BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND THE CALIFORNIA ENERGY COMMISSION

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

Energy Commission Docket 07-OIIP-01

CALENERGY OPERATING CORPORATION'S RESPONSE TO ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT

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CALENERGY OPERATING CORPORATION'S RESPONSE TO ADMINISTRATIVE LAW JUDGES' RULING REQUESTING COMMENTS AND LEGAL BRIEFS ON MARKET ADVISORY COMMITTEE REPORT

CalEnergy Operating Corporation ("CalEnergy") appreciates the opportunity to respond to the Administrative Law Judges' request for comments on the June 30, 2007 Market Advisory Committee Report entitled "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California" ("MAC Report"). CalEnergy respectfully submits these comments in accordance with the Administrative Law Judges' request, dated July 19, 2007, and pursuant to Rules 1.9 and 1.10 of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure.

I. GENERAL COMMENTS

CalEnergy is an international leader in the development and production of energy from diversified fuels sources, including geothermal, natural gas and hydroelectric. Of particular relevance in this docket, CalEnergy operates ten generating plants utilizing the Salton Sea Known Geothermal Resource Area in Southern California's Imperial Valley. The energy produced by CalEnergy's geothermal plants is reliable, renewable, clean, indigenous, and economical.

CalEnergy believes that the California Legislature and the Commission policies to promote renewable energy and greenhouse gas ("GHG") reduction in California should be mutually reinforcing given that renewable energy sources have lower GHG emissions than fossil fuel-based generation. CalEnergy is concerned that the approach outlined in the MAC Report may pit these important policies against each other absent recognition that renewables do not have significant GHG emissions. CalEnergy does not believe that a "first seller" approach should be adopted for renewable electricity generators. Absent recognition that the GHG emissions associated with renewable energy are less than significant, the "first seller" approach

would impose significant reporting burdens, and possibly compliance burdens, on sellers of renewable energy in California, thus deterring development of renewable power here.

Further, the "first seller" approach will create disruption for renewable energy providers, such as CalEnergy, with existing long-term contracts. Currently, eight of CalEnergy's ten plants sell power to Southern California Edison under 30-year power purchase agreements. If reporting or compliance burdens are placed on renewable energy, companies like CalEnergy may, at a minimum, become embroiled in contractual disputes over the added costs and potential benefits.[1] Unless renewable generators/operators like CalEnergy are able to recover the costs to comply with new reporting and/or compliance burdens under long-term, fixed-rate power purchase agreements, the economics of operating renewable energy plants may be significantly and negatively impacted. The risks of this approach, which cannot be quantified at this time due to the uncertainty as to many other aspects of future GHG regulations, should be avoided.

The Commission should ensure that renewable energy is not adversely impacted by regulation or reporting requirements contained in the MAC Report.

II. SPECIFIC COMMENTS

CalEnergy responds to certain of the questions set forth in the July 19, 2007 Administrative Law Judges' request for comments.

Response to Question No. 22: Interaction with Renewable Portfolio Standard:

If the "first-seller" approach outlined in the MAC Report is applicable to renewable energy, it has the potential to discourage the development of renewable energy, and thus undermine the Renewable Portfolio Standard ("RPS"), by imposing costly administrative burdens on renewable energy generators.

Renewable energy generators have GHG emissions below the level of significance. In D.07-01-039, addressing whether Load Serving Entities ("LSEs") must show

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[1] Some power purchase contract clauses require the generator pass on "environmental attributes" to purchasing utilities. If the final rules utilize early action credits, offsets, or grant free allocations based upon energy output, it is unclear how they will be distributed given these clauses.

that renewable energy providers meet the Emission Performance Standard, the Commission stated:

> We agree with GPI, NRDC, TURN and others that requiring the LSE to demonstrate compliance with the EPS for each and every long-term commitment with a baseload renewable resource would not further our policy objectives or those of the Legislature. Those stated objectives recognize that renewable resources are valued as being both environmentally and economically sound in the context of addressing the adverse consequences of climate change on the economy, health and environment of California. In fact, SB 1368 echoes the policy expressed in the Energy Action Plan II that renewables (along with energy efficiency) are to be used to satisfy increasing energy and capacity needs before LSEs turn to fossil-fired generation.
>
> It is therefore fully consistent with these objectives to consider the approach recommended by these parties, that is, to issue an upfront finding in today's decision that renewable resources comply with the EPS. Moreover, if the record clearly demonstrates that these resources will pass the standard on a net emissions basis, it would be redundant and costly to require that LSEs demonstrate EPS compliance for each new ownership investment, new contract or renewed contract with renewables. Therefore, the general approach suggested by GPI and others would also enable us to reduce those costs, thereby reducing overall costs to electricity customers as well.

D.07-01-039 at 117 (emphasis added). In Attachment 6, the Commission reviewed various types of renewable generation, including geothermal, and found that they did not have significant GHG emissions. Therefore, the Commission made an "up front" finding that such renewables complied with the EPS.

