February 11, 2005 **BY HAND DELIVERY**

Docket Clerk
California Public Utilities Commission
505 Van Ness Avenue, Room 2001
San Francisco, CA 94102

Re: Procurement Incentive Mechanism Pre-Workshop Comments

Dear Docket Clerk:

Enclosed for filing in the above-captioned matter are an original and five (5) copies of **PRE-WORKSHOP OPENING COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON PROCUREMENT INCENTIVE FRAMEWORKS** filed pursuant to Administrative Law Judge's Ruling Scheduling Workshops on Procurement Incentive Framework, dated November 23, 2004.

Please file the original document, date-stamp a copy, and return the endorsed copy in the stamped self-addressed envelope provided for this purpose.

Very truly yours,

/s/
Jennifer K. Post

JKP/dl

Enclosures

cc: President Michael R. Peevey
ALJ Meg Gottstein
Service List for R.04-04-003 and R.04-01-025

BEFORE THE
PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

PRE-WORKSHOP COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON PROCUREMENT INCENTIVE FRAMEWORK

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Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

PRE-WORKSHOP COMMENTS OF
PACIFIC GAS AND ELECTRIC COMPANY (U 39 E)
ON PROCUREMENT INCENTIVE FRAMEWORK

Pacific Gas and Electric Company (PG&E) hereby submits these Pre-Workshop Comments on a Procurement Incentive Framework pursuant to the *Administrative Law Judge's Ruling Scheduling Workshops on Procurement Incentive Framework*, dated November 23, 2004.

I. INTRODUCTION AND SUMMARY

In the ruling scheduling workshops and requesting these comments, Administrative Law Judge Meg Gottstein requested that parties inform the Commission regarding the type of procurement incentive frameworks it should consider in this proceeding, the advantages and disadvantages of the "Sky Trust" carbon cap-and-trade framework (the "Sky Trust proposal"), the advantages and disadvantages of any alternative procurement incentive frameworks, and the key implementation issues associated with each (Ruling at 5-6).[1] The Commission's ruling correctly recognized that any procurement incentive framework must be developed and implemented in the context of and be consistent with the resource goals contained in the Energy Action Plan (EAP) and the Commission's procurement decisions. (Id.)

At the same time it is considering procurement incentive frameworks, the Commission is focused on taking additional action in support of its commitment to reducing the greenhouse gas (GHG) emissions of the entities it regulates. Toward that end, the Commission scheduled a Climate Change Policy *en banc* on February 23, 2005, and issued a policy paper affirming its

[1] On February 4, 2005, the Commission issued an Addendum to the Sky Trust proposal, proposing alternatives to the Sky Trust Proposal ("Addendum").

commitment to reducing GHG emissions and announcing plans to require the entities it regulates to reduce those emissions. Thus, two important policy goals provide the backdrop for the Commission's consideration of procurement incentive frameworks. Specifically, the Commission noted its goal to

> [P]lay a key role in helping to reduce both the footprint and the impact of GHG emissions on California's economy and public health and to contribute positively to the long-term growth of businesses operating in this state.

In addition to this goal, the Commission must support the goal of the EAP to:

> Ensure that adequate, reliable and reasonably-priced electrical power and natural gas supplies, including prudent reserves, are achieved and provided through policies, strategies, and actions that are cost-effective and environmentally sound for California's consumers and taxpayers.

PG&E shares the Commission's commitment to meeting both of these important policy goals. However, PG&E believes the Commission should address climate change issues and policy in a separate proceeding or forum from procurement incentive mechanisms. Consideration of climate change requires a cooperative arrangement among state agencies, similar to the effort that resulted in the EAP. Any program adopted to address climate change should include a broad set of participants: the electric generation sector, including municipal utilities,[2] transportation, and other business sectors. Therefore, PG&E urges the Commission to increase its coordination with the California Energy Commission, the California Environmental Protection Agency (EPA), and the West Coast Governors' Global Warming Initiative, all of whom are performing carbon dioxide modeling studies and developing programs to achieve GHG emission reductions in the Western United States. It is through these concerted efforts, which could be applied across the Western region and across industries, that the most cost-effective plan can be developed.

