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

OPENING COMMENTS OF PACIFICORP (U 901 E) ON THE PROPOSED FINAL OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES

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Pursuant to the proposed *Final Opinion on Greenhouse Gas Regulatory Strategies*, dated September 12, 2008, ("Proposed Final Opinion") PacifiCorp respectfully submits these opening comments relating to regulation to be used to reduce greenhouse gas ("GHG") emissions in the electricity sector. PacifiCorp appreciates the opportunity to provide further comments in this proceeding on these important issues.

I. INTRODUCTION

PacifiCorp is one of the West's leading utilities, serving more than 1.6 million customers in six western states (California, Idaho, Oregon, Utah, Washington, and Wyoming). In California, PacifiCorp serves approximately 46,500 customers in Del Norte, Modoc, Shasta and Siskiyou counties. PacifiCorp has more than 10,400 megawatts of generation capacity on a system-wide basis from coal, hydro, wind power, natural gas-fired combustion turbines, solar and geothermal. PacifiCorp also has ownership interests in thermal generation units located in three additional western states (Arizona, Colorado, and Montana).

PacifiCorp has been an active participant in this proceeding, both before the California Public Utilities Commission (the "Commission") and the California

Energy Commission ("CEC"). PacifiCorp's participation has included the submission of numerous written comments, attendance at countless Commission and CEC workshops, and continued work with Commission and CEC staff to effectuate a workable approach to GHG emissions regulation for PacifiCorp. PacifiCorp respectfully requests that the Commission and the CEC not perceive the absence of comments by PacifiCorp on any specific issue or other matter as a conclusive indication of PacifiCorp's implied consent or indifference with respect thereto.

PacifiCorp has advocated for a phased-in, technology and policy-driven national approach to reduce long-term global greenhouse gas ("GHG") emissions while minimizing the costs and risks to the economy.[1] In this context, PacifiCorp recommends that California implement a multi-phased, economy-wide approach that matches electricity sector GHG emissions reduction goals to reasonable expectations of technology development. It is critical to address technology research and development that will assist in long term solutions. In addition, measures that offer immediate carbon benefits from investments in energy efficiency, renewable energy, and increasing the efficiency of existing fossil generation should be implemented.

Parties agree that technological advancement is key to achieving GHG emissions reductions from the electricity sector. Imposing carbon emissions caps prior to the availability of the technology needed to meet the emissions caps simply convert cap-and-trade into a carbon tax. The cost of reducing carbon emissions increases the potential to create a disproportionate impact on the poor, elderly, and those on fixed incomes and a "glide slope" approach that allows time to develop the appropriate technologies is necessary to shift from a carbon-intensive to less carbon-intensive economy. A phased approach would also allow time for renewable energy to advance

[1] See, "Testimony of David L. Sokol, Chairman and CEO MidAmerican Energy Holdings Company "Challenges to Climate Change Legislation" presented during the February 19, 2008 meeting of the National Association of Regulatory Utility Commissioners ("NARUC") (available at: http://www.narucmeetings.org/Presentations/Challenges%20to%20Climate%20Change%20Legislation_DavidSokol.pdf)

(while also accounting for new transmission and energy storage investments) and energy efficiency to take effect in order to reduce the use of traditional energy sources. Early implementation of a cap-and-trade system with unreasonable reduction targets and timetables will cause immediate rate shock.

Regrettably, the Proposed Final Opinion lacks a robust discussion by the Commission and the CEC on specific measures and funding mechanisms it anticipates regulated entities will pursue in support of technology research and development. Absent a strategy for supporting technology development, regulated entities will be incentivized to prioritize the spending of scarce compliance dollars on known, commercially available technologies or allowances, rather than supporting the development and commercialization of untested technologies that might otherwise achieve more significant or cost-effective emissions reductions over the long-term.

