing the actions of the POU. The governing boards ensure the POU is following legal requirements as well as policies consistent with the views of the public.

Most POUs own at least some if not all of the generation needed to support their load. But, each POU faces a different carbon content of existing generation, a different level of investment in energy efficiency, renewable resources and solar development. Each needs to look at the unique circumstances in which they operate for the most cost effective means of reducing the carbon content in their generation. The governing boards are in

[1] Administrative agencies have only such powers as are conferred by law creating them and may not act in excess of those powers. *20th Century Ins. Co. v. Quackenbush,* 64 Cal.App.4th 135, 139 (1998), *Weber v. Board of Retirement of Los Angeles County Retirement Assn.*, 62 Cal.App.4th 1440, 1446 (1998), *Larson v. State Personnel Bd.,* 28 Cal.App.4th 265, 273-274 (1994), *General Telephone Co. v. Public Utilities Comm.*, 34 Cal.3d 817, 823-825 (1983).

the best position to make these important decisions. To add CARB or CEC oversight of these decisions adds a second and sometimes third public review of these decisions. The IOUs face only one public review, that before the CPUC. The public review should be the same for POUs.

For POUs the regulations should set clear targets and allow the publicly elected governing boards to decide how best to meet this target taking into account the unique circumstances of the individual POU and the need to comply with other co-effective requirements such as RPS and AB 2021.

13. **What sources would a source-based system cover? Could it cover California utility-owned facilities located outside of California?**

SMUD reserves the right to provide comments in reply.

14. **Would a strengthened EPS assist in reducing emissions due to California imports? What recommended changes would you make to the EPS?**

The California Energy Commission and California Public Utilities Commission recently adopted the EPS. SMUD believes the EPS itself and the implementing regulations resulted from an intensive effort between various stakeholders and should be allowed to be implemented prior to further examination. POUs consistently invest in or purchase power on a long-term basis to provide a hedge against future price increases and provide price stability. The EPS needs to be allowed to function at its current level prior to further adjustment. Furthermore, SB 1368 requires re-evaluation of the standard and the program after development of the regulations for AB 32, and SMUD believes such an evaluation should occur at that time. Evaluating a change at this point would simply create regulatory uncertainty.

Deliverer/First Seller

15. **Please comment on the "First Seller Design Description" paper, which is Attachment A to this ruling. Does the paper accurately describe the deliverer/first seller program? If not, describe your concerns and include an accurate description from your perspective.**

The paper does not address the treatment of power swaps or exchanges. SMUD is concerned about how these transactions will be treated under a first seller system. These power exchanges provide an efficient use of resources both in California and in other states. Without these programs, additional generation would be needed in both locations to provide the power provided by these exchange transactions. We cannot fathom how developing additional generation in each location would result in a net reduction in greenhouse gas emissions. These transactions have allowed entities in each location to fully use existing resources and ultimately reduce the number of generators needed to support both locations. SMUD believes that any first seller system needs to correctly identify these transactions and ensure that the generation is only counted once, either once on receipt or once on the sale, but in no event twice.

Source-based for In-state Generation, Load-based for Imports

16. **Please describe in detail your view of how this option would work.**

SMUD reserves the right to provide comments in reply.

17. **Do you support such an approach? Why or why not?**

SMUD is concerned about the potential complexities this hybrid system may present. SMUD is also concerned about potential double counting of energy swaps and exchanges with this hybrid structure. How will this hybrid structure account for generation produced in California and exchanged with the Pacific Northwest for imported generation at another time of year?

18. **Does this approach have legal issues associated with it? Provide a detailed analysis and legal citations.**

SMUD reserves the right to provide comments in reply.

19. **If retail providers are responsible for internalizing the cost of carbon for imported power, all power generated in-state may need to be tracked to load to avoid double regulation of in-state power. Do you agree?**

As a result of AB 32, getting more information about the source of power will be important. Nonetheless, existing mandatory reporting and accounting regulations when trued up and applied consistently by all providers will provide this information. To reiterate comments made above, double counting is a huge concern to SMUD because SMUD both sells power and participates in power exchanges with the Pacific Northwest. California should not be taking the double responsibility of all power produced in the state *and* all power imported without deducting the power exported or sold. Therefore, the GhG program in California needs to take care to avoid counting carbon twice or accounting for carbon rightfully accounted for in another state.

20. **If that is the case, does a mixed source-based/load-based approach offer any advantages compared to a load-based approach in terms of simplifying reporting and tracking? What if the load-based system uses TEACs? How could imports be differentiated from in-state generation in a way that reduces the complexity of reporting and tracking compared to a load-based approach?**

SMUD believes a load based approach provides the simplest way to track and account for emissions while also allowing for deductions of wholesale sales and counting exchange transactions only once. SMUD is concerned that a hybrid system would require extensive accounting to avoid double counting. As recognized by Attachment A, tracking power through the various transactions can be extremely difficult.

Deferral of a Market-based Cap-and-Trade System

21. **How important is it that a cap-and-trade system be included in the near-term as part of the electricity sector's AB 32 compliance strategy?**

As SMUD has explained in earlier filings, if a cap is going to be used, a secondary market needs to be developed to allow for flexibility in meeting the cap. SMUD would be concerned if the regulations used a cap but did not allow for trading between those subject to the cap. The inherent fluctuations in demand and weather driven resources such as hydroelectric power require a secondary market for trading emissions. If the weather turns out to be warmer in the north and cooler in the south, SMUD would like to be able to purchase additional credits from those entities located in the southern part of the state that may not need all of their credits. A secondary market will reduce the costs of compliance and allow for adjustments based upon weather and other factors that cannot be precisely determined in advance.