Moreover, the Sky Trust proposal and alternatives are not "procurement" incentive mechanisms. PG&E proposes that the Commission focus its attention in this proceeding on

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[2] The Los Angeles Department of Water and Power produces more than three times as much carbon per kWh as PG&E ("Estimating Carbon Dioxide Emissions Factors for the California Electric Power Sector," Lawrence Berkeley National Laboratory, August 2002)

simpler, more direct procurement incentive mechanisms. California's aggressive legislative and regulatory requirements setting a renewables portfolio standard (RPS) and energy efficiency goals have already contributed to significant reductions in GHG emissions. In the near term, the Commission can take advantage of these simpler, more direct ways to encourage environmentally sound energy portfolios and environment-friendly energy technologies. A procurement incentive framework should be designed around these goals. PG&E presents the essential elements of this type of incentive mechanism below and will be prepared to discuss them in more detail at the March workshops.

II. PG&E SHARES THE COMMISSION'S COMMITMENT TO GHG REDUCTION AND HAS ALREADY TAKEN SIGNIFICANT STEPS TO ADDRESS THIS ISSUE

In its recent climate change policy paper, the Commission identified several "Recommended Next Steps" to reduce the impact of GHG emissions on California's economy and public health. PG&E commends the Commission for taking a leadership role on climate change policy and looks forward to continuing to work with the Commission, and other state and federal agencies, to identify cost-effective responses to climate change.

As PG&E will discuss in more detail at the Climate Change Policy *en banc* on February 23, PG&E has taken a proactive approach with regard to GHG emissions for close to a decade. Since the 1990s, PG&E has taken action to better understand and to reduce its GHG emissions. Most recently, for example, PG&E's 2002 and 2003 entity-wide carbon dioxide emissions inventory was certified according to the stringent protocols of the Climate Change Action Registry, of which PG&E is a Charter Member.[3] The inventory is publicly available on PG&E's website. Beyond those efforts and other potential regional and California initiatives, PG&E

[3] The Registry's General Reporting Protocol is based on the principles contained in the World Resources Institute/World Business Council for Sustainable Development's (WRI/WBCSD) "Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard," (GHG Protocol) a multi-stakeholder effort to develop a standardized approach to the voluntary reporting of GHG emissions. The GHG Protocol is the preeminent international standard for GHG accounting systems, used by both public and private sector interests worldwide. By building on this framework, the Registry's reporting protocols embody best international practices in GHG accounting. To provide further coordination and ensure parallel development and consistency between these programs, both the WRI and the WBCSD provide direct input to the Registry on protocol development.

supports taking a national approach to reducing GHG emissions. Specifically, PG&E's parent company, PG&E Corporation, is a member of the Clean Energy Group, a coalition of energy companies advocating federal legislation to reduce CO_2 and other air emissions from the electric generating sector.

In addition to those actions, PG&E supported including a carbon-adder as a bid evaluation component in this proceeding. The Commission adopted a carbon-adder in Decision 04-12-048.

III. THE COMMISSION SHOULD ADOPT INCENTIVES FOCUSED ON ACHIEVING THE RPS AND ENERGY EFFICIENCY GOALS IN THE UTILTIES' LONG TERM PLANS

The Commission's climate change policy paper cited plans to accelerate and expand the RPS and renewable energy procurement, and to expand and broaden its existing energy efficiency and demand response programs. PG&E believes that application of performance metrics or targets and incentives around these existing programs will be simpler, and more effective in reducing GHG emissions than creating a market for carbon emissions limited to the IOUs in California. Another benefit of these types of incentive mechanisms is that they reflect both risks and rewards. In addition to disincentives for noncompliance or nonattainment, a well-designed incentive system will share benefits between customers and participating companies, encouraging a positive alignment of interests.

Most importantly, the success of any incentive mechanism will be based on the Commission's consistent implementation of the incentive on an ongoing basis. In other words – for an incentive to work, the reward must be given when a goal is achieved. Prior to adopting new energy efficiency incentives, the Commission should address the pending customer energy efficiency (CEE) incentive payments to the utilities.[4] This would provide a clear signal that the Commission supports incentives as a meaningful tool to encourage superior performance.

[4] *See, e.g.*, PG&E's requests for shareholder incentive payments in Application Nos. 00-05-004, 01-05-002, and 03-05-002, for the years 2000, 2001, and 2002, respectively.

PG&E will present energy efficiency and RPS incentive proposals at the March workshops. Generally, PG&E supports

- Flexible shared savings mechanisms for demand-side options – CEE, demand response and distributed generation— to incent the utility to achieve savings in all of the programs.
- Reasonable goals for demand-side options with meaningful rewards for implementing state policy.
- Balancing existing RPS penalties with incentives for reaching RPS targets or for early achievement of RPS targets and ensuring that existing RPS penalties are not imposed if the IOU is unable to reach the targets due to market concerns or other issues outside of the IOUs' control.
- Incentives rewarding progress toward any increased RPS target.
- Incentives encouraging development of emerging renewable technologies.