II. DISCUSSION

A. Regulatory Programmatic Strategies Should Be Promulgated to Achieve the Bulk of the Required GHG Emissions Reductions

Given the breadth of the challenge, PacifiCorp continues to support a national regulatory solution to greenhouse gas issues. Transitioning to a low-carbon economy cannot take place overnight, but there are measures that should and can technologically be undertaken now by California. In the first phase (2009-2017), PacifiCorp has argued for a focus on technology development and sector-specific reductions from existing technologies that may have incremental costs that are slowing deployment. In the electricity sector, for example, PacifiCorp has proposed six priorities:

1. Adoption of flexible renewable and clean technology portfolio goals.

2. More stringent energy efficiency mandates.

3. Policies to encourage efficiency improvements at existing facilities.

4. A ten-year, multi-billion dollar research and development program for emission reduction, funded equally by the private sector and the government.

5. Removing the legal and regulatory barriers to the development of low-emissions technologies such as carbon sequestration and new nuclear development.

6. Tax policies to support these programs, such as a long-term extension of the renewable energy tax credit and clean coal initiatives.

PacifiCorp supports the Commission and CEC's emphasis on regulatory programmatic strategies as "the foundation of our recommended strategy, [and that] a [GHG cap-and-trade] market would provide a backstop to the programs, should they fail to deliver sufficient GHG emissions reductions." Proposed Final Opinion at 8. The joint agencies' emphasis within the Proposed Final Opinion on additional energy efficiency and renewables goals complement PacifiCorp's above-referenced priorities #'s 1, 2, and 3 and PacifiCorp looks forward to the joint agencies developing specific policies and measures, or suggesting legislative proposals meant to support PacifiCorp's above-referenced priorities #'s 4, 5, and 6.

B. The level of the 2020 GHG Emissions Cap

During the course of the proceeding, most parties were unable to offer specific recommendations or feedback on many of the cap-related issues raised because of the shared expectation that the electricity sector will be regulated within a larger, multi-sector cap-and-trade program. PacifiCorp recommended that the Commission and the CEC endorse a modest initial approach, with goals for the electricity sector's

participation within a cap-and-trade program. The primary focus of the cap-and-trade program was to provide significant flexible compliance tools and cost containment mechanisms, while seeking to stabilize emissions and achieve modest reductions from current levels by 2020. The Proposed Final Opinion observed:

> "... [the California Air Resources Board's] Climate Change Draft Scoping Plan envisions that the electricity sector will contribute at least 40% of the total statewide GHG reductions, even though the sector currently creates just 25% of California's GHG emissions. This is before considering the additional emissions reductions that are projected to result from a GHG emissions allowance cap-and-trade system, if such a system is adopted and implemented. The electricity sector is expected to reduce its emissions further due to its participation in such a market-based system."

Proposed Final Opinion at 2. Since the Commission and CEC also agree "with ARB's Draft Scoping Plan, which calls for aggressive energy efficiency programs, obtaining 33% of California's energy from renewable sources, and increased reliance on combined heat and power (CHP) facilities as principal strategies for reducing GHG emissions" Proposed Final Opinion at 2, the electricity sector's contribution to the 2020 cap should similarly be limited to the GHG reduction goals embodied within the regulatory programmatic strategies.

C. The Proposed "Straightline" Rate of Decline

During the course of the proceedings, parties concurred that there are only three near-term options for reducing emissions from electricity generation: 1) redispatch existing generation; 2) add new generation to cover load growth and generation retirements; and 3) substitute new generation to cut existing generation emissions. While other programs target electricity consumption, there is consensus that to achieve significant GHG emissions reductions, California sources for electricity will change

dramatically. The Commission and the CEC also correctly observe that the ability of the electricity sector to achieve additional GHG emission reductions, especially when relying on renewables, is contingent upon California committing significant new resources and investments in transmission infrastructure. Either an absence or delay in these additional investments will have a direct impact on the electricity sector's ability to achieve GHG emission reductions.

The Commission and CEC's recommendation that "the trajectory of the multi-sector cap and the required annual reductions be generally a straightline reduction between 2012 and 2020 for all sectors including electricity" Proposed Final Opinion at 121 is arbitrary and not linked to the status of technology or the anticipated GHG reductions attributable to the regulatory programmatic strategies. California's interim GHG emissions reduction goals must reflect the existing near-term GHG emission reduction options, plus lead times to develop new generation technologies, build new capacity and recognize other constraints on operations, transmission, and new investment.

