

November 30, 2007

Ms. Janice Adair, Special Assistant
Washington Department of Ecology
Chair, Western Climate Initiative

Mr. Steve Owens, Director
Arizona Department of Environmental Quality
Co-Chair Western Climate Initiative

Dear Ms. Adair and Mr. Owens:

I am writing to you on behalf of PacifiCorp to provide you with our comments on the draft Workplan for the Western Climate Initiative (WCI). 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). PacifiCorp also has ownership interests in thermal generation units located in three additional western states (Arizona, Colorado, and Montana). 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.

By way of the background, PacifiCorp has been active in several state and regional policymaking endeavors similar to WCI. It is our experience in these regional endeavors that informs our comments on the WCI Workplan.

GREATER TRANSPARENCY IS NECESSARY

With respect to the process of the WCI, it is PacifiCorp's understanding the deliberations of the WCI partners will only be open to Partners and officially sanctioned "Observers." There will be no participation from non-governmental entities such as industry, environmental groups, and etcetera. We believe the significant public policy issues associated with the development and implementation of regional market strategies to address climate changes are far-reaching and as such are too important to be conducted behind closed doors. It is important to the credibility of the effort that all interested stakeholders be involved in the development of strategies to meet regional greenhouse gas reduction goals.

GREATER EMPHASIS ON POLICIES PROMOTING TECHNOLOGY ADVANCEMENT ARE NECESSARY

At PacifiCorp, we believe it is possible to get to a low carbon future, but only with substantial and consistent investment in technology advancement, the right policy choices and a realistic timeline. This belief is based primarily on concepts developed by the Electric Power Research Institute ("EPRI") and described within their recently released

study “The Power to Reduce CO₂ Emissions: The Full Portfolio.”¹ EPRI describes a technology path for the electricity sector to return to 1990 emissions levels by 2030. Domestically, this will require the long-term commitment of billions of dollars in energy research, development and deployment in every aspect of electric generation, transmission and consumption. EPRI establishes specific technology deployment targets in seven areas: efficiency, renewables, nuclear generation, advanced coal generation, carbon capture and storage (CCS), plug-in hybrid electric vehicles (PHEV) and distributed energy resources. The most encouraging aspect of the study is that, as we move toward 2030, greenhouse gas (GHG) emissions levels can begin falling fairly dramatically and the potential of some of the more dire predictions of climate change can be minimized.

Concerning the questions about program design issues outlined in the Workplan, PacifiCorp views those as an appropriate initial set of issues for the WCI to consider as it works to design a regional market program. However, we are concerned that the Workplan does not envision the technical analysis and modeling needed to provide you, decision makers, with the information you will need to effectively answer those questions.

THE WCI WORKPLAN DOES NOT CONTEMPLATE MODELING TO INFORM ITS DESIGN DECISIONS

PacifiCorp observes that the Workplan questions, in particular as they apply to the electricity sector, have been or are being considered by other state and regional climate endeavors. Unlike the WCI, however, these other efforts sought expertise and resources to undertake modeling to examine the possible implications of different policy designs on regional electricity markets in order to achieve the best combination of cost, fairness, and enforceability.

For example, the Northeastern states, through the Regional Greenhouse Gas Initiative (RGGI), engaged in a two-year design process that included extensive stakeholder and expert input and detailed and comprehensive technical analyses by the states to develop a model rule that would underpin a regional cap-and-trade program.² Examples of the detailed analysis used by RGGI to arrive at its memorandum of understanding include energy and macroeconomic modeling and retail rate impact analysis. Much of this electricity sector modeling was performed by ICF Consulting using the Integrated Planning Model (IPM).

Another example is California, where the California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) are engaged in a joint effort to develop a model rule for regulating greenhouse gas emissions from the electricity and natural gas sectors. To inform their decision making, these two agencies have secured the services of

¹ See, <http://epri-reports.org/DiscussionPaper2007.pdf>

² See, <http://www.rggi.org/stakeholder.htm>

Energy and Environmental Economics, Incorporated (E3).³ The modeling expertise is meant to provide the CPUC and the CEC with critical information on how different methods of reducing GHG will achieve emission reduction goals for the sector and affect utility costs and consumers' electricity and natural gas bills. This information will be used by the CPUC and CEC to advise the California Air Resource Board (CARB) on setting and implementing GHG standards for the electricity and natural gas sectors. According to the Workplan, it appears that the WCI does not envision a similar level of effort with respect to performing the necessary technical analysis to inform the design of its multi-state market mechanism. PacifiCorp urges the WCI states undertake modeling and rely on its results to optimize any proposed market mechanism in order to achieve the best combination of cost, fairness, and enforceability.

