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December 7, 2009

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

Chairman Goulder and EAAC Committee Members:

The Sacramento Municipal Utility District appreciates the opportunity to provide our views to the Economic and Allocation Advisory Committee EAAC regarding effective allowance allocation policy. SMUD recognizes that the EAAC was specifically instructed to examine, and has indicated in public discussions an affinity for, a cap and dividend type approach. However, SMUD feels that direct allocation of electric sector allowances to Local Distribution Companies provides a much better match to the evaluation criteria the EAAC presented in their draft recommendations of Fairness, Cost Effectiveness, Environmental Effectiveness, and Simplicity. The following comments examine why each of these criteria are more likely to be met with a direct allocation to LDC's.

Fairness

Direct allocation to LDC's will ensure that fairness is maximized, as value associated with electricity emissions will be spent in the electricity sector, on programs and infrastructure that benefit electricity customers and reduce emissions. It is fundamentally fair to have allocation value in the electricity sector used to benefit electricity customers, who will bear the increased costs of reducing climate impacts from the sector. LDC's already have a mandate to mitigate rates for low-income customers, and will be guided by their governing Boards or the PUC to specifically mitigate impacts on low-income communities. In addition, this value creates an opportunity for enhancing existing offerings and developing new opportunities to reduce emissions in these communities. LDC's already have an established consumer relationship and would enable faster more effective reduction programs than could be achieved in these communities through a new state-run program. LDC's and their regulators also regularly balance rates between customer categories and with the help of billing information can ensure that allowance value is distributed fairly between customer classes without loading excessive new costs on any one customer segment. This combination of information, existing relationships and existing process to ensure fairness and assist disadvantaged communities will ensure that fairness is maximized through direct allocation to LDC's.

Cost Effectiveness

Local Distribution Companies are positioned at a critical decision-making point in California's electricity sector. Supply-side resource, demand-side program, and key electricity infrastructure decisions are made at the LDC. The LDCs can most effectively translate the carbon price signal by making resource decisions to reduce emissions and mitigate costs, and through rate designs that best translate the carbon price signal to customers. More importantly, LDCs can induce a non-price customer response by building upon long-established programs for encouraging energy efficiency and assisting low-income customers. These programs have been developed and promoted to address recognized market barriers that stand in the way of rational customer response to energy costs, including external environmental costs. Energy efficiency is one of the most cost effective ways to reduce emissions. Ensuring that revenue generated from cap and trade can be directly spent on enhancing energy efficiency options for customers will have far more impact on near-term emissions reductions than trying to induce conservation through a marginally increased electricity rate. Finally, direct allocation to LDC's ensures that all of the value will be spent in the best interests of customers, as LDC's are directly regulated by the PUC or local governing boards, which have as their primary function ensuring the effective use of ratepayer funds. In this manner, none of the value will be able to be siphoned off for private profit, or for programs unrelated to reducing emissions and mitigating the costs of implementing the cap and trade program.

Environmental Effectiveness

Direct use of allowance value to enhance complementary programs that benefit electricity customers and reduce emissions is the most environmentally effective option. Getting a price signal to customers to reduce energy use is only one aspect of an environmentally effective cap and trade program. Given the fact that electricity consumers have low price elasticity, it is unlikely that relying on price signal at the consumer level alone can ensure environmental effectiveness. The more important aspect is using the value generated from cap and trade directly on measures that reduce emissions. SMUD calculates that the average value of a cap and dividend to its customers for a carbon price of \$20/tonne will be approximately \$7 per month on consumers' bills. This represents a value of approximately \$50 Million per year that could be used to make significant investments in reducing carbon emissions associated with providing electricity to these customers. But distributing it in \$7 rebate credits will do little to meet the criteria of environmental effectiveness. By instead directing the money towards emission reductions, the state can ensure that these reduction measures are not delayed while waiting for the right price signal. It will also ensure that market prices provide a stable signal upon which to make major infrastructure decisions, rather than being volatile and increasing risk associated with these decisions, further delaying them, and threatening California's ability to meet its AB32 goals. Finally, enabling the LDC use of allowance value for complementary emission reduction programs associated with transportation electrification appears likely to have a high degree of co-benefits through reduction in transportation-related criteria emissions.

Simplicity

California's LDC's already have established mechanisms for billing customers, reducing emissions through energy efficiency and renewable energy, setting electricity rates, mitigating costs on low income customers, ensuring fairness between customer classes, and planning for long-term infrastructure decisions. These aspects are fundamental to maintaining simplicity because value can be deployed in a way that builds upon this existing foundation rather than creating complicated new parallel structures to accomplish these same goals. Further, given pending federal legislation and proposed legislation which rely heavily on free allocation in the electricity sector, creating a compatible California program will minimize the complication that will necessarily occur with a transition from a state to a federal cap and trade program.

Summary

The nexus for allocating the use of allowance value among complementary programs and effective price signals is the LDC, overseen by their respective rate making authorities, with existing processes for ensuring cost effectiveness of investments, fairness, and environmental effectiveness. Using this existing nexus rather than creating new parallel structures ensures simplicity and promotes effectiveness. Allocation of allowances to the electric distribution companies for the benefit of their customers maximizes the value of the allowances, as it concentrates revenues for the efficient use of resources to achieve the objectives of AB 32. In addition, such allocation reduces uncertainty in AB 32 implementation, as it most clearly relates the value associated with allowances with programs and policies related to AB 32 goals. As such it is less likely to suffer legal challenge, and most likely to achieve the reductions we are all striving for in the implementation of AB 32.

Thank you for the opportunity to provide these comments.

Respectfully submitted,

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Government Affairs Representative
Sacramento Municipal Utility District