D. Free Allowances to Emitting Deliverers Relying on a Fuel-Differentiated Output-based Allocation Method Avoids Windfalls

PacifiCorp continues to support a free allocation of allowances to emitting regulating entities and thus, supports the Proposed Final Opinion's recommendation for "a fuel-differentiated output-based allocation, [where] allowances would be allocated only to emitters, using weighting factors based on fuel type" and that "the use of weighting factors would reduce, and could largely eliminate, wealth transfers from customers of coal-dependent retail providers to customers of natural gas-dependent retail providers." PacifiCorp also concurs that "this reduction of wealth transfers would be accomplished by providing emitting deliveries with allocations that more closely reflect their emission levels." Proposed Final Opinion at 154-155.

Utilities that built hydroelectric dams many decades ago or nuclear plants in the sixties and seventies did not do so to avoid GHG emissions. Utility investments in renewables or energy efficiency were largely required by regulatory mandates that included numerous public policy rationales, including avoiding new sources of GHG emissions. PacifiCorp concurs with the joint agencies' observation that these sources "do not need [free allowances]." Proposed Final Opinion at 156. These zero-emitting resources do not bear the burden or the direct costs of effectuating GHG emissions reductions. Therefore, there is no reason to provide them with a financial windfall.

Some stakeholders conveniently ignore the fact that any allocation of free allowances declines as allowances are transitioned to an auction and as the cap (pool of allowances) declines over time. A fuel-differentiated output-based allocation equitably allows for a transition to a low carbon generating portfolio. At the same time, this type of allocation helps manage the cost impacts on such a transition in electricity rates and avoids disproportionate impacts among utility customers (based upon an existing generation portfolio).

The Commission and the CEC questioned "whether the higher weighting factor to be used in determining allowance distributions for coal-fired electricity should apply to all coal deliveries or should be restricted to only electricity from coal plants owned or under long-term contract to California retail providers" Proposed Final Opinion at 209, applying the higher weighting factor to all coal deliveries will encourage parties to identify the underlying source of energy rather than characterizing these types of transactions as unspecified power.

E. If the California Air Resource Board Adopts Less Auctioning, Free Allowances Within the Electricity Sector Should Not be Distributed Using a Pure Output-Based Approach

PacifiCorp strongly opposes the Commission and CEC's recommendation that "[if] [the California Air Resource Board] adopts less auctioning than we recommend (either less than 100% as the ultimate goal, or 100% phased in later than 2016), we recommend that distributions to deliverers transition toward a pure output-based approach, to be reached by 2020 if 100% auctioning is not achieved by that time. A pure output-based approach would be more effective than a fuel-differentiated approach in providing strong incentives to develop lower-emitting resources." Proposed Final Opinion at 209. This recommendation is arbitrary and punitive. The Commission and the CEC appear willing to ignore all of their arguments for the fuel-differentiated output-based method (meant to mitigate short-term "economic harm" to customers of retail providers that depend on coal).

The Commission and the CEC have provided no analysis supporting a proposition that a pure output-based method will result in additional GHG emissions reductions when compared to the fuel-differentiated output-based method. On the contrary, its own modeling suggests a change to a pure output-based method will only result in wealth transfers from high-emitting entities to low-emitting entities, which the joint agencies have sought to avoid.

The Proposed Final Opinion asserts "allowance distributions to deliverers on the basis of historical emissions would provide a stronger incentive to reduce emissions than would distributions on an output basis because the historical emissions approach would provide allowances that deliverers could sell if they reduce their emissions." Proposed Final Opinion at 200. If the logic behind the recommendation is to provide a more effective mechanism to reduce GHG emissions, the Commission and CEC should recommend a reversion to a historical emissions allowance distribution method. This method provides a stronger incentive to reduce emissions, rewards early action, and avoids the wealth transfers between retail providers. A declining emissions cap, scarcity in GHG emissions reduction options in the short-term, and liquidity issues

within the carbon offsets market will likely create market conditions favorable to low- and zero-carbon emitting technologies.

