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IOWA UTILITIES BOARD

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October 19, 2009

Ms. Judi Cooper
Executive Secretary
Iowa Utilities Board
350 Maple Street
Des Moines, IA 50319-0069

RE: Interstate Power and Light Company
The American Clean Energy and Security Act of 2009
Docket No. NOI-2009-0002
Additional Comments

Dear Secretary Cooper:

Enclosed please find Interstate Power and Light Company's Additional Comments in the above-referenced docket, as filed today on EFS.

Very truly yours,

/s/ Kent M. Ragsdale
Kent M. Ragsdale
Managing Attorney - Regulatory

KMR/kjf
Enclosure

STATE OF IOWA

BEFORE THE IOWA UTILITIES BOARD

IN RE: **THE AMERICAN CLEAN ENERGY AND SECURITY ACT OF 2009**	**DOCKET NO. NOI-2009-0002**

ADDITIONAL COMMENTS

COMES NOW, Interstate Power and Light Company (IPL) and responds to the Iowa Utilities Board's (Board) "Order Setting Post-Workshop Comment Schedule" (Order) issued on September 24, 2009. The Board has requested any additional comments regarding the American Clean Energy and Security Act of 2009 (ACES) may do so. In compliance with the Board's Order, IPL provides the following comments in the following areas:

<u>Impacts to customer bills from other requirements in ACES - increased energy efficiency, any new Renewable Portfolio Standard (RPS) and new transmission to support an RPS</u>

The estimated impacts to IPL retail customers from other requirements in ACES, such as increased energy efficiency, any new RPS and new transmission to support an RPS are provided in Figure 1 below.

Figure 1

Estimated Percentage Increases of Average IPL Monthly Bill by Customer Class with Additional Renewable, Energy Efficiency, and Transmission			
Customer Class	**2013 % Increase**	**2025 % Increase**	**2030 % Increase**
Residential	8%-10%	15%-20%	25%-30%
Commercial	10%-15%	20%-25%	35%-40%
Industrial	15%-20%	35%-40%	55%-60%

<u>Tax implications of allowance transactions</u>

H.R. 2454 and the recently introduced Senate bill (S. 1733) do not make any determinations about how emission allowances will be taxed under a cap-and-trade program. This issue will likely be determined by House and Senate conferees should a bill be sent to conference, or by a future Treasury rulemaking. Under the rules developed by the Internal Revenue Service in the 1990's for NOx and SOx, allowances were taxed when they were sold or transferred. They were not taxed at the time of receipt.

On June 16, 2009, the Senate Finance Committee held a hearing entitled, "Climate Change Legislation: Tax Considerations," to examine this issue in more detail. As a part of that hearing, the Joint Committee on Taxation provided a background report that may be of interest to the Board. That report can be found at: http://www.jct.gov/publications.html?func=startdown&id=3559

A fact sheet prepared by the Edison Electric Institute that provides a quick summary of the tax treatment of allowances is provided as Attachment A.

Studies on Impacts to Low-Income Customers from ACES

IPL has not conducted any studies on impacts to low-income customers from a cap-and-trade system. A study has been conducted by the Congressional Budget Office (CBO).

On June 19, 2009, at the request of Congressman Dave Camp (R-MI), the Congressional Budget Office (CBO) provided an economic analysis of H.R. 2454. This is the most commonly-cited study that examined the bill's impact on low-income customers from a cap-and-trade program.

The CBO analysis concluded that by the year 2020, the cap and trade provision within the bill would cost the average household approximately $175 annually. As mentioned in our previous testimony, CBO's $175 estimate may need to be recalculated due to a couple of factors that were not a part of their analysis.

Below are four points/questions that IPL believes needed to be addressed in order to have proper estimates on the potential economic impacts to low-income households and all Iowa households.

1) The CBO Report did not analyze the bill that passed the House of Representatives.

- The committee-approved version of H.R. 2454 included both an energy refund program and an energy tax credit for lower income households.
- The committee-approved version of the bill used Census data and set the eligibility for the energy refund program at 150% of the poverty line. For a

typical family of four, this threshold is $33,000 per year (adjusted gross income).

- The energy tax credit that was in the committee-approved version would have covered families in the second quintile (incomes from $27,001-$47,000 per year) and could have covered a small portion of families in the lower part of the middle quintile (incomes from $47,001-$71,200).
- The House approved version of H.R. 2454 did not include the energy tax credit. It was removed from the bill and in its place the House included an additional energy refund program for those in the lowest quintile which was an expansion of the earned income tax credit to include individuals with no qualifying children. With the inclusion of this provision, those individuals that fall into this category may also have the ability to qualify for the original energy refund as well, creating a potential double-dipping.
- With the removal of the tax credit that was contained in the committee approved version, some of the families in the second quintile and all of those that fall into the middle quintile or "middle class taxpayers" would see an increase in costs above the $175 the CBO calculated in its analysis.