22. **Would your answer to Q[21] be different if there is no market-based cap-and-trade system? If so, please explain.**

No.

23. **Address the following:**

- **How emission reduction obligations could be met if there is no cap-and-trade system for the electricity sector,**
- **How increased programmatic goals would impact rates, and**
- **How deferral of a cap-and-trade program for the electricity sector would facilitate or hinder California's integration into a subsequent regional or federal program.**

As stated above, SMUD believes that a secondary market for trading of allowances is required to meet a hard cap for the electric sector.

There is no question this program will impact rates. The preliminary modeling results, although very inaccurate by entity, do show significant increases in rates due to the implementation of this program. SMUD is concerned that strict command and control goals in each area such at RPS, energy efficiency, solar installations, etc will lead to excessive costs. Each utility is in a unique situation regarding the amount of renewable generation, installed energy efficiency and other programs that are a part of their current portfolio. In addition, the varying weather and energy sources for each utility require that any system provide flexibility in determining the best way to reduce carbon. Therefore, in order to obtain the most cost effective reductions, the regulations need to allow flexibility in compliance instead of strict command and control specifying X% RPS, Y% energy efficiency, Z% installed solar, etc. If strict command and control levels are set the compliance costs will not be the most cost effective as required by AB 32. (Cal. Health and Safety Code Sections 38561(a) and 38562(a).

The California system will need to be modified for a regional or federal program regardless of what California adopts at this time. The level of modification will depend on the regional or federal program adopted. Since we do not have a clear indication of the form of a federal or regional program at this time, we could only speculate on the transition requirements.

24. **How deferral of a cap-and-trade program for the electricity sector would facilitate or hinder California's integration into a subsequent regional or federal program.**

SMUD reserves the right to provide comments in reply.

25. **If neither a regional system nor a national system is implemented within a reasonable timeframe, should California proceed with implementing its own cap-and-trade system for the electricity sector? If so, how long should California wait for other systems to develop before acting alone?**

As stated earlier, SMUD believes a secondary cap and trade system should be allowed to develop to smooth out the inherent weather and demand related impacts to energy use in California.

26. **What flexible compliance mechanisms could be integrated into a non-market based GHG emission reduction approach?**

If a load based approach is provided, SMUD would support setting a clear target and allowing each utility the flexibility to determine the most cost effective means of reaching that target. As stated above, because each utility faces unique challenges, a one-size-fits-all solution will not provide the best results. Each entity should be given the latitude to determine the most cost-effective way to reduce carbon. SMUD has recommended in earlier filings creating a suite of potential actions available to each entity to meet its requirements. The regulations should not be so restrictive as to limit genuine innovation in carbon reduction. The use of a clear target in place of strict command and control requirements will foster innovation and direct reductions to the most cost effective options for each utility.

27. **If a market-based cap-and-trade system is not implemented for the electricity sector in 2012, how would you recommend addressing early actions that entities may have undertaken in anticipation of a market?**

A correct partitioning of utility responsibility in the capping mechanism is a property way to recognize early action. If each entity is given a specific amount of carbon to reduce (tons), the amount of reduction should be reduced for those taking early action. This credit is especially important because early actors have already taken advantage of the lowest cost reductions. It will be more expensive and more difficult for early acting entities to reduce their carbon emissions than those who have not yet taken those initial steps. If specific carbon reduction amounts are provided to each entity, those with lower carbon profiles should receive proportionately smaller reduction requirements to acknowledge the actions they have already taken to reduce carbon.

Recommendation and Comparison of Alternatives

28. **[sic 29.] Submit your comprehensive proposal for the approach California should utilize regarding the point of regulation and whether California should implement a cap-and-trade program at this time for the electricity sector. If you recommend that another approach be considered besides those detailed above, propose it here. If you recommend one of the above options, give as detailed a discussion as possible of how the approach would work.**

SMUD proposes the point of regulation at the retail service provider. SMUD also proposes using a load base system. Under this system the number of regulated entities would be minimized and the participants relatively stable and identifiable. Assumptions about the carbon content of market purchases would have to be made but these assumptions would be required under the first seller concept as well. The retail service provider would be in the best position to balance the level of energy efficiency, renewable energy or other low carbon strategies needed to meet its GhG goals.

SMUD proposes that CARB set clear targets to be met by 2020. These targets could decline slowly in the initial years to allow time to execute some of the more difficult GhG emission reduction strategies such as modifying the resource mix, and decline more quickly leading to 2020 when some of these efforts begin to produce real carbon reductions. The specific method used by each entity could be flexible to recognize the wide variation of current carbon intensity of the different utilities. By setting a target, innovation and creative solutions would be encouraged.

As stated in our previous submittals, SMUD believes a secondary cap and trade system will be required to meet hard emissions caps and should be allowed to develop and function.

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CONCLUSION

SMUD requests that the CPUC and CEC take these comments into account in developing proposed decisions on these matters.

Dated: December 3, 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 TYPE AND POINT OF REGULATION ISSUES IN ELECTRICITY SECTOR

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 3rd day of December, 2007, at Sacramento, California.

Lois Navarrot

Lois Navarrot

Service List R. 06-04-009, updated November 30, 2007

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