F. Allowance Auction Phase-In is Arbitrary

Most parties were unable to offer specific recommendations or feedback on an amount of allowances to be auctioned over time because of the shared expectation that the electricity sector will be regulated within a larger, multi-sector cap-and-trade program. PacifiCorp suggested that the Commission and the CEC endorse a modest initial auction approach for the electricity sector and expressed support for some nominal level of auction (i.e., initially $\leq$ 5 percent of the annual allowance budget) at the beginning of a cap-and-trade program to ensure market liquidity and an opportunity for trading and a transition to a greater percentage over time, but informed by modeling and additional information about the larger, multi-sector cap-and-trade program.

It is unclear from the Proposed Final Opinion what the basis was for selecting the initial goal of 20% auction beginning in 2012 and the transition to a 100% auction goal by 2016. The expressed rationale for starting with a modest auction provision was to "reduce short-term impacts on generating resources, and would help generators adapt to the new regulatory environment." The rationale goes on to state "such distributions would provide time and financial resources that deliverers may need to make necessary adjustments to their financial and investment plans to account for the impacts of GHG compliance obligations." Proposed Final Opinion at 202.

PacifiCorp concurs with the Proposed Final Opinion's expressed rationale in advocating for a modest auction provision at the beginning of the program, but unfortunately it appears this rationale is tossed out the window with the adoption of an aggressive transition to 100% auction within a five year period (i.e., 2016). It is unrealistic to expect emitting deliverers to make the necessary adjustments to financial

and investment plans required to meet emission reduction obligations within such a short period of time.

While one of the motives for a five-year transition to a 100% auction is to ensure that any undue windfall profits to deliverers would be short-term and declining in nature (Proposed Final Opinion at 203), this motive is contradicted by the Commission and CEC's staff's argument in support of the fuel-differentiated output-based allocation, where relying upon "... an output-based approach, deliverers would have an incentive to maintain or increase sales levels, since the number of allowances they receive would depend on continued generation levels. Because of this incentive to maintain sales and generation, generators likely have an incentive to not include the full value of allowances in wholesale bids or in negotiated prices in power purchase agreements. Essentially, there would be no opportunity cost for the allowances because the allocation depends on continued deliveries." Proposed Final Opinion at 155.

If emitting sources reduce generation to free up and sell allowances in one period, they would lose allowances in the future period. In theory, wholesale prices would increase only if, and to the extent that, the marginal generator setting the market clearing price does not receive free allowances sufficient to meet its compliance costs. This theory has merit and ought to be tested. The Commission and the CEC correctly observe that this allocation approach has never actually been used in practice, but then again, neither has a 100% auction.

If the favored market behavior expected from the fuel-differentiated output-based allocation approach does not occur, then California would be in a better position to argue the efficacy of a swifter transition to a 100% allowance auction. Unfortunately, in implementing the recommendation within the Proposed Final Opinion, the Commission and the CEC, as part of an equitable solution, provides short-term impact relief to emitting deliverers and their customers, but eliminate the relief much too

soon given the long lead times necessary to permit, finance, construct and operate new transmission and lower-carbon generation capacity.

G. Method for Distributing Allowances to Retail Providers for Auction.

The Proposed Final Opinion recommends a method for allocating allowances to retail provides for auction that starts off being divided amongst the retail providers based upon a "historical emissions" baseline. For many of the same reasons cited in favoring the fuel-adjusted output-based approach used for allocating free allowances, a historical emissions approach for allocating allowances to retail providers for auction is the most equitable solution.

Much like PacifiCorp's comments on the proposed transition from freely allocated allowances to auctioned allowances, PacifiCorp disagrees with the Commission and CEC's recommendation to transition to a 100% electricity "sales" based allocation method by 2020. No analysis has been provided to justify the transition to a 100% electricity "sales" based allocation approach. Instead the Commission and the CEC simply adopt a position that "transitioning to a sales basis would provide long-term incentives for retail providers to reduce their reliance on high-emitting generation sources." Proposed Final Opinion at 155. PacifiCorp argues that a declining GHG emissions cap already accomplishes the same effect and that transitioning to a 100% electricity "sales" based allocation method is arbitrary and punitive, and merely reintroduces the wealth transfer effect among deliverers and retail providers the joint agencies originally sought to avoid.