The Commission should adopt a similar approach to renewable energy generators under either the "first seller" approach or the "load-based" approach. Requiring renewable energy generators to monitor, report and account for their insignificant GHG emissions would add an unreasonable and pointless cost to the production of renewable energy. Unlike non-renewable energy sources that can reduce costs by decreasing emissions, renewable energy generators will be forced to pay what is essentially an operational tax that they have no means of reducing and that is unrelated—and in fact contrary—to the Legislature's and the Commission's policy goals. Renewable energy is often more expensive to produce than non-renewable energy and requiring renewable energy generators to incur reporting and compliance costs for GHG

emissions will simply increase that cost and make it more difficult for renewable energy generation to be cost competitive.

Fundamentally, the CPUC and CEC should consider the conflict that is created by imposing GHG-related requirements on renewable energy. Imposing such requirements on renewable generators will inherently increase operating costs. Depending upon many other aspects of the GHG regulations that are not known yet, such added costs (and likely other costs) may render the plants subject to these contracts uneconomic. At the same time California utilities attempt to achieve their increasing RPS requirements, increasing costs of renewable generation will be passed on to California ratepayers. Existing renewable generators, to the extent they are unable to recover increased costs under long-term contracts, will inevitably suffer the economic consequences of any new regulatory provisions, potentially discouraging investment in maintaining and improving existing facilities at a time when California is seeking to promote investment in renewable energy technology. Given that renewables' GHG emissions are below a level of significance, there is no good reason to impose extra costs on California ratepayers or renewable generators.

The Commission also should recognize that imposing the reporting and compliance obligations on the LSEs under the "load-based" approach does not eliminate administrative costs downstream. The LSEs will seek to impose at least reporting requirements on the generators from which they purchase energy by contract. Thus, the generators will incur some additional costs that ultimately will be reflected in energy prices. For this reason, the Commission should recognize that renewables' GHG emissions are less than significant even under a "load-based" approach, thus eliminating LSEs' need to impose contractual reporting requirements on renewable energy generators. Additionally, as the Commission is aware, some renewable energy contracts allow for the purchasing utility to take title to the environmental attributes of the renewable generator. It is unclear how these clauses will be interpreted under a first-seller approach, but it would be grossly unfair to force renewable generators to incur compliance and monitoring costs without receiving any benefit under the first-seller approach.

Thus, the "first-seller" approach, if applied to renewable energy generators, will frustrate the goals of the RPS and Assembly Bill 32 ("AB 32") by increasing costs and discouraging investment in renewable energy. Under either the "first seller" approach or the "load-based" approach, the Commission should either exempt renewable energy generators or make "up front" determinations as to the extent of their GHG emissions.

Response to Question No. 23: Treatment of Renewable Energy Under a First-Seller System:

CalEnergy reiterates its position that California should not adopt a "first seller" approach to regulation of GHG from the electricity sector. Nonetheless, renewable energy should be treated under either the "first seller" or "load based" system as it is under the EPS. As discussed above, renewable energy GHG emissions are insignificant and including them in the "first-seller" system will undermine both the goals of the RPS and AB 32. Under either the "first seller" or "load based" approach, renewable energy should be assigned an emission value of zero so that (a) renewable energy generators have no need to report emissions because they are below the level of significance (Section 38505(i)) and (b) renewable energy generators do not need to acquire GHG allowances and thus can avoid the costs of engaging in auctions or allocation issues.

If renewable energy is to be regulated under a "first-seller" approach rather than exempted or found insignificant through "up front" findings, the system should be designed to sustain or increase incentives for renewable energy. For renewable energy generators already locked into long-term contracts, the Commission may alleviate the harm by: (a) allowing the purchasing utilities to compensate the renewable energy generators for their reasonable costs of compliance and for the utilities to recover that cost in rates; or (b) allocating GHG allowances to renewable energy generators based on their energy output, allowing the sale of excess GHG allowances to offset the added regulatory costs. Allocation of GHG allowances based on energy output (as an alternative to historic emissions) would allow renewable energy generators to sell excess credits, decreasing the price of renewable energy and promoting growth in the industry.

This system is acceptable as long as renewable generators are allowed to retain the GHG allocations and are not forced to pass them on to power purchasers under purchasing agreements.

Response to Question No. 24: Impact on Voluntary Renewable Energy Market:

As noted above, if the "first-seller" approach is applicable to renewable energy, it has the potential to discourage the development of renewable energy, and thus undermine the RPS, by imposing costly administrative burdens on renewable energy generators. These added costs are incorporated in the cost of renewable energy. Increasing the cost of renewable power will tend to drive up rates on new, and potentially existing, power purchase agreements. Once the major utilities have met their Renewable Portfolio Standard requirements, they will have less incentive to purchase renewable energy, depending on energy prices, their allocation of GHG allowances (if any), the cost of GHG allowances and offsets on the market, and their cost of achieving emissions reductions in their own operations.