SPECIFIC RESPONSES TO THE WORKPLAN'S "SECTION VI. DESIGN QUESTIONS"

PacifiCorp has reviewed the Workplan's initial design questions, but given the breadth of the subject matter and the very real challenge in responding to the questions without knowing the WCI preferred regulatory approach (i.e., source-based, load-based, first seller, and etcetera), PacifiCorp will simply articulate its initial position on a possible regional market mechanism designed for the electricity sector. PacifiCorp also assumes that the WCI process will produce a model rule, whereby individual states would be entitled to make key decisions based upon their individual circumstances. PacifiCorp also observes that the Workplan does not include a process to discuss other approaches besides cap-and-trade; like a carbon tax.

I. Type and Point of Regulation

Unlike many investor-owned utilities located within deregulated states, PacifiCorp remains a vertically-integrated utility owning approximately 80 percent of its generation portfolio, and utilizes the electricity generated from those facilities to meet its obligation to serve customers. Should the WCI decide the point of regulation should be the load-serving entity, the rate impact risks to PacifiCorp's customers may be disproportionately higher compared to the customers of utilities in deregulated states, which have already divested themselves of fossil generation. Those deregulated utilities have had, for several years, the ability to contract away any potential stranded cost risk, while also placing new construction risk squarely on independent generators competing for their business.

II. Should Emissions Allowances Be Auctioned or Allocated?

Assuming that a cap and trade program is adopted by the WCI as an appropriate market mechanism to reduce greenhouse gas emissions, PacifiCorp supports a free allocation of GHG emission allowances based upon historic emissions. The transition to a low-carbon economy is a significant undertaking and the costs of doing so are, likewise, significant. An allocation based on historic emissions allows for such a transition while, at the same

³ See, http://www.ethree.com/cpuc_ghg_model.html

time, managing the cost impacts on such a transition in electricity rates and avoiding disproportionate impacts on customers based on an existing generation portfolio. To the extent WCI states opt for the auction method, PacifiCorp encourages WCI states to adopt an approach that transitions from a free allocation of allowances, based upon historic emissions, to an auction in a manner that avoids rate shock. An example would be where the auction revenues are returned to the load serving entity to mitigate adverse rate impacts.

It is important to recognize that the decisions to build fossil fueled power plants, which were made over many decades and were intended to achieve a fuel mix, were economically rational and, in virtually all cases, approved as prudent by regulatory authorities. Load serving entities and their customers should not be punished for past prudent decisions. PacifiCorp also vigorously opposes providing GHG emission allowances to non-emitters based on “benchmarking” or megawatt-hour “output-based” methodologies which would simply create large wealth transfers among utilities that is unrelated, and potentially contrary to, the overall goal of GHG emissions reduction. It is unclear what public purpose would be served by distributing allowances to non-emitters. Utilities that built hydroelectric dams many decades ago or nuclear plants in the sixties and seventies did not do so to avoid GHG emissions and there is no reason to provide them with a financial windfall. These zero-emitting resources do not bear the burden or the direct costs of effectuating GHG emissions reductions.

III. How Should Allowances Be Distributed?

PacifiCorp supports dividing an annual GHG emission allowance budget into three separate distributions: 1) a new entrant set-aside; 2) free allocations to emitters; and 3) an auction. As PacifiCorp urged within its earlier remarks, the amount budgeted for each should be the subject of further modeling with a goal of achieving the best combination of cost, fairness, and enforceability. Again, PacifiCorp assumes that the WCI process will produce a model rule, whereby individual states would be entitled to make key decisions based upon their individual circumstances, but consistent with the design criteria articulated within a WCI model rule.

A. Free Allocation for New Entrant Set-Aside

PacifiCorp supports some nominal amount (< 3 percent) of the overall GHG emission allowance cap being set aside each year for new market entrants (with projects that will produce GHG emissions) prior to the distribution of the GHG emission allowances. PacifiCorp recommends that a load-based CO₂ cap-and-trade rule include a specific provision for new entrants, such as new self-generators who had not been previously served by a load serving entity, where the state would hold a “new entrant” GHG emission allowance set-aside each year. At the end of each year, the state would pro-rate any unused “new entrant” allowances to the various regulated entities. The WCI states would set the size of the allowance pool through rulemaking.

