



*Pacific Gas and
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September 23, 2009

Dr. Lawrence Goulder, Chairman
AB 32 Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95815

Dear Dr. Goulder:

Pacific Gas and Electric Company ("PG&E") welcomes the opportunity to provide comments in response to the information presented at the August 13, 2009 meeting of the Economic and Allocation Advisory Committee (EAAC). As noted at the meeting, EAAC's tasks include work on the planned cap-and-trade market, and, more broadly, assisting the ARB on its revised economic analysis.

Much commentary on the economic analysis has focused on whether AB32 will impose a net cost or yield a net benefit to California. Answering that question involves macroeconomic modeling, including assumptions about factors such as the extent to which each CO₂-reducing measure will create jobs for Californians. Empirical data on job creation and similar factors may be elusive, and the answer to this question may remain controversial.

PG&E has a more directed focus. Our goals for climate-change policy are sustained, long-term emission reductions at manageable costs to our customers. Consequently, PG&E's concerns focus on the cost and GHG reduction potential of each individual program, the design of California's planned cap-and-trade market and the resulting price of GHG emission allowances, and the distribution of revenue from the sale or auction of those allowances.

Cost-Effectiveness Analysis

PG&E strongly urges EAAC to recommend that ARB thoroughly evaluate the cost-effectiveness and technological feasibility of each proposed emission reduction measure, and explicitly demonstrate that the measures minimize costs and maximize benefits to the California economy as required by AB32. More thorough analysis across sectors and measures will enable ARB to assess overall compliance costs, potential allowance prices, and the need for cost-containment mechanisms, and will ensure that we pursue the right mix of programs and market-based mechanisms to achieve AB 32's goals in a cost-effective manner.

GHG Allowance Price and Market Design

The revised economic analysis may yield improved forecasts of allowance prices, but we remain concerned with the quality of the inputs relied upon. Input data are affected by unavoidable uncertainties over the emission reductions that will actually result from the GHG-reducing measures in ARB's Scoping Plan. The accumulation of those uncertainties will ultimately affect the severity of the cap and the resulting allowance price.

We are also concerned about the static nature of the current economic analysis. A more dynamic analysis would consider factors that change over time. The cap-and-trade market, as currently planned, may lack the flexibility necessary to ameliorate such factors. For example, how much will the allowance price increase if 2012 and 2013 have average hydroelectric generation, but 2014 is very dry? Would the allowance market function effectively in such a situation? These are important questions for our customers. Means exist to address these risks, such as expanded use of offsets, or a strategic allowance reserve that preserves environmental integrity. We hope that EAAC will address such questions and make appropriate recommendations to the ARB.

Distribution of Revenue from Sale or Auction of Allowances

In evaluating the use of cap-and-trade allowances under AB 32 the EAAC should be guided by environmental integrity and customer cost criteria. First, the objective of any proposal for the use of allowances should be to accelerate emission reductions and help transition California's economy to low-carbon technologies. Second, because the ultimate costs of meeting sustained greenhouse gas ("GHG") reduction goals in the electric sector will flow through commodity markets to utility customers, allowances or revenue from allowance auctions should be used to mitigate those increased customer costs.

PG&E recommends that allowance revenue be allocated to local utilities for the direct or indirect benefit of their customers. Local utilities are uniquely positioned to use allowance value to mitigate cost for customers because 1) they have an established service relationship with customers; 2) they are subject to state utility commission or governing board oversight; and 3) many have existing energy efficiency and low-income programs on which to build. The CPUC/CEC Final Decision recommended a similar approach. For the portion of allowances that would be auctioned, the CPUC/CEC recommended the following:

We believe that it may be appropriate for ARB to retain a small portion of allowances for the electricity sector, to be owned by the State, in order to use the related auction revenues for state-wide electricity-related purposes consistent with AB 32. With that possible exception, ARB should distribute all electricity sector allowances to be auctioned directly to retail providers, in a manner that we discuss in Section 5.4.2. The retail providers would then be required to sell the distributed allowances through a centralized auction, as we describe in Section 5.3. We recommend that all auction revenues from allowances allocated to the electricity

sector, whether owned by the retail providers or resulting from the sale of allowances that ARB has retained, be used to finance investments in energy efficiency and renewable energy or for bill relief, especially for low-income customers. Subject to this directive, the loading order and other statutory and ARB guidance, the Public Utilities Commission for load serving entities and the governing boards for publicly owned utilities should determine the appropriate use of retail providers' auction revenues. (CPUC D. 08-10-037, p. 228).

PG&E supports the use of auctions to distribute emission allowances either following direct allowance allocation to the utilities as recommended by the CPUC/CEC or through an initial auction conducted under the auspices of the ARB. Auctioning would ensure that utility-owned and privately-owned generators would have equal access to allowances. Under the CPUC/CEC approach, auction proceeds would be used for customer benefit. Alternatively, a fixed percentage of the proceeds from an ARB-run auction could be dedicated for benefit of PG&E's customers.

PG&E recommends that the customer impact be mitigated in a way that returns revenue to customers but does not impair the price signal from the cap-and-trade market. One possibility is a periodic rebate to each customer, proportional to the average electricity or natural gas use across that class of customers rather than individual customer usage.

Allocation Method

Allocation of allowance revenue among utilities raises equity issues. If no credit is given for early action, is that fair to customers who invested in a low-GHG portfolio before it became required by law?

The most equitable methodology by which to allocate emission allowances in the electric sector, and the one we believe will best expedite the transition to a low carbon economy, is based on an updating output metric such as retail electricity sales adjusted for verified customer energy efficiency savings. This approach recognizes the investments made by utility customers who have already paid for increased supplies of low-carbon energy and for energy efficiency and demand response programs.

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PG&E appreciates the opportunity to provide these comments to the EAAC. Please contact us if you have questions about these comments or if we may be of further assistance.

Very truly yours,

/s/

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