

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Promote Consistency
in Methodology and Input Assumptions in
Commission Applications of Short-run and Long-run
Avoided Costs, Including Pricing for Qualifying
Facilities.

Rulemaking 04-04-025
(Filed April 22, 2004)

**PRE-WORKSHOP REPLY COMMENTS OF THE NATURAL RESOURCES DEFENSE
COUNCIL AND UNION OF CONCERNED SCIENTISTS ON THE DRAFT AVOIDED
COST REPORT**

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Introduction

The Natural Resources Defense Council (NRDC) and Union of Concerned Scientists (UCS) respectfully submit these pre-workshop reply comments on the Commission's draft report entitled "A Forecast of Cost Effectiveness Avoided Costs and Externality Adders" (Draft Report) dated January 8, 2004, in accordance with the schedule set forth in the Order Instituting Rulemaking for this proceeding. NRDC is a non-profit membership organization with a long-standing interest in minimizing the environmental, public health and economic costs of the reliable energy services that Californians demand. UCS is a non-profit membership organization with a Clean Energy Program that is devoted to cost-effectively reducing the environmental impacts of energy use.

In these comments, NRDC and UCS respond briefly to the opening comments of other parties on the Draft Report. Our comments elaborate on the following points:

- Avoided costs for energy efficiency should be approved as soon as possible.
- It is appropriate to include the financial risk associated with carbon dioxide emissions in the avoided cost.
- There are differences between the use of avoided costs for resource evaluation and comparison, and the prices paid to resource providers.

Avoided costs for energy efficiency should be approved as soon as possible.

NRDC and UCS agree with PG&E that the Commission should promptly adopt avoided costs to use in evaluating energy efficiency programs. (p. 12) As PG&E notes, one benefit of the updated avoided costs is that the time-differentiation included in the Draft Report will more accurately value the benefits that energy efficiency programs can provide. The Commission has approved a portfolio of energy efficiency programs through the end of 2005. In order for the 2006 programs to be as effective as possible, they must be approved six months prior to the start of the program year; thus, the portfolio development and program selection process must occur in early 2005, and the updated avoided costs must be available for this process. We urge the Commission to ensure that updated avoided costs are available for energy efficiency by early 2005.

Based on parties' opening comments, it is clear that numerous issues will have to be addressed if the Draft Report is used to assess the value of resources such as distributed generation or QF pricing. NRDC and UCS urge the Commission not to let approval of the avoided costs for the purposes of evaluating energy efficiency programs get delayed by consideration of these other issues.

It is appropriate to include the financial risk associated with carbon dioxide emissions in the avoided cost.

As NRDC discussed in its opening comments, NRDC agrees with the Draft Report that it is quite likely that carbon dioxide emissions will be regulated within the twenty-year timeframe addressed in the analysis, and a cost for carbon emissions must be included in the avoided cost stream. UCS concurs with this conclusion. The comments of PG&E and the California Cogeneration Council (CCC) support our position. PG&E states that it is "appropriate to include unpriced environmental externalities in comparing the relative merits of projects." (p. 8) Similarly, CCC expresses its support for the "inclusion of CO₂ emission costs in a long-run avoided cost forecast." (p. 11) In addition, PG&E's comments affirm the Draft Report's rationale for including an imputed cost of carbon emissions: "PG&E shares this belief that future regulation of CO₂ is probable and will have an impact on the plants chosen to add to the state's electric resources." (p. 8) Indeed, as PG&E and the Draft Report note, the Commission required

that the financial risk associated with carbon emissions be addressed in the avoided cost update. (D.04-01-050, p. 108)

NRDC and UCS strongly disagree with SDG&E, SoCal Gas and SCE's claims that costs for carbon emissions should not be included in the avoided costs. SDG&E and SoCal Gas' discussion of the issue is off-point; for example, SDG&E and SoCal Gas state that "since no one knows how much 'damage' such emissions may cause, an adder for such damage is arbitrary at best." (p. 5) However, the Draft Report does not seek to estimate the damage caused by carbon emissions, although such studies have been performed and would clearly result in a non-zero value since carbon dioxide emissions, as a primary contributor to global warming, impose a societal cost that is not adequately captured in the "market" price for power. SDG&E and SoCal Gas further argue that they "doubt that California can comply with the Kyoto Protocols" (p. 5), but their discussion has no relevance to the subject at hand. Similarly, SCE acknowledges that "there have been extensive worldwide efforts to encourage control of 'greenhouse gas' emissions, including a multinational treaty," but argues that the U.S. is not a participant. (Appendix, p. 5)