B. Free Allocation to Existing Emitters

PacifiCorp supports using 95 percent of the adjusted annual GHG emission allowance budget for free GHG emission allowance allocations to existing emitters (i.e., which would either be the generator under a source-based or deliverer/first seller approach or the load serving entity under a load-based approach). To establish each existing emitter's share of the emission allowances, a regional GHG baseline would need to be calculated using the most recent emissions data. A regional GHG baseline would be the sum of each state or province's GHG baseline.

PacifiCorp supports calculating a GHG baseline using multiple historical years.⁴ A baseline should rely on historical CO₂ emissions data from all existing emitters, using data from a five year period prior to the rule's effective start date. The state or province would drop data from the years with the highest and lowest emissions for each existing emitter. Average emissions for the three remaining years would form the basis for calculating the historic emissions for each existing emitter. The sum of all existing emitters' historic emissions would establish a state or province's GHG baseline. Each emitter's ratio to the GHG baseline would define its share of emission allowances (i.e., an emitter would multiply its ratio against each year's cap). Note, an existing emitter's ratio would not change, regardless of the decline in the overall cap or in the case of a gradual transition to an auction method for distributing allowances. This predictability is extremely valuable for new fossil-fueled resource development.

C. Auction Allocation

PacifiCorp has expressed support for some nominal level of auction (≤ 5 percent) regardless of the regulatory approach to ensure GHG emission allowance market liquidity and an opportunity for trading. PacifiCorp also supports each state or province conducting at least two auctions a year. To the extent auction proceeds are returned to the load serving entities to manage the rate impacts, the increased cost of the auction allocation method on customer rates could be partially mitigated. PacifiCorp supports auction proceeds returning to the electricity sector and their use toward achieving the overall goal of GHG emissions reductions. The amount to be auctioned each year should be the subject of further modeling with a goal of achieving the best combination of cost, fairness, and enforceability.

However, under any auction method, PacifiCorp is concerned about the creation of artificial scarcity. Where GHG emission allowances are auctioned, there is a risk of, and, indeed, an incentive for, non-generators bidding to acquire 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

⁴ When establishing a GHG baseline, evaluating a larger number of years allows the state to more equitably address year-over-year hydro production variability and accommodate unit-specific concerns, such as reduced emissions as a result of scheduled maintenance or unscheduled outages.

on to electricity consumers, market manipulation that drives up the cost of allowances, the supply of which will be limited, should be prevented.

Restricting auction participation is the most direct way to address this risk. Rules for bidders could include either currently being a first-seller of electricity (as being contemplated by California), having a pending application for a 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 or new entrant during the compliance period for which the allowances apply—coupled with administrative/criminal penalties if they are shown not to have pursued such plans in good faith during the compliance period.

IV. Other Market Mechanism Design Considerations

To the extent carbon offsets can be verified, the electricity sector should have the flexibility to pursue the lowest cost carbon reductions, even if they occur outside of the electricity sector. PacifiCorp also supports the unlimited use of verifiable carbon offsets. These carbon offsets would be surrendered for compliance purposes in addition to any greenhouse gas emission allowances.

As far as other flexibility and cost-containment mechanisms, PacifiCorp supports the use of an allowance safety-valve price. A safety valve price is a known price cap on allowances that would be adjusted annually for inflation. The purpose is to protect customers, individual states, and the regional economy from the risk of economic harm during the initial stage of the market mechanism by setting a reasonable limit on the price of allowances. The amount and its duration are key design criterion which should be informed by modeling.

PacifiCorp supports the WCI states adopting a GHG emission allowance banking provision, whereby a regulated entity could “bank” any surplus allowance for use within a future compliance period. However, to address artificial scarcity, auctioned allowances should have an identified expiration date, such as two years from the date of auction. Such a rule would ensure market liquidity.

PacifiCorp also supports additional GHG emission allowances be allocated for early action (i.e., “early action” GHG emission allowances). These allowances would be in addition to those issued in subsequent years as part of the cap. The purpose of this mechanism are to (1) fully reward and encourage all legitimate early actions to reduce GHG emissions, and (2) avoid penalizing regulated entities that are unable to qualify for early action allowances.