The CBO should examine the current House passed legislation and re-calculate the economic impacts to average households.

2) <u>Average Households versus Regional Households:</u>

- The CBO report concluded that average U.S. households in 2020 would face a cost of only $175 annually. The CBO, however, used *national* averages, but did not breakdown the potential economic impacts on a regional basis.
- It is a wide known fact that many states in the Midwest are greatly dependent on coal for the generation of electricity. As mentioned in IPL's previous comments, under the allowance distribution formula contained in H.R. 2454, many Midwest local distribution companies (LDC's) that depend on coal for generation will not receive enough allowances to cover their emissions.
- These LDC's will be forced to purchase additional allowances or offsets in order to cover the short fall, further increasing the impact to their residential, commercial and industrial customers.
- In the report, CBO even stated that "Some regions and industries would experience substantially higher rates of unemployment and job turnover as the program became more stringent."

The U.S. Census Bureau in its annual Income, Poverty and Health Insurance in the United States report, shows regional income and expenditures. IPL is concerned why the CBO analysis did not show this as well.

3) <u>Economic Data used is not reflective of current economic conditions:</u>

- When providing household income analysis for the distribution of costs and benefits of the cap and trade program, CBO based its estimates on data from the 2006 distribution of income and expenditures.
- According to the Department of Labor's Bureau of Labor Statistics (BLS), the average National unemployment rate in 2006 was 4.6% with the subsequent unemployment averages at 4.6% in 2007 and 5.8% in 2008. BLS in its most recent jobs report on July 2, 2009 showed a National unemployment rate of <u>9.5%</u>.

The CBO report does not take into consideration the current recession which could greatly alter the costs to households and the federal government.

4) <u>CBO looked only at a 10-year window, not at the full phase-in of the cap and trade bill, when large price spikes may occur.</u>

- The CBO, in providing analysis to Congress on the costs associated with the legislation, provided only a 10-year economic snap shot of the affects of H.R. 2454.
- With a very quick phase out of the allocation program occurring after 2020, many utilities - especially in the Midwest - are expecting a substantial rise in the electricity costs to customers.

In order to fully understand the costs to all households under H.R. 2454, CBO should look further than a 10-year budgetary window.

Additional Information Regarding Domestic Offsets

IPL has begun outreach activities with interested parties in Iowa to investigate the potential to partner and support the investment in domestic offsets as the first choice before considering international offsets. IPL supports the inclusion of offsets for best management practices incorporated by our customers in the agricultural and forestry industries. In addition, IPL supports the ability to earn offsets for diverting biomass from landfills. Offsets earned by these industries are necessary to subsidize the cost of converting the biomass to a fuel utilizable by our power plants.

Additional Comments

Wisconsin Senator Russ Feingold recently requested the US Environmental Protection Agency (EPA) provide an analysis of how many allowances individual states may receive under various formulas, including: the 50/50 formula, 100% emissions, and 100% load. Attachment B is the document the EPA provided Sen. Feingold that breaks down the state-by-state impact. It is worth noting the EPA also agreed with IPL's comments in the NOI that the excess allowance provision would not be effective in preventing some states and utilities from receiving more allowances they do not need to comply with the program.

WHEREFORE, Interstate Power and Light Company respectfully requests that the Board give due consideration to IPL's additional comments. Representatives of IPL are available to meet with the Board or the Board's Staff to answer questions or to provide additional information as needed.

Dated this 19th day of October, 2009.

Respectfully submitted,

INTERSTATE POWER AND LIGHT COMPANY

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EDISON ELECTRIC INSTITUTE

Tax Treatment of Emissions Allowances

H.R. 2454, the "American Clean Energy and Security Act of 2009", would limit or cap the quantity of certain greenhouse gases (GHGs) emitted from facilities that generate electricity and from other industrial activities over the 2012-2050 period. The Environmental Protection Agency (EPA) would establish two separate regulatory initiatives known as cap-and-trade programs—one covering emissions of most types of GHGs and one covering hydrofluorocarbons. EPA would issue allowances to emit those gases under the cap-and-trade programs. Some of those allowances would be auctioned by the federal government, and the remainder would be distributed at no charge. Present law concerning the tax treatment of emissions allowances should apply to emissions allowances authorized under H.R. 2454 as well.