These comments fail to note, however, that activity throughout the U.S. suggests that carbon dioxide emissions will be regulated in the relatively near future, and within the timeframe covered in the avoided costs. For example, the Climate Stewardship Act (S.139), introduced by Senators McCain and Lieberman, received 43 votes in the Senate in 2003. The bill is likely to be brought to a vote again this year, and a companion bill has already been introduced in the House.¹ At the state level, twenty-eight states either have or are planning to institute a greenhouse gas emission reduction strategy.² In addition, in September 2003, the Governors of California, Washington, and Oregon called for a regional greenhouse gas reduction initiative.

In light of the very real financial risk associated with carbon emissions, the Draft Report appropriately assesses the range of likely future scenarios of regulation of carbon emissions, and the associated costs of those emissions, and develops a best estimate of the financial costs the utilities and/or their customers will be exposed to due to carbon emitting resources.

¹ "Bipartisan Group to Unveil House version of McCain-Lieberman Bill", Energy and Environment Daily, March 30, 2004. www.eenews.net.

² "Climate Change Activities in the United States: 2004 Update," Pew Center for Climate Change, March 2004 www.pewclimate.org.

PG&E cautions that “care should be taken not to over-prescribe” the use of externalities in resource selection. (p. 9) However, the Draft Report’s value for carbon emissions is not an “externality value” per se; rather, it represents the *real* financial risk associated with the potential future regulation of greenhouse gas emissions, which PG&E agrees should be considered in the process of evaluating resources. We believe that the imputed cost of carbon emissions must be a best estimate based on available information, and that a cost of carbon emissions must be considered in resource selection. NRDC and UCS expect to provide additional relevant information on the financial risk associated with greenhouse gas emissions in the procurement proceeding (R.04-04-003).

NRDC and UCS support the Draft Report’s analysis of the financial risk associated with carbon emissions. While we believe the Draft Report’s estimate of the cost of carbon emissions is on the low end of the range, the analysis settles on a reasonable expected cost that is consistent with a similar analysis conducted by PacifiCorp in its recent Integrated Resource Plan.³

There are differences between the use of avoided costs for resource evaluation and comparison, and the prices paid to resource providers.

The Commission should strive to ensure that the utility portfolio managers are evaluating all resources on a level playing field. That means ensuring that all the costs and benefits of each resource are accounted for appropriately. Since carbon emitting resources clearly face a financial risk associated with the potential future regulation of those emissions, that risk must be included in the analysis of resource alternatives. Since energy efficiency resources reduce pollution emissions, the avoided cost comparison is relatively straightforward in this regard. However, for other resources such as distributed generation or cogeneration resources that may emit carbon dioxide and other air pollutants, the comparison needs to account for those emissions on both sides of the equation.

As PG&E discussed in its comments, there are differences between the avoided costs used for resource evaluation and comparison, and the prices paid to resource providers. (p. i) The primary purpose of the avoided costs discussed in the Draft Report, particularly in the context of energy efficiency, is to determine what *quantity* of the resource should be procured,

³ UCS illustrated scenarios and provided estimates of the likely cost of carbon emissions in its April 2003 opening testimony in the RPS phase of R.01-10-024. UCS intends to address the Draft Report’s estimate in the due course of this proceeding.

not what *price* should be paid for the resource. Energy efficiency program implementers are not paid the avoided cost for the energy savings they provide. Instead, the avoided cost is used to determine how much energy efficiency is cost-effective. Thus, attempting to use the Draft Report to set pricing policy poses some different challenges and different analytical questions than using the Draft Report for evaluating the cost-effectiveness of energy efficiency programs as it was initially intended.

NRDC and UCS appreciate the opportunity to respond to parties' opening comments on the Draft Report.

Dated: June 18, 2004

Respectfully submitted,

Devra Bachrach

Devra Bachrach

On Behalf of:

Natural Resources Defense Council [Devra Bachrach]

Union of Concerned Scientists [Alan Noguee]

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **“Pre-Workshop Reply Comments of the Natural Resources Defense Council and Union of Concerned Scientists on the Draft Avoided Cost Report”** (R.04-04-025) on all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on June 18, 2004 at San Francisco, California.



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