Dr. Frank A. Wolak
Chair, Market Surveillance Committee
California Independent System Operator

Re: SCE Comments on the California Market Surveillance Committee Draft Opinion on Load-Based and Source-Based Trading of Carbon Dioxide in California

Dear Dr. Wolak,

Southern California Edison (SCE) appreciates the opportunity to submit these comments regarding the Market Surveillance Committee's (MSC) Draft Opinion on Load-Based and Source-Based Trading of Carbon Dioxide in California (Draft Opinion).

In Assembly Bill (AB) 32, California established an aggressive goal of reducing statewide greenhouse gas (GHG) emissions. SCE is committed to working with the MSC, California Air Resources Board (CARB), California Public Utilities Commission (CPUC), other state agencies and stakeholders to achieve that goal. SCE recognizes the effort and insightful analysis of the members of the MSC to provide the Draft Opinion.

Grid Reliability Must Be Paramount

The MSC Draft Opinion presents a balanced, expert opinion on the merits and demerits of various mechanisms to facilitate emission reductions and compliance with AB 32. SCE agrees with the Draft Opinion's recommendation that a load-based structure does not provide the best approach for California to reduce its emissions. Among the metrics by which various regulatory structures must be evaluated is the manner in which each structure coordinates with the functioning of electricity markets in California. California can ill afford to adopt regulations that place undue risk on the reliability of the grid. SCE has expressed concerns that a load-based cap will not coordinate well with the California electricity markets.[1] By contrast, a source-based approach, such as First Seller can more easily be constructively coordinated with the operations of electricity markets in California without presenting generators with incentives that conflict with the efficient operation of the California electricity grid.

A First Seller Approach Recognizes the Value of Energy Efficiency and Renewable Energy

As stated in the Draft Opinion, the state of California has taken strong leadership in promoting Energy Efficiency (EE) and Renewable Energy (RE) through traditional regulatory approaches. Specifically, the California Public Utilities Commission and the California Energy Commission have placed EE at the top of the stacking order in California. As the Draft Opinion correctly recognizes, load serving entity (LSE) incentives to pursue greater customer energy efficiency in order to reduce emissions associated are not fundamentally different under a First Seller approach as compared to a load-based cap-and-trade approach.[2] Indeed, as energy prices rise to incorporate the cost of emissions, additional EE projects will become cost effective under the Resource Cost Test. Thus, a First Seller approach is completely consistent and compatible with increasing the level of EE investment in California.

[1] In its May 17, 2007 letter to the California Market Advisory Committee (CMAC), SCE expressed concern that a load-based approach may not best coordinate with the smooth functioning of electricity markets.
[2] The California Market Advisory Committee Report also noted that LSE incentives to pursue EE and RE are no different under a First Seller approach as compared to a LBC.

A Load-Based Cap Presents an Unnecessary Administrative Burden with No Real Benefits

Concern over potential emission leakage was a key driver in the initial consideration of a load-based cap-and-trade structure. SCE agrees with the Draft Opinion's conclusion that the potential for leakage is no different under a First Seller approach than it is under a load-based cap-and-trade structure. Indeed, as the Draft Opinion states, the potential for leakage under a load-based cap is at best no more costly than under a source-based cap, and is likely more expensive.

Additionally, because a load-based cap does not regulate in-state emissions at the source, costly and imprecise measurement and reporting rules must be adopted. Since a load-based cap does not provide any real improvements in reducing emission leakage, but does impose a much more costly administrative burden, SCE agrees with the Draft Opinion's conclusion that a load-based cap is clearly inferior to other source based options.

SCE agrees with the Draft Opinion's statement that a source based approach (including a First Seller) will more easily coordinate with a regional or national source-based program.

Allowance Allocation

SCE recommends that emission allowances be allocated in a way that mitigates economic displacement and harm to carbon-regulated companies and their employees. Such an allocation process is important to recognize the substantial investments currently in place in California. The Draft Opinion correctly notes that LSEs cannot capture economic rents from freely allocated allowances. The cap-and-trade system will establish a value to emission reductions and as such will motivate entities to reduce emissions. The allocation method itself will not affect the emission reduction decisions of carbon-regulated entities. However, the ability of a carbon-regulated entity to pass along its GHG mitigation costs to customers will vary across industries. As a result, it is important to allocate allowances in a manner which will mitigate economic harm to all carbon-regulated entities and recognize the substantial economic benefit of existing and future investments in California.

Thank you again for the opportunity to submit these comments. SCE looks forward to working with the ISO, CPUC, CEC, CARB, other state agencies and stakeholders to achieve the emission reduction goals established in AB 32.

Best Regards,

Frank Harris
Environmental Economist
Southern California Edison