TRANSPORTATION IS POORLY REPRESENTED WITHIN THE WORKPLAN

The Workplan does not sufficiently address the transportation sector. Since the transportation sector is a significant contributor of GHG, adoption of the California Clean Car program is inadequate in addressing the sector. The transportation sector should

have its own subcommittee, like electricity, to address the complex issues facing that sector. Examples of additional measures that could be promulgated include ones modeled after rules adopted by the South Coast Air Quality Management District⁵ which in addressing emissions of nitrogen oxide and diesel particulates. The District has promulgated various fleet procurement rules⁶ for light- and medium-duty public fleet vehicles, transit buses, trash trucks, commercial airport vehicles, school buses, and heavy-duty public fleet vehicles, as well as various other mobile source emission offset programs targeting private fleet operations.⁷ There are also numerous examples of state programs focused on state-, municipally- or privately owned and operated fleets.⁸

The Workplan also does not acknowledge the potential impact of GHG emissions transfers from one sector to another. Possible revisions to the California Clean Car program that could facilitate manufacturer introduction and the broad use of plug-in hybrid electric vehicles⁹ would be a net reduction of transportation-related GHGs, but would put additional pressure on the electric sector serving this new load. California's newly proposed mandatory GHG reporting rule acknowledges this potential issue and will allow utilities to separately report emissions associated with serving load creating by transportation-related electrification.¹⁰

CONCLUSION

Finally, PacifiCorp respectfully requests that the WCI states carefully consider the impact of its GHG rules on PacifiCorp and other vertically integrated, multi-jurisdictional utilities. The combination of utility-owned generating resources and resources providing contracted for power located throughout the western United States, coupled with load-serving responsibilities and multi-state cost structures, places multi-jurisdictional utilities in the complicated position of having to equitably assign the costs of system energy, including emissions/allowances, to each state's retail load, which may include western states that are not members of the WCI.

⁵ The South Coast Air Quality Management District is a California regulatory agency responsible for emissions occurring within portions of Los Angeles, San Bernardino, and Riverside counties and all of Orange County (see <http://www.aqmd.gov>)

⁶ See, Regulation 11, Rules 1191, 1192, 1193, 1194, 1195, and 1196. (available at: http://www.aqmd.gov/rules/reg/reg11_tofc.html)

⁷ See, Regulation 16, and the various rules (available at: http://www.aqmd.gov/rules/reg/reg16_tofc.html)

⁸ See, interactive map of state incentives (available at: http://www.eere.energy.gov/afdc/incentives_laws.html)

⁹ See, California Air Resources Board website (available at: <http://www.arb.ca.gov/msprog/zevprog/zevreview/zevreview.htm>)

¹⁰ See, page 39 of the California Air Resources Board "Proposed Regulation for Mandatory Reporting of Greenhouse Gas Emissions Pursuant to the California Global Warming Solutions Act of 2006 (Assembly Bill 32)" (available at: <http://www.arb.ca.gov/regact/2007/ghg2007/isor.pdf>)

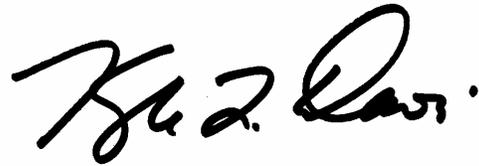
PacifiCorp looks forward to participating as a stakeholder in the WCI and hopes the process will become more transparent. WCI has the promise of developing a western perspective on how best to address greenhouse gas emissions reductions within our region. Modeling should be used by the WCI states to inform the design of the market mechanism with the goal of achieving the best combination of cost, fairness, and enforceability. While a national climate program would be the most effective and efficient path to address greenhouse gas emissions, the regional approach is certainly preferred over a state-by-state patchwork approach. The inter-connected nature of the western electricity grid is such that what happens in one western state directly affects electricity consumers elsewhere throughout the region. Finally, the WCI should establish a subcommittee dedicated to evaluating opportunities to achieve additional emissions reductions from the transportation sector.

Thank you for your consideration of these comments.

Dated: November 30, 2007

Respectfully submitted,

By

A handwritten signature in black ink, appearing to read "Kyle L. Davis". The signature is fluid and cursive, with a period at the end.

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