Under present law, allocated emission allowances are excluded from income of the taxpayer. Accordingly, a taxpayer does not have a basis in allocated emission allowances. A taxpayer who purchases emission allowances does have a basis equal to their cost, assuming the taxpayer pays no transaction costs for the allocated emission allowances or, alternatively, that such costs are currently deductible. Upon surrender of allocated allowances, a taxpayer may not claim a deduction. If a taxpayer sells all or some portion of the allocated allowances, that taxpayer recognizes gain equal to the difference between its basis (zero, in the case of an allocated allowance) and the proceeds received.

Present law concerning the tax treatment of emissions allowances has developed in the context of the Clean Air Act of 1990, which generally prohibits sulfur dioxide emissions without an allowance to do so. Emissions allowances under the Clean Air Act are allocated by the EPA. Furthermore, section 403(b) of the Act, 42 U.S.C. §7651b(b), authorizes parties to acquire, hold, and transfer emission allocations. Allowances may be applied against sulfur dioxide emissions occurring in the year to which they have been allocated by the EPA, or held for and applied against sulfur dioxide emissions occurring in a future year. Allowances may not be applied against sulfur dioxide emissions occurring in a year before the year to which an allowance was allocated.

The Internal Revenue Service (IRS) has provided guidance regarding the tax consequences of the implementation of the Clean Air Act in Rev. Rul. 92-16, *Internal Revenue Bulletin*, No. 1992-12, March 23, 1992, p.6; Rev. Proc. 92-91, *Internal Revenue Bulletin*, No. 1992-46, November 16, 1992, p. 32-33; and Announcement 92-50, *Internal Revenue Bulletin*, No. 1992-13, March 30, 1992, p. 32.

The IRS guidance provides that receipt of allowances by a utility under the EPA allocation process is not regarded as receipt of taxable income. Generally, emission allowances will be treated as capital assets of utilities. The costs of acquiring and holding the allowances, including any amount paid to purchase them or legal or accounting fees, must be capitalized. The costs cannot be depreciated or otherwise deducted prior to the time the allowances are used. The costs constitute the utility's tax basis in the allowances. Generally, a utility will be allowed to deduct the basis of allowances used to offset emissions during a year. If allowances are sold or exchanged, the proceeds minus the basis of the allowances will be treated as a capital gain or loss. Capital losses by corporate taxpayers are allowed in any tax year only to the extent of capital gains in that year. Capital losses which exceed capital gains generally may be carried back to each of the three years preceding the loss year, and carried forward to each of the five taxable years succeeding the loss year. (section 1212(a)(1)(B)).

In the case of a utility receiving an allowance from the EPA and using it to offset emissions during a year, the allowance will have no effect on the utility's tax status when it is received. Correspondingly, it will have zero basis: when it is used it will not result in a deduction. If a utility sells an allowance received from the EPA, the proceeds will be taxable, and, because the basis of the allowance will be zero, there will be no deduction to offset the income. For utilities which limit emissions below their allowances and thus generate extra allowances for sale, the tax treatment of those allowances will be the same as allowances allocated by the EPA. The cost of pollution control equipment, for example, will not be factored into the basis of the allowances. Such costs will be capitalized and depreciated. Further, the proceeds of the sale of the allowances will be fully taxable.

Updated: September 2009

EPA was asked to provide technical assistance on the following questions. EPA's responses are provided below the questions.

Do you have any analysis of the effects of distributing allowances to utilities based on W-M formula vs. based 100% on emissions vs. 100% load (any regional/state break-down; any calculations of %age of emissions covered)? I understand EEI might have some of this too. I believe this is what my boss discussed with the Administrator, and is the issue my boss is hearing a lot about from the state. And what is the Agency's read on often over-looked insertion before House floor vote that appears to prevent a utility from receiving more allowances than its emissions? Does EPA agree that this language trumps the formula and would in fact prevent windfalls for major energy producers of low-carbon emitting sources (e.g., nuclear)? There seems to be a split interpretation of this restriction.

EPA RESPONSES:

Allocation Estimates

Estimates for state allocations are included in Table 1. Note that these are rough estimations based on the best currently available data, described in more detail below. Actual allocations will be different, since the owner or operator of each LDC has the ability to define their baseline as a period of any 3 consecutive years from 1999-2008. Furthermore, this analysis does not consider the impact of new coal generation built prior to 2013.

Only 2012 allocations are presented, as the following years will change proportionately (absent updating based on number of customers). In 2012, LDC allocations are equal to 43.75% of the total allowance pool after 1% of allowances are withheld for strategic reserve auctions. We assume the maximum allocation to merchant coal generators (10% of LDC allocations, phasing out over time), and withhold that value from these estimates.

