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VIA ELECTRONIC MAIL

October 18, 2011

Clerk of the Board
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: PE-Berkeley, Inc.'s Comments to ARB's Proposed Cap-and-Trade Regulation

Dear Executive Officer Goldstene:

These comments are offered to the California Air Resources Board ("ARB") on behalf of PE-Berkeley, Inc ("PEB"), a 22.47 MW cogeneration power plant located in Berkeley, California, and Olympus Power, LLC, an independent power company which is both an equity investor in, and the Asset Manager of, this facility. PEB supplies thermal energy to the University of California-Berkeley ("UC-B") and electric power to Pacific Gas & Electric (PG&E) under long-term but separate agreements. Compared to other typical cogeneration (i.e., combined heat and power or "CHP") facilities, a relatively larger percentage of the energy generated at PEB is in the form of steam compared to electricity.

For the reasons described below, PEB strongly believes that ARB should provide—as part of this rulemaking—the necessary and appropriate relief to PEB and other similarly situated CHP facilities, that are contractually barred from recovering the cost of allowances

under ARB's proposed Cap-and-Trade Regulation (CTR).[1] We believe such relief is especially warranted in circumstances in which facilities entered into such contracts well in advance of California's adoption of AB 32.[2]

PEB's Proposed Modifications to Cap-and-Trade Regulation or Board Resolution

As you know, PEB and other cogeneration providers have worked diligently with ARB throughout this rulemaking to highlight the concerns of "stranded" cogeneration facilities that cannot recover the costs of CTR allowances under the terms of long-term contracts that lack an effective pass-through mechanism. The contractual bar which prohibits PEB and other similarly situated facilities from recovering (or passing through to the end user) the cost of these allowances has created a uniquely inequitable situation. As noted above, PEB provides a larger percentage of its generated energy in the form of steam relative to other cogeneration facilities. In fact, at PEB, thermal energy delivered to UC-B has a priority of dispatch over the generation of electricity. Given PEB's unique attributes in this regard, attempts by ARB to work with the California Public Utility Commission (PUC) to increase electric sector allowances to include emissions attributable to electricity production at CHP facilities would not alone address PEB's circumstance (assuming such measures are effective). To avoid unfairly imposing these costs, ARB should provide PEB (and other similarly situated facilities) with the necessary and appropriate relief that adequately compensates for the CTR allowance burdens imposed upon both the electric and thermal requirements of such facilities. To this end, PEB recommends that:

[1] PEB incorporates by reference its prior comments to ARB's proposed Cap-and-Trade Regulation dated August 11, 2011 and September 27, 2011.

[2] PEB's steam and electricity supply agreements were finalized and executed by the parties in 1987.

1. The Board revise the CTR as shown in Attachment 1 to provide such equitable relief (or its equivalent) to similar cogeneration facilities stranded with these types of long-term contracts; or

2. In the alternative, if the Board does not revise the CTR as provided in Attachment 1, the Board should include the language provided in Attachment 2 (or its equivalent) as part of its resolution adopting the CTR.

Administrative Record Substantially Supports PEB's Request for Relief

There is substantial support in the administrative record for ARB to provide relief to PEB and similar cogeneration facilities stranded with Legacy Contracts.[4] Throughout this rulemaking, ARB staff has been advised of—and to a certain extent has recognized—this important issue, but has chosen not to provide the appropriate remedy to such CHP facilities. Significantly,

- ARB's Initial Statement of Reasons (ISOR) for the CTR recognizes that "Some generators have reported that **some existing contracts do not include provisions that would allow full pass-through of cap-and-trade costs**. These contracts pre-date the mid-2000's and many may be addressed through the recently announced combined heat and power settlement at the California Public Utilities Commission. **Staff is evaluating this issue to determine whether some specific contracts may require special treatment on a case-by-case basis**."[5] However, the settlement described in the ISOR addresses only the electricity—not the steam—portion of a CHP facility such as PEB and is also term-limited such that it may not extend through the full life of certain project agreements.

- The Board appears to have attempted to address this concern through language in ARB Resolution 10-42: "BE IT FURTHER RESOLVED that the Board directs the Executive

[4] Contracts entered into prior to the final approval of AB 32 (i.e., September 27, 2006) are referred to as "Legacy Contracts."

[5] Staff Report: Initial Statement of Reasons: Proposed Regulation to Implement the California Cap-and-Trade Program, page II-32, n. 22 (October 28, 2010) (emphasis added). This statement is also repeated in Appendix J to the ISOR. ISOR, Appendix J, p. J-16, n.15.