IV. PRINCIPLES FOR REGULATING GREENHOUSE GAS EMISSIONS

PG&E respectfully offers the following principles for the Commission's consideration as we work together to find sustainable, practical responses to climate change.

- Market-based regulatory regimes, such as cap-and- trade programs, are the most cost-effective solutions. PG&E believes cap-and-trade programs can achieve cost effective GHG emission reductions provided there is sufficient diversity of participants and demand to create a viable market.[5] Ideally, PG&E supports taking a national approach to formulating and implementing GHG emission reduction policies and programs, including cap-and-trade programs. In the absence of a national approach, PG&E supports regional programs that incorporate diverse industries and the broadest geographic area.

5 As discussed in more detail later in these comments, the most significant disadvantage of the Sky Trust proposal is that it would be limited to the California IOUs.

- The Commission, and its sister California agencies, should coordinate their actions in the climate change arena in order to maximize sound decision-making. CalEPA, the California Energy Commission, and the California Air Resources Board ("CARB") are all taking significant steps in the climate change arena. For example, CARB recognized and addressed the significant GHG emissions of the transportation sector by promulgating rules regulating GHG emissions from passenger vehicle tailpipes, making California the first state in the country to do so. PG&E respectfully suggests that the Commission demonstrate its leadership by harmonizing the multiple state-level efforts to create the equivalent of an EAP for climate change. Without greater coordination, all participants will face greater challenges in finding solutions to this complex issue. One way the Commission could demonstrate its leadership by increasing the coordination among state agencies is to invite representatives from one or more of these agencies to attend the March workshops.
- Any regulatory regime must:
    - take into account costs to customers;
    - be based on sound economic modeling;
    - have a rigorous GHG measurement and accounting system. PG&E believes that it is critical that credible measurement protocols be in place as a first step toward the creation of effective, workable policies and programs regarding climate change and GHG emissions reductions;
    - not penalize participants for taking early action, either when setting target emissions reduction requirements or through the auction or allocation of GHG emissions allowances;
    - give credit for non-procurement actions, including fleet and facilities improvements, diesel engine conversions, and reductions in GHG carbon equivalents; and

- prevent “leakage” or export of GHG emissions.

These are the principles that guide our analysis of climate change regulatory proposals such as Sky Trust. PG&E respectfully suggests that these principles should provide a framework for the Commission’s analysis as well. .

V. SKY TRUST PROPOSAL AND ALTERNATIVES

A. Summary of the Commission’s Sky Trust-Based Carbon Cap-and-Trade Program

The Commission described how a Sky Trust-based carbon cap-and-trade proposal might be developed and implemented for the California IOUs in Appendix B to R.04-04-003. The following summarizes that description:

The Commission would establish short-and long-term procurement goals for energy efficiency and renewable resources in its rulemaking proceedings, in coordination with other State agencies. These goals would be expressed as an annual limit on carbon-based energy procurement. The utilities would be required to hold (tradable) allowances to procure carbon-based energy up to the Commission-established limit. The Commission would issue the allowances at a price established through an auction on an annual basis. Allowance costs would be added to the other costs of carbon-based energy and would become an integral component of the avoided cost used in cost-effectiveness and least-cost-best-fit evaluations when considering energy efficiency and renewable energy proposals or projects. Customers would pay for allowance costs through rates, but the allowance revenues would be set aside and accounted for as an offset to the amounts for energy efficiency programs currently collected from customers through procurement rates and the public goods surcharge. The IOUs’ overall performance in energy procurement would be evaluated based on achieving the targets for specific types of preferred resources (i.e., energy efficiency and renewable resources) as well as performance targets established for long-term portfolio costs – including the cost of allowances.

B. PG&E's Concerns with the Sky Trust Proposal

PG&E supports carbon cap-and-trade programs built upon broad participation and demand from diverse participants. These are essential elements of a robust market. These elements are missing from the Sky Trust proposal, and most of the alternatives to the Sky Trust proposal presented in the Addendum. If implemented, PG&E is concerned that these proposals could unintentionally create market distortions without significantly reducing GHG emissions. PG&E's most significant concern with the Sky Trust proposal, and with the alternatives presented in the Addendum, is that they would be limited to the California IOUs. A one-state, one-industry cap-and-trade program with only three electric participants and three gas participants, all of whom could have similar needs at the same time in any given year (e.g., depending on whether it is a "wet" or "dry" year), lacks diversity and will not yield a sufficiently robust market to result in any significant GHG emissions reductions.

