



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

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Order Instituting Rulemaking to Create a
Consistent Regulatory Framework for the
Guidance, Planning, and Evaluation of
Integrated Distributed Energy Resources.

Rulemaking 14-10-003
(Filed Oct. 2, 2014)

**REPLY COMMENTS OF THE INSTITUTE FOR POLICY INTEGRITY
ON STAFF PROPOSAL RECOMMENDING A SOCIETAL COST TEST**

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I. Introduction

In accordance with Rule 14.3 of the California Public Utilities Commission (“Commission”) Rules of Practice and Procedure (“Rules”), the Institute for Policy Integrity at New York University School of Law¹ (“Policy Integrity”) respectfully submits these reply comments on the Staff’s proposed societal cost test from the issued in the above captioned proceeding on February 9, 2017. Policy Integrity is a nonpartisan think tank dedicated to improving the quality of government decisionmaking through encouraging a rational approach to environmental and regulatory policymaking that makes use of the best available economic tools. Policy Integrity advocates for sound cost-benefit analysis at every level of government and argues for an unbiased approach to measuring the costs and benefits of environmental, public health, and safety policy. Policy Integrity has previously filed public comments and written reports and articles on issues pertaining to economic analysis of grid modernization and distributed energy resources. Policy Integrity seeks to apply its economic, legal, and policy

¹ These comments do not purport to represent the views of New York University School of Law, if any.

expertise to help advise the Public Utilities Commission on how to ensure that its societal cost test reflects the best available economic analysis.

II. Reply Comments

Using a societal cost test (“SCT”) will allow the Commission to select the combination of distributed energy resource (“DER”) projects that will result in the greatest net benefits to society. Many of the other parties have made excellent points supporting a stronger societal cost test in their opening comments. A few points made by other parties warrant a response. In particular, contrary to the assertions of some parties:

- The Commission has statutory authority to apply an SCT that includes the full value of externalities;
- A damage cost approach, rather than an avoided cost approach, is the appropriate method for determining the value of greenhouse gas reductions; and
- The Commission’s proposed selection of a 3% societal discount rate is reasonable.

A. The Commission Has Legal Authority to Use a Societal Cost Test that Includes the Full Value of Externalities

As staff articulated in its proposal, and as Policy Integrity explained in its opening comments, a number of California statutes support using a SCT that includes externalities in the analysis. Cal. Public Utilities Code § 701.1(a) directs the Commission to “minimize the cost to society of the reliable energy services that are provided by natural gas and electricity, and to improve the environment” as well as “encourage the diversity of energy resources” This language indicates that the legislature wants the Commission to pursue policies that maximize net social benefits, not just keep costs low for consumers. Likewise, section 701.1(c) directs the Commission to include environmental costs when analyzing energy resources: “In calculating the cost-effectiveness of energy resources, including conservation and load management options, the commission shall include, in addition to other ratepayer protection objectives, a value for any costs and benefits to the environment, including air quality.” Similarly, Cal. Public Utilities Code § 400 tells the Commission to “[t]ake into account the opportunities to decrease costs and increase benefits, including pollution reduction and grid integration, using renewable and

nonrenewable technologies with zero or lowest feasible emissions of greenhouse gases, criteria pollutants, and toxic air contaminants onsite in proceedings associated with meeting the objectives.” Instructing the Commission to decrease costs and increase benefits suggests that the legislature wants the Commission to maximize net benefits in its decisionmaking. Additionally, a number of statutory sections discussing “smart grid” deployment plans instruct the Commission to prioritize “efficiency.” In economics, “efficiency” is defined as maximizing net social welfare—the goal of a societally focused cost-benefit test.

Some parties, including the Utility Reform Network and the Independent Energy Producers Association argue that Cal. Public Utilities Code § 701.1(d) limits the ability of the Commission to put a value on greenhouse gas reductions beyond that assigned through California’s cap and trade system.² However, the scope of section 701.1(d) is limited to determining the “emission values associated with the **current operating capacity of existing** electric powerplants.”³ The Social Cost Test is intended to be used, in part, to determine the value of avoided emissions associated with the development of new, distributed energy resource, not emissions values associated with the current operating capacity of existing powerplants. As such, section 701.1(d) does not apply in this case.

B. The Commission Should Use a Damage Cost Approach to Determine the Value of Greenhouse Gas Reductions

A damage cost approach is the appropriate method to determine the benefits of greenhouse gas reductions. Under either a damage cost or an avoided cost valuation approach, the Commission would be comparing the costs of proposed DER projects to something; the question

² See California Public Utilities Commission, Order Instituting Rulemaking to Create a Consistent Regulatory Framework for the Guidance, Planning, and Evaluation of Integrated Distributed Energy Resources, Rulemaking No. 14-10-003, Comments of the Independent Energy Producers’ Association on the ALJ Ruling Taking Comment on Staff Proposal Recommending a Societal Cost Test 8-9 (Mar. 23, 2017); California Public Utilities Commission, Order Instituting Rulemaking to Create a Consistent Regulatory Framework for the Guidance, Planning, and Evaluation of Integrated Distributed Energy Resources, Rulemaking No. 14-10-003, Opening Comments of The Utility Reform Network 7-8 (Mar. 23, 2017).

