COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY ON CALIFORNIA AIR RESOURCES BOARD COST CONTAINMENT WHITE PAPER

MICHAEL D. MONTOYA
LAURA I. GENAO
CATHY A. KARLSTAD

Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
Post Office Box 800
Rosemead, California 91770
Telephone: (626) 302-1096
Facsimile: (626) 302-1935
E-mail: Cathy.Karlstad@sce.com

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I.

INTRODUCTION

Southern California Edison Company (SCE) appreciates the opportunity to provide comments on the recent California Air Resources Board (CARB) staff white paper evaluating various cost containment options within a greenhouse gas (GHG) emissions cap-and-trade program. Cost containment is a critical element of CARB's effort to develop an Assembly Bill (AB) 32 scoping plan. The Legislature expressly stated that: "It is the intent of the Legislature that the State Air Resources Board design emissions reduction measures to meet the statewide emissions limits for greenhouse gases established pursuant to [AB 32] in a manner that minimizes costs and maximizes benefits for California's economy. . . ."[1] Moreover, AB 32 requires CARB to adopt a scoping plan and rules and regulations to achieve "the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions from sources or categories of sources of greenhouse gases by 2020";[2] and defines "cost-effective" or "cost-effectiveness" to mean "the cost per unit of reduced emissions of greenhouse gases adjusted for its global warming potential."[3] Cost-effectiveness and cost minimization are also mentioned in several other parts of the legislation.[4] Additionally, the long-term success of any emission reduction program relies on the public acceptance of such efforts. Implementing such program at the lowest possible cost is a critical part of this acceptance.

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1 Cal. Health & Safety Code § 38501(h) (emphasis added).

2 *Id.* § 38561(a) (emphasis added); *See also id.* §§ 38560, 38561(b), 38562(a).

3 *Id.* § 38505(d).

4 *See id.* §§ 38562(b)(1) (stating that CARB shall design the regulations, including distribution of allowances where appropriate, in a manner that "seeks to minimize costs"); 38562(b)(5) (requiring that CARB "[c]onsider [the] cost-effectiveness of these regulations"); 38562(c) (providing that CARB may establish a system of market-based declining annual aggregate emission limits that CARB determines "will achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions"); 38564 (requiring CARB to consult with other states, the federal government, and other nations "to facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs").

II.

CARB SHOULD CONTINUE TO EVALUATE ALL POSSIBLE COST CONTAINMENT MECHANISMS

The staff white paper presents a variety of cost containment mechanisms that could work within a cap-and-trade system to protect electricity ratepayers and the economy from unforeseen interactions between the electricity and allowance markets. SCE encourages CARB to continue to consider all cost containment mechanisms. Regulated entities will be best equipped to select the most appropriate of the mechanisms to minimize compliance costs for their customers and the economy as a whole. The available set of cost containment mechanisms should include the following:

- Offsets: As explained in more detail in Section III below, a robust offsets program without geographic restrictions is an important cost containment mechanism that should be included as part of CARB's approach to reducing GHG emissions.
- Safety Valve: The emission allowance market and the electricity market can interact in unforeseen ways. CARB should retain the option of offering additional allowances at a predetermined price in the event that the market demonstrates economically burdensome price swings. These allowances would be offered in addition to any borrowing allowed under the cost containment rules.
- Allowance Banking and Borrowing: Regulated entities should be allowed to manage their compliance across compliance periods in such a way so as to minimize the economic impact of compliance over the long-term while allowing California to achieve its emission reduction goals. Technology and offset projects often require multiple years to come on-line. The ability to borrow or bank forward will give regulated entities the flexibility needed to meet long-term emissions reduction goals at the lowest possible cost.
- Multi-Year Compliance Periods: The electricity sector is characterized by dynamic changes in weather patterns, leading to both changes in electricity demand and

available generation. Multi-year compliance periods will help smooth these patterns so as to reduce the volatility of the compliance burden.