Additionally, PG&E is concerned with the auction component of the Sky Trust because an auction would be unstructured and the results of an auction cannot be forecast. As a result, there is no way of assuring a fair allocation of GHG credits, recognizing an IOU's existing position and without penalizing early achievers. Among California utilities, there is a range of CO_2 emission rates: the statewide average is 849 pounds of CO_2 per megawatt hour delivered,[6] including municipal utilities, while the corresponding rate for PG&E is 509.[7] Therefore, any allocation method must be structured such that entities (like PG&E) are not penalized for having already significantly reduced GHG emissions. Additionally, the auction proposal unnecessarily complicates energy efficiency program funding as a means to accommodate the revenue generated from an auction. A direct allocation of allowances, on the other hand, would provide more certainty, lower overhead costs and eliminate the need to complicate energy efficiency funding.

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[6] "Pounds per megawatt hour delivered" consists of power purchases and owned generation.

[7] Lawrence Berkeley Lab, "Estimating Carbon Dioxide Emission Factors for the California Electric Power Sector," Marnay, Chris; Fisher, Diane; Murtishaw, Scott; Phadke, Amol; Price, Lynn; Sathaye, Jayant. August 1, 2002. http://www.osti.gov/dublincore/ecd/servlets/purl/806108-7FLzOP/native/806108.pdf. These emission factors appear to be the best estimates publicly available.

PG&E appreciates the Commission's willingness to consider alternative proposals. We have not yet had a chance to thoroughly review and assess the alternatives presented in the Addendum, but will review those alternatives more thoroughly and be prepared to discuss them at the March workshops. PG&E's initial impression is that these alternatives improve upon the Sky Trust proposal to varying degrees, but because they would all be limited to the California IOUs, our fundamental concern remains the same. Alternatives 4 and 5, in particular, contain promising elements, which could potentially produce cost-effective GHG emission reductions if included in a broader, state-wide or regional cap-and-trade program. We offer the following preliminary thoughts:

Alternative 4 contains an incentive for the IOUs, recognizes the need to minimize customer costs and provides for allocation of allowances to the IOUs as an alternative to an auction. Alternative 5 would allow the utilities more flexibility to pursue the least cost mix of energy options that are not constrained by set-asides or individual program goals. This is an important concept and a key flaw with most other variations on the proposal. Ideally, utilities should be allowed to make the most efficient tradeoff between alternative means of achieving the same result. Unfortunately, most programs already have their set-asides prescribed by regulation or law, seriously limiting the ability to make meaningful choices between alternatives.

VI. CONCLUSION

PG&E is looking forward to working with the Commission and other parties to develop and implement meaningful procurement incentive mechanisms at the March workshops and to participating with the Commission and other parties in the development of realistic, cost-effective ways to reduce GHG emissions.

Respectfully submitted,

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/s/

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February 11, 2005

CERTIFICATE OF SERVICE BY ELECTRONIC MAIL AND U.S. MAIL

I, the undersigned, state that I am a citizen of the United States and am employed in the City and County of San Francisco; that I am over the age of eighteen (18) years and not a party to the within cause; and that my business address is Pacific Gas and Electric Company, Law Department B30A, 77 Beale Street, San Francisco, CA 94105.

I am readily familiar with the business practice of Pacific Gas and Electric Company for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, correspondence is deposited with the United States Postal Service the same day it is submitted for mailing.

On the 11th day of February 2005, I served a true copy of:

PRE-WORKSHOP OPENING COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E) ON PROCUREMENT INCENTIVE FRAMEWORKS

[XX] By Electronic Mail – serving the enclosed via e-mail transmission to each of the parties listed on the service list for R.04-04-003 and R.04-01-025 with an e-mail address.

[XX] By U.S. Mail – by placing the enclosed for collection and mailing, in the course of ordinary business practice, with other correspondence of Pacific Gas and Electric Company, enclosed in a sealed envelope, with postage fully prepaid, addressed to those parties listed on the service list for R.04-04-003 and R.04-01-025.

I certify and declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on this 11th day of February 2005 at San Francisco, California.

/s/

DONNA LEE