H. Excluding Legacy Hydro and Nuclear from the Electricity Sales Based Allocation Method is Justified.

The Commission and CEC's rejection of the staff recommendation that the sales calculation be performed on a "net load" sales basis (excluding large hydro and

nuclear) is equally perplexing. It was correctly argued that a pure sales-based approach, unadjusted to exclude large hydro and nuclear, would distribute allowances to retail providers with non-emitting legacy hydropower and nuclear generation out of proportion to the financial impact of GHG compliance on their customers. The Commission and CEC's position that "we believe that the longer-term priorities should be to provide strong incentives for increased reliance on all low- and non-emitting resources, including legacy generation" Proposed Final Opinion at 155, again ignores the potential wealth transfer effect. PacifiCorp argues that the simple act of regulating GHG emissions, coupled with a declining emissions cap and transition to an auction allowance allocation method provide more than sufficient motivation to increase reliance on low- and non-emitting resources. The legacy hydro and nuclear generation at issue is owned by existing retail providers who do not require new strong incentives for increasing their reliance on these legacy assets.

I. Three-Year Compliance Periods and Unlimited Banking Incentivize Early Action and Assist with Managing Compliance Risk.

PacifiCorp supports the Proposed Final Opinion's recommendation to establish three-year compliance periods for the early years of the cap-and-trade program, and to consider the possibility of shorter compliance periods as the program matures. PacifiCorp was also encouraged that the Commission and CEC endorsed PacifiCorp's suggestion that the California Air Resources Board give further evaluation and consideration to staggered or rolling compliance periods as a means to discourage market manipulation.

PacifiCorp agrees with the Proposed Final Opinion's discussion on how unlimited banking can be an effective strategy to counter the uneven nature of the emissions in the electricity sector due to weather-driven variations in energy consumption and the supply of zero-emitting hydropower. PacifiCorp was also encouraged that the

Commission and CEC acknowledged PacifiCorp's concerns about possible "hoarding" and market manipulation, and as a result encouraged the California Air Resources Board to ensure that there are adequate safeguards to reduce these risks.

J. Recommendation Does Not Adequately Address Consumer Protection / Cost Mitigation Measures.

As previously commented, depending on the annual cap levels and flexible compliance tools, cost containment mechanisms are essential to protect consumers from drastic price increases, mitigate economic disruptions and provide for regulatory certainty. Without such mechanisms the overall program is at risk to volatile markets and the resulting consequences to the regional economy and consumers. PacifiCorp believes the Commission and the CEC should reserve its judgment on the efficacy of cost containment mechanisms, such as a safety valve, until more details are known regarding the effectiveness of the larger, multi-sector cap-and-trade program. Instead, the Proposed Final Opinion's explicit rejection of a safety valve (Proposed Final Opinion at 262) suggests that if allowance prices were to wildly escalate to $200 or more per ton of carbon dioxide, the Commission and the CEC would is simply chalk it up to market forces at work. A cost-containment mechanism is not only a means to provide additional compliance flexibility, it is also a means to inform the market that controls are in place to ensure regulators an opportunity to review a broken market if costs are wildly different than what stakeholders and policymakers had otherwise expected.

K. Verifiable Offsets Should Not be Geographic Limited.

Carbon offsets are a risk management and cost containment tool and PacifiCorp was pleased to see the Commission and CEC concurred with our recommendation to include carbon offsets as part of the proposed GHG cap-and-trade regulatory program. Regulated entities should have the flexibility to pursue the lowest

cost carbon reductions, even if they occur outside of the electricity sector, as long as their environmental integrity and emissions benefits are real and can be verified. The Commission and CEC also agreed that carbon offsets should also be bankable and surrenderable for compliance purposes on a per ton basis.

PacifiCorp disagrees with the Commission and CEC's agreement with "[the California Air Resource Board's Draft Scoping Plan [inclusion of] a provision to allow covered entities to use high-quality offsets for not more than 10% of their compliance obligation." Proposed Final Opinion at 270. No specific analysis or data was provided justifying a limit on the use of carbon offsets. A limit on a regulated entity's ability to rely on carbon offsets is unnecessary. The Commission and the CEC should endorse the generous use of carbon offsets, as long as the carbon offsets satisfy minimum verification standards set by the California Air Resources Board, or preferably set by a national or international organization. Most parties support broad offset project eligibility criteria and international projects. Reducing GHG emissions, reliably, in some other part of the United States or the world will have just as significant a benefit as making an equivalent GHG emissions reduction within California.