The optimal system for the renewable energy market is "load-based" regulation. Under a load-based approach, LSEs will be encouraged to purchase power from renewable sources to ensure they have sufficient GHG allowances to serve their load. This will increase demand for renewable energy and increase investment in new technologies and facilities. By contrast, a "first-seller" approach provides incentives for LSEs to purchase power from the least expensive sources. Depending upon the cost of GHG allowances and offsets, it is likely that renewable energy, if regulated, will remain more expensive than non-renewable energy. It is unlikely that, under the "first-seller" approach, a non-RPS market for renewable energy will develop to its fullest potential if renewable energy generators face unnecessary operating costs.

Thus, if a "first-seller" approach is employed, it should exclude renewable energy generators from regulation, either directly or through an up front finding that renewables' GHG emissions are less than significant.

Response to Question No. 32: Would Implementation of a First-Seller Approach Necessitate Auctioning of GHG Emissions Allocations?:

Use of a "first seller" approach would not require auctioning of GHG allowances

as such allowances could be allocated to "first sellers" that exist in California, or can be shown will exist in California, during the compliance period for which the GHG allowances are allocated. CalEnergy believes that any allocation system should provide incentives for renewable energy. The best way to promote renewable energy is to implement a load-based system or to exempt renewable energy generators from either approach, either directly or by an up front finding that renewables' GHG emissions are insignificant. If, however, a "first-seller" approach is to include renewable energy generators, then CalEnergy believes that GHG emissions allocations should not be auctioned off, but should instead be dispersed to first-sellers based upon their historic output of energy. By basing the allocations on historic output of energy, renewable energy generators may be able sell a portion of their allocations (since their GHG emissions are insignificant). That revenue can be used to make their energy more cost competitive with other energy, and to invest in new and more efficient technologies.

Response to Question No. 34: If Allocations are Administered to Retail Providers and then Auctioned to First-Sellers, How Should that Auction Be Administered:

CalEnergy does not see the point in allocating GHG allowances to the retail providers, who then would auction the allowances to first sellers. Why should revenue from such sales go to the retail providers? If the Commission were to require that such revenue go to the benefit of retail customers, less the retail providers' costs of running the auction system, the Commission would have to incur the time and expense of administrative proceedings to determine the retail providers' reasonable costs of running an auction system and presumably the retail providers would want some rate of return on their investment. If there is an auction, it should be run by a government body.

Where allowances are auctioned, there is a risk of non-generators bidding to acquire GHG allowances. Financial speculators could participate, hoping to acquire allowances cheaply and sell them to companies that need them to operate at a higher price. The risk alone could drive up the bid price in these auctions. As the cost of acquiring allowances eventually will be passed on the California electricity consumers, market manipulation that drives up the

cost of allowances, the supply of which will be limited, should be prevented.

CalEnergy believes that limitations on auction participants are the most direct way to address this risk. Rules for bidders could include either currently being a first-seller of electricity in California, having a pending application for a California-based generation unit, or being able to show to the satisfaction of regulatory staff that they have a good faith and reasonable expectation that they will be a first seller in California during the compliance period for which the allowances apply.

Dated: August 6, 2007

Respectfully submitted,

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MOTION FOR PARTY STATUS OF CALENERGY OPERATING CORPORATION

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MOTION FOR PARTY STATUS OF CALENERGY GENERATION

Pursuant to Rule 1.4(a)(4) and Rule 11.1(b) of the California Public Utilities Commission's Rules of Practice and Procedure, CalEnergy Operating Corporation ("CalEnergy") respectfully submits this motion for party status. In support of this Motion, CalEnergy states as follows:

CalEnergy is the operator of ten power plants, generating 349 megawatts of geothermal energy in Calipatria, California from the Salton Sea Known Geothermal Resource Area. CalEnergy sells power to Southern California Edison and to third parties pursuant to long-term contracts. As an in-state generator and seller of energy, CalEnergy may be subject to the "first-seller" approach described in the June 30, 2007 Market Advisory Committee Report ("MAC Report"). The MAC Report's recommendations may have a substantial impact upon CalEnergy's operations in California by imposing significant transactional and operation costs for compliance and monitoring. Further, the Commission's determinations in this rulemaking will have significant impacts on CalEnergy's business in California.

For these reasons, CalEnergy seeks to intervene in these proceedings. CalEnergy plans to participate in these proceedings by filing comments on the MAC Report as requested in the July 19, 2007 Administrative Law Judges' Ruling Requesting Comments and Legal Briefs on

Market Advistory Committee Report and Notice of En Banc Hearing, and by participating on other issues as they may arise and affect CalEnergy's interests. CalEnergy accepts the record as it exists in these proceedings to date, and thus will not broaden the issue in this matter.

CalEnergy is a subsidiary of CE Generation LLC, which is owned equally by MidAmerican Energy Holdings Company and TransAlta (CE Gen) Investments USA, Inc.

All pleadings, correspondence, Commission Orders or other communications should be directed to the following CalEnergy representatives:

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CalEnergy respectfully asks other parties to include CalEnergy on their service list in this proceeding effective with the date of this filing and to serve CalEnergy with any documents submitted in the future for the record in these proceedings.

In conclusion, CalEnergy asks to be granted active party status in R. 06-04-009

Dated: August 6, 2007

Respectfully submitted,

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