- Rolling and Flexible Compliance Periods: Because of the binding nature of the AB 32 GHG emissions cap, the regulated sectors as a whole will be short allowances. A single compliance period that ends on one date for all regulated entities will create wild peaks in allowance prices. In contrast, a rolling compliance period, in which compliance end dates are staggered, will mitigate this tendency for prices to spike at the end of the compliance period. However, due to the regulated nature of the electricity industry, that sector's compliance obligation will be known by entities that may be able to manipulate the market for allowances. SCE therefore suggests that CARB consider how a flexible compliance period, in which individual regulated entities have the option of choosing to end their current compliance period early, might mitigate the tendency for manipulation in the emissions market.
- Linkage: SCE supports the most geographically and economically broad regulatory umbrella as possible. Global warming is a global challenge and although California is a large economy, the needed reductions cannot be achieved in California alone. Linking to other regional, national, or international programs is not only a cost containment mechanism, but it is also a means to improve the overall environmental worth and integrity of the joint regulatory program.

III.

OFFSETS MUST BE PART OF THE AB 32 COMPLIANCE POLICY

SCE strongly recommends that CARB incorporate a robust offsets program as part of California's approach to reducing GHG emissions. Offsets present an important cost containment mechanism because offsets give regulated entities the incentive to look for the lowest cost emission reduction opportunities, both inside and outside California. Additionally, it is critical that CARB bear in mind that the purpose of achieving GHG reductions is to obtain a beneficial reduction in the risk of global warming. Without substantial reductions in GHG emissions worldwide – especially in the developing countries that are currently resisting committing to reductions – California's efforts are unlikely to significantly affect the worldwide risk of global warming. Inclusion of a strong offsets program without geographic restrictions gives CARB the opportunity to:

- Achieve significant cost savings for regulated entities and the California economy;
- In conjunction with the cost savings from offsets, reduce the potential for emission and economic leakage when enterprises move from within California to areas lacking GHG caps;
- Encourage early reductions in GHG, which are ton-for-ton more valuable than later reductions from a global warming perspective; and
- Encourage innovative GHG reduction technology and practice and transfer these to areas of the globe that have not yet embraced such technology and practice. As other parts of the world receive the benefits of energy efficiency technology, among other things, they will be able to devote effort to adopting more effective low or zero technology without locking in high-emitting transition technologies.

IV.

COST CONTAINMENT MECHANISMS SHOULD NOT BE SUBJECT TO A PRICE TRIGGER

Cost containment mechanisms, such as offsets, should not be subject to an emissions price trigger. A price trigger will unnecessarily complicate the market for allowances and emission abatement opportunities, and will increase the cost of compliance as compared to a structure without price triggers. Consider, for example, an offset project that could provide real, permanent, quantifiable, verifiable, and enforceable emissions reductions at $10 per ton. If California imposed an allowance price restriction or price trigger of $25 per ton before offsets could be used, then the emissions reductions from the offset project would not become eligible for AB 32 compliance until the allowance market price reached $25. This would create a complicated scenario in which it may be in the best interest of some regulated entities to drive the market price of allowances up to the trigger price in order to make the $10 offset project eligible for AB 32 compliance. In addition to the potential market manipulation that a price trigger may incent, a price trigger could also cause cost-effective emissions reduction opportunities to be ignored simply because of an arbitrary price trigger. The purpose of cost containment is to allow for the least cost, and most efficient emissions reduction and compliance opportunities to be utilized. A price trigger defeats the purpose of cost containment.

V.

REGULATED ENTITIES SHOULD NOT PAY ANY FEE TO UTILIZE A COST CONTAINMENT MECHANISM

Cost containment mechanisms should be available for use by regulated entities as a means to mitigate the compliance costs for their ratepayers and the California economy. Implementing suggestions that penalize the use of cost containment mechanisms such as an interest rate on borrowing allowances or other monetary penalties for utilizing cost containment mechanisms directly contradicts the goal of such mechanisms. SCE encourages CARB to evaluate mechanisms that will promote the lowest cost of achieving the State's emission reduction goals.

VI.

SCE ENCOURAGES CARB TO FURTHER EVALUATE THE ROLE OF A MARKET OVERSIGHT GROUP

SCE sees potential value in a market oversight group, modeled after the Federal Reserve Bank. However, too little is known about the interaction or structure of such a group at this time to adequately consider its regulatory value. SCE looks forward to continued discussion on this topic.

Respectfully submitted,

MICHAEL D. MONTOYA
LAURA I. GENAO
CATHY A. KARLSTAD

/s/ Cathy A. Karlstad
By: Cathy A. Karlstad

Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
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Rosemead, California 91770
Telephone: (626) 302-1096
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