Finally, a mature, liquid market for carbon offsets that are additional, verifiable, permanent, and enforceable, and in the volumes anticipated for a regulated market, does not currently exist. It is also difficult for carbon offset project sponsors to guarantee delivery of a minimum amount of GHG emissions reductions over a specified time period. With these factors in mind, it is unlikely regulated entities will be able to obtain significant amounts of cost-effective carbon offsets during the early years of the cap-and-trade program.

The Commission and CEC also failed to consider the efficacy of allowing a greater percentage of carbon offsets to be used during different compliance periods (i.e., perhaps earlier in the program when options to reduce GHG emissions are more limited) or in response to market conditions or hitting a pre-determined price trigger, as is done

within the Northeastern states' Regional Greenhouse Gas Initiative cap-and-trade program. Both possible approaches would ensure the environmental integrity of the GHG emissions cap, while also offering an additional means for regulated entities to moderate adverse economic impacts.

L. Modeling Results Reported by E3.

The Commission and CEC correctly observed "PacifiCorp states that the E3 modeling results appear to support similar modeling performed by the Electric Power Research Institute ("EPRI") that examined the effects of different CO2 prices on the [Western Electricity Coordinating Council] power market, including natural gas being dispatched ahead of coal once CO2 is priced closer to $60/ton (i.e., reducing coal electricity imports into California)." Proposed Final Opinion at 61.

PacifiCorp would like to update its testimony by citing the final results of the analysis. The preliminary results were presented by the Electric Power Research Institute during a June 5, 2008 public webinar and a second public webinar on June 24, 2008 with the materials posted on the Institute's website.[2] The final analysis was publicly released in August 2008 and downloadable from the Western Climate Initiative website.[3]

The final analysis concluded that within a Reference Case, $50 per ton of carbon dioxide was the required price signal to stabilize GHG emissions within the Western Electricity Coordinating Council, with $75 to $100 per ton of carbon dioxide causing GHG emissions reductions through the redispatching of natural gas ahead of coal and existing coal-fueled unit retirements.

Equally important were the results of a "wild card" alternative case, which assumed different market conditions, found $75 per ton of carbon dioxide necessary to

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[2] Please see: http://globalclimate.epri.com/PDF/EPRI-Western_Climate_Policy_Impacts_Collaborative_webcast_6-5-08.pdf.

[3] Please see the Western Climate Initiative's website, specifically Appendix B within PacifiCorp's August 13, 2008 comments filed with the Western Climate Initiative's Economic Analysis Team (see, http://www.westernclimateinitiative.org/ewebeditpro/items/O104F19751.pdf).

stabilize western regional electricity sector GHG emissions, and $125 to $150 per ton of carbon dioxide as being necessary to bring about significant GHG emissions reductions within the western electricity sector. The results of the final EPRI analysis do not necessarily impact the Commission or CEC's analyses or underlying rationales relied upon for the Proposed Final Opinion, but they do elaborate on the original information PacifiCorp provided during the course of the proceeding.

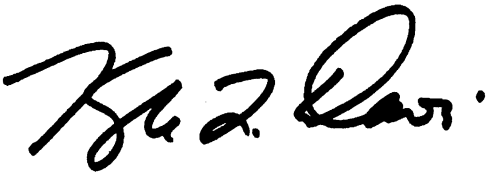
III. CONCLUSION

PacifiCorp appreciates the opportunity to provide opening comments relating to regulation to be used to reduce GHG emissions in the electricity sector. PacifiCorp strongly supports the Commission and the CEC developing recommendations to the California Air Resources Board on GHG regulatory strategies for the energy sector.

Dated: October 2, 2008

Respectfully submitted,

By



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CERTIFICATE OF SERVICE

I hereby certify that on this 2nd day of October, 2008, I caused to be served, a true and correct copy of the foregoing Opening Comments of PacifiCorp (U 901 E) on the Proposed Final Opinion on Greenhouse Gas Regulatory Strategies to be served via Electronic Mail and/or US Mail to the following:

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Executed this 2nd day of October, 2008

/Ariel Son

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