Delivery estimates are based on sales reported in EIA 861, taking the average of 2006 and 2007 total retail sales by distribution company.

Emissions were estimated using the average of 2006 and 2007 EIA 861 retail sales by delivery state and applying EPA eGRID regional emission factors. These emission values are rough estimates, since the emission factors are based on large geographic regions (see figure 1), and were calculated using available 2005 emission and generation data.

Prohibition against excess distributions in Sec. 783(b)(4)

The language prohibiting distribution of more allowances than "necessary to offset any increased electricity costs to [the electric distribution company's] retail ratepayers, including increased costs attributable to purchased power costs, due to enactment of this title" does take precedence over, and sets a limitation on each electric distribution company's [LDC's] annual distribution of allowances under, the language establishing an allowance distribution methodology based on LDC emissions and deliveries. This is because the prohibition language states that the prohibition applies "notwithstanding" the distribution methodology language.

However, the prohibition provision would be very difficult to implement because it would require a great deal of speculation. First, the Administrator would need to determine (either through projection before the year for which allowances are distributed or through actual data after the year for which allowances are distributed) the total cost of the electricity distributed to its customers each year starting with 2012. Second, the Administrator would need to estimate (again either up front or after the year of the allowance distribution) what each LDC's total cost of electricity would be each year <u>in the absence</u> of the ACES GHG cap and trade program. Total electricity costs would depend on a number of factors that would have to be projected, including the sources and amounts of purchased power, the mix of generation of purchased and LDC generated power, fuel costs, technology advancements (e.g., in generation), transmission constraints, and electricity demand. Any attempt to remove the impact of the cap and trade program on these factors and thus on total electricity costs would be speculative at best. The Administrator might also have to consider the ability of each LDC to pass through these costs to its customers. The difference between these two total cost figures for a given year, divided by the market value of an allowance for that year, would be the limitation on the amount of allowances that an LDC could be distributed for that year. The limitation could be implemented by limiting up front the distribution or by requiring the LDC to return later to the Administrator any amount of allowances in excess of the limitation. The excess allowances would be redistributed to other LDCs, but an iterative process would be required to ensure that the redistribution of excess allowances would not increase any LDC's total allowance distribution above that LDC's limitation. EPA notes that the prohibition provision could reward higher costs to LDC retail ratepayers in that the higher the level of an LDC's costs, the higher the limitation on the LDC's allowance distribution.

Table 1. Allocation Estimates by Delivery State

		2012 Allocation (Million Tons)					2012 Allocation (Million Tons)		
Delivery State	Annual Emissions Estimate (Million Tons)*	HR 2454 Formula (50/50 Emission /Load)	100% Emissions-Based	100% Load-Based	Delivery State	Annual Emissions Estimate (Million Tons)*	HR 2454 Formula (50/50 Emission /Load)	100% Emissions-Based	100% Load-Based
AK	3	3	3	3	MT	6	6	5	7
AL	62	47	50	44	NC	67	58	54	62
AR	26	22	21	23	ND	10	7	8	6
AS	0	0	0	0	NE	23	16	19	13
AZ	45	36	36	36	NH	5	5	4	5
CA	87	99	70	127	NJ	41	36	33	39
CO	43	30	35	24	NM	14	11	11	11
CT	14	14	11	16	NV	19	16	15	17
DC	6	5	5	6	NY	57	58	46	69
DE	6	5	5	6	OH	110	82	89	76
FL	138	111	112	111	OK	41	30	33	27
GA	92	70	74	66	OR	20	20	16	23
GU	1	1	1	1	PA	84	70	68	72
HI	8	6	7	5	PR	14	11	11	10
IA	36	25	29	21	RI	3	3	3	4
ID	10	9	8	11	SC	42	37	34	39
IL	107	78	87	70	SD	9	6	7	5
IN	75	56	61	52	TN	72	54	58	51
KS	35	24	29	19	TX	205	165	166	164
KY	62	47	50	44	UT	11	11	9	13
LA	42	36	34	38	VA	61	51	49	53
MA	24	23	19	27	VI	1	0	0	0
MD	35	29	28	31	VT	2	2	2	3
ME	5	5	4	6	WA	35	35	28	41
MI	77	57	62	52	WI	55	39	44	34
MN	56	39	45	33	WV	23	17	19	16
MO	70	49	57	40	WY	8	7	7	7
MS	29	23	24	23	Total	2,234	1,802	1,802	1,802

* Estimate calculated using 2006-2007 retail sales and eGRID emission factors

Figure 1. eGRID Emission Factor Regions