³ Cal. Pub. Util. Code § 701.1(d) (emphasis added). See also *id.* (“The commission shall not assign a value or cost to that residual pollutant **for the current operating capacity** of that powerplant because the alternative protocol for dealing with the pollutant operates to internalize its cost for the purpose of planning for and acquiring new generating resources.” (emphasis added)).

is what the Commission will be comparing those costs to. In order to choose energy resource projects that will result in net benefits to society, the Commission must compare the costs of proposed DER projects to the benefits of those projects, selecting only those projects where the benefits justify the costs (or, more selectively, the projects with the highest net benefits). Using the damage cost approach will allow the Commission to value the benefits of greenhouse gas reductions from the DERs, which can then be combined with the projects' other benefits and costs to assess whether to move forward.

In contrast, using the avoided cost approach will result in the Commission comparing the costs of proposed DER projects to the costs of other policies that the state is using to reduce greenhouse gas emissions. The costs of these other policies are perhaps a rough proxy for how much society is willing to pay to reduce greenhouse gas emissions, but they do not reflect the actual benefit to society of those reductions. In contrast, the Social Cost of Carbon is designed to reflect the best available estimate of the benefit to society of reducing a ton of carbon emissions. Clean energy advocates may find the avoided cost approach attractive now because it appears to lead to numbers higher than the federal Social Cost of Carbon. However, the choice of which other policies to include in the avoided cost analysis is subjective and could be considered arbitrary. And using a greenhouse gas adder based upon these subjective abatement costs will not serve to correct the externality market failure and could distort the market even further. Additionally, the abatement costs depend on market conditions and may decrease in the future. However, the marginal damage costs associated with carbon dioxide emissions are independent of such changes in market conditions.

The joint investor-owned utilities comments illustrate one of the problems with the subjectivity of the avoided cost approach. The utilities argue, "If the Commission chooses to create a SCT as an interim tool, the appropriate GHG adder to inform DER cost-effectiveness tests, should be the projection of Cap and Trade prices in light of a new State-mandated 2030 emissions reduction target, capped at a projection of ARB's cap and trade ceiling price."⁴

⁴ California Public Utilities Commission, Order Instituting Rulemaking to Create a Consistent Regulatory Framework for the Guidance, Planning, and Evaluation of Integrated Distributed Energy Resources, Rulemaking No. 14-10-003, Opening Comments on Administrative Law Judge's Ruling Taking Comment on Staff Proposal Recommending a Societal Cost Test of Pacific Gas and Electric Company (U 39 M), Southern California Edison Company (U 338 E),

Though the utilities describe this approach of valuing greenhouse gases at a projection of the cap-and-trade ceiling price as an entirely distinct third approach (neither damage cost nor avoided cost), the utilities' approach could be described as an avoided cost approach, in that it is based on the costs of other approaches to reducing greenhouse gases. It is unclear how the Commission plans to explain which types of policies it plans to include in the avoided cost analysis and why. The damage cost approach avoids the problem of having to choose which policies to include in the analysis, because it is based on an external value—the best available estimates of the benefits from reducing a ton of greenhouse gas emissions. For additional information on these issues, please refer to Policy Integrity's opening comments.

C. The Proposed 3% Societal Discount Rate Is Reasonable

The Investor Owned Utilities argue that the SCT should use a discount rate higher than 3% because it is “not the case” here that “private consumption is not being impacted by government spending,” but instead “the issue is how best to allocate private capital, based on cost benefit analysis.”⁵ Being utilities, they would naturally have a utility-centered view of the DER development process, but they are not the only actors making relevant decisions in this case. System users are involved in the process, as well, through both purchasing electricity and through developing DERs on their property. The project proposals for DERs will be financed primarily through electricity rates for consumers, meaning that a lower, societal discount rate (the Office of Management and Budget recommends 3%) is appropriate.⁶ It is particularly important that the societal discount rate be used for societal benefits, such as the long-term climate benefits. For additional analysis supporting a low, societal discount rate, please refer to Policy Integrity's opening comments.

III. Conclusion

For the foregoing reasons, the Commission should: (1) expand its discussion of the legal basis for applying a societal cost test that includes a full range of externalities; (2) use the damage cost approach to determine the value of greenhouse gas abatement, rather than the

Southern California Gas Company (U 904 G), San Diego Gas & Electric Company (U 902 M) at 17 (Mar. 23, 2017).

⁵ *Id.* at 11-12.

⁶ *See* OFFICE OF MGMT. & BUDGET. CIRCULAR A-4 at 33-34 (2004) [hereinafter CIRCULAR A-4].

proposed marginal abatement cost approach; and (3) apply a societal discount rate to the analysis.

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Respectfully submitted,

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