Officer to review the treatment of combined heat and power facilities in the cap-and-trade program **to ensure that appropriate incentives are being provided for increased use of efficient combined heat and power**."[6]

- In Attachment B to Resolution 10-42, ARB staff committed to "work with interested stakeholders **to ensure proper treatment under the regulation of** . . . **combined heat and power facilities with pre-AB 32 long-term contracts that do not allow for pass-through of costs associated with greenhouse gas emissions**."[7]

- In the revised CTR released on July 25, 2011, ARB took an initial step toward addressing this issue by increasing the allocation of allowances to the electric sector from 89 million metric tons to 97.7 million metric tons in order to increase electric sector allocations to include emissions attributable to combined heat and power electric production. However, increasing the allowances available *for the IOUs* to provide at auction does not incentivize the IOUs to negotiate PPA modifications to provide cost recovery for the qualifying facilities in recognition of their new GHG compliance burden.[8] Similarly, in most cases, this step does nothing to resolve the problem caused by the requirement to purchase allowances in connection with the thermal energy portion of such a project.

- Further, Section 38562 of the Health and Safety Code requires ARB, to the extent feasible and in furtherance of achieving the statewide greenhouse gas (GHG) emissions limit, to design the regulations, including distribution of emissions allowances where appropriate, **in a manner that is equitable, and seeks to minimize costs and maximize total benefits to California**.

Other commenters have submitted written comments indicating that the bilateral negotiations were not successful and expressed skepticism whether they would be successful in the future, without a backstop regulatory provision from ARB.[9] Despite its apparent understanding of this issue and these extensive public comments, the CTR makes no

[6] ARB Resolution 10-42, p. 11 (emphasis added).
[7] Id., Attachment B, p. 8 (emphasis added).
[8] ACE Cogeneration comment letter to ARB, p. 4 (August 11, 2011).
[9] See Calpine comment letter to ARB, p. 9 (September 27, 2011); Panoche Energy comment letter to ARB, p. 1 (September 23, 2011); CCC comment Letter to ARB, p. 8 (August 11, 2011); Wellhead Electric comment letter to ARB, p. 2 (September 23, 2011).

allocation of allowances to CHP facilities subject to Legacy Contracts that do not allow for recovery of the costs associated with a mandated purchase of allowances.[10] Indeed,

- The CTR fails to provide transitional assistance to such generators until such time as their existing Legacy Contracts expire or are substantively amended.[11]

- Almost a year ago in December 2010, several commenters, including the California Cogeneration Council ("CCC"), submitted written comments asking ARB to resolve this issue prior to the adoption of the CTR.[12]

- Throughout this rulemaking, ARB staff has neglected to propose any regulatory provisions that would alleviate the extreme economic burden imposed upon CHP facilities that cannot recover allowance costs from their customers. Rather, without any apparent recognition that certain contracts may not provide for the necessary modification, ARB staff simply noted in its Notice of the First 15-Day Amendments that this problem should be resolved through bilateral contract negotiations.[13]

Conclusion

Because these material negative impacts to CHP facilities are extensively described in the administrative record for this rulemaking (and ARB staff's apparent recognition of this issue), PEB remained confident that ARB staff would provide the necessary and appropriate relief. This seemed especially reasonable given that PEB represents clean, efficient and reliable power generation technology promoted by California as well as federal law and policy. As described in its prior comment letters, PEB operates pursuant to energy supply agreements that were executed in 1987**—almost 20 years prior to California's adoption of AB 32—**and could not possibly have contemplated the application or recovery of any form of greenhouse gas tax or similar regulatory program.

[10] Calpine comment letter to ARB, p. 3 (December 9, 2010).
[11] Id.
[12] CCC comment letter to ARB, p. 2 (December 9, 2010).
[13] Notice of Public Availability of Modified Text and Availability of Additional Documents (July 25, 2011).

PEB's existing contract to supply steam to UC-B does not provide for recovery (or allow for the necessary modifications to address) of the costs to comply with the CTR. In addition, there are no change-in-law or tax and regulatory cost recovery provisions that will provide PEB with the leverage necessary to allow for renegotiation of its agreement with UC-B. PEB will soon be forced to bear an unrecoverable economic cost that risks a potential shut down of the facility—a result that is clearly at odds with the goals of the CTR.

In an attempt to provide constructive comment, we have read with interest proposals from a variety of interest groups and believe the proposal from Wellhead Electric (modified in Attachment 1 to reflect the needs of a thermal energy Legacy Contract) may achieve the appropriate level of relief. In the alternative, if the Board adopts the CTR without including such modifications (or its equivalent) to the CTR, we have provided in Attachment 2 a proposed Board Resolution utilizing, in part, language from the comment letters from other CHP facilities.

We appreciate your time and consideration with respect to this important issue.

Respectfully submitted,

Michael Mazowita
Vice President
P.E. Berkeley, Inc.

Sean P. Lane
General Counsel and Secretary
Olympus Power, LLC

cc:
Michael R. Barr, Esq., Project Counsel & Environmental Counsel to P.E. Berkeley, Inc.
Peter H. Weiner, Esq., Environmental Counsel to Olympus Power, LLC

PEB Comment Letter
Attachment 1

PEB recommends that ARB amend the CTR to provide transition relief for GHG emissions attributable to the generation of electricity and/or thermal energy by cogeneration facilities with long-term contracts that do not directly or indirectly provide for or refer to recovery of GHG emissions-related costs, were fully executed before approval of AB 32 (September 27, 2006) or such earlier time, as the Executive Officer deems equitable and proper, and have not been renegotiated by the long-term contract parties to address such costs.

Proposed Amendments to §95834[14]

Add a ~~new~~ subparagraphs (~~[4]~~ 5) to section 95834(a) of the proposed regulations to read as follows:

§95834 Disclosure of Beneficial Holding Relationships

(a) There are two types of participants in a beneficial holding relationship, an agent and a principal:

(~~[4]~~ 5) In the event that there is a long-term contract for the sale of electricity at wholesale to an electrical distribution utility ~~which~~ and the long-term contract:

A) does not directly or indirectly provide for or refer to GHG costs either explicitly or through a CPUC authorized pricing basis that includes GHG costs;

B) was fully executed before the final approval of AB 32 (September 27, 2006), or such earlier time as the Executive Officer deems equitable and proper; and

C) has not been renegotiated by the long-term contract parties and approved by the appropriate regulatory authority as of January l, 2012 to address GHG costs,

then, a beneficial holding relationship is deemed to exist pursuant to section 95834~~(a)(l) (A)~~ without further action. Until such time as the long-term contract for the sale of electricity at wholesale to an electrical distribution utility has expired under its then existing terms,~~T~~the electric distribution utility party to that long-term contract shall, as agent, purchase and hold allowances for the eventual transfer to the other party to the long-term contract (the principal) for the sole purpose of supplying ~~that other party~~ the principal with compliance instruments to cover emissions resulting from deliveries under the long-term ~~power supply~~ contract.

[14] The proposed language from **Wellhead Electric** (in blue) has been modified by **PEB** (in red) to clarify and address the needs of a thermal generation Legacy Contract and also to address the possibility of transition issues related to electricity sales contracts with electric distribution utilities.

Proposed Amendments to §95870

Add a new subsection (f) as follows:

§95870 Disposition of Allowances

(f) Transition Allowances for Cogeneration Facilities with Long-Term Contracts for the Sale of Thermal Energy: Allowances available for allocation to cogeneration facilities with long-term contracts that do not directly or indirectly provide for or refer to GHG costs, were fully executed before approval of AB 32 (September 28, 2006) or such earlier time as the Executive Officer deems equitable and proper, and have not been renegotiated by the long-term contract parties to address GHG costs, shall be equivalent to the annual reported greenhouse gas emissions attributable to the production of thermal energy. The Executive Officer will transfer these transition allowances to a "Thermal Energy Holding Account".

Proposed Amendments to §95890

Add a new subsection (c) as follows:

§95890 General Provisions for Direct Allocations

(c) Eligibility Requirements for Cogeneration Facilities with Long-Term Contracts for the Sale of Thermal Energy. Cogeneration facilities with long-term contracts that do not directly or indirectly provide for or refer to GHG costs, were fully executed before approval of AB 32 (September 28, 2006) or such earlier time as the Executive Officer deems equitable and proper, and have not been renegotiated by the long-term contract parties to address GHG costs, shall be eligible for direct allocation of California GHG allowances if they have complied with the requirements of MRR and have obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to MRR.

(1) The Executive Officer shall transfer allowances from the Thermal Energy Holding Account to the cogeneration facility that satisfies the requirements of §95890(c)

PEB Comment Letter

Attachment 2

If ARB adopts the final regulation order as proposed and does not incorporate PEB's proposed amendments provided in Attachment 1, PEB requests that ARB include the proposed Resolution language provided below at its October 20, 2011 hearing.

Proposed Resolution Language

> **WHEREAS** the Executive Officer recognizes the importance of providing appropriate incentives for increased use of efficient combined heat and power, recognizes that the proposed Cap-and-Trade Regulation makes no allocation for generators subject to long-term contracts that do not allow for recovery of the costs associated with purchasing allowances, and recognizes that the proposed Cap-and-Trade Regulation provides no allocations to such generators so as to avoid or otherwise mitigate the adverse financial impact of the mandatory purchase of such allowances until such time as their existing contracts expire or are substantively amended.
>
> **BE IT FURTHER RESOLVED** that the Executive Officer, after consultation with generators subject to long-term contracts that do not allow for recovery of the costs associated with purchasing allowances, shall adopt amendments to the Regulation by February 1, 2012 that provide free allowances to contract generators with long-term contracts where costs cannot be recovered due to a contract that (1) was executed before the passage of AB 32, or such earlier time as the Executive Officer deems equitable and proper, and (2) has, by its terms, no ability to permit the generator to recover such GHG allowance costs. In instances where the generator does not receive free allocations, the Executive Officer shall adopt amendments to cause the compliance obligation to reside with the end user.