WASTE MANAGEMENT

Public Affairs
915 L Street, Suite 1430
Sacramento, CA 95814
916/552-5859
916/448-2470Fax

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California Air Resources Board
1001 "I" Street
Sacramento, California 95814

Via Email: http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=may1-unilegbutfor-ws&comm_period=1

Subject: Comments of Waste Management on 2013 Proposed Regulation Amendments to Cap & Trade Regulations as pertains to Legacy Contracts

Introduction

On behalf of Waste Management (WM) and its subsidiary Wheelabrator Technologies, I am pleased to offer our comments on the Workshop convened on May 1, 2013, to consider Board Resolution 12-33. In this resolution, the California Air Resources Board (the ARB) directed staff, among other things, to develop methodologies that provide transition assistance to entities subject to the Cap & Trade Regulation (the "C&T" or the "Regulation") that have a compliance obligation cost that cannot be reasonably recovered due to a legacy contract.

It was our hope that, through this rulemaking process, essential relief would be provided to all facilities with contracts entered into long before the C&T implementation – particularly those that have no contractual means to recover the cost of compliance with the Regulation. Decisions made to resolve this issue of cost recovery have a direct and significant impact on Wheelabrator's Norwalk Energy (Norwalk) power plant and its ability to remain a viable source of Combined Heat and Power (CHP) to its customers, the State of California and Southern California Edison (SCE).

Unfortunately, the ARB has so far refused to provide relief for the few facilities like Norwalk with non-standard legacy power purchase agreements (PPAs) with utilities. The proposals for which comment is solicited today do not address non-standard legacy contracts that sell

electricity to utilities and are subject to proceedings at the California Public Utilities Commission (CPUC), most notably Rulemaking 11-03-12. For its part, the CPUC has declined to provide any relief to facilities like Norwalk and directed parties instead to invoke alternative dispute resolution provisions in their agreements with utilities to settle cost recovery issues. *Norwalk has no such provision in its contract with SCE*, leaving the facility saddled with an exorbitant cost of C&T compliance. While, all the while, SCE holds *freely* allocated allowances that could be used to cover this facility's compliance obligation – at least to the end of its current PPA in 2018. Some of these allowances are indirectly attributable to the power generated by Norwalk. Norwalk currently has no forum nor means of acquiring relief, short of asking the CPUC or the ARB for relief. We urge the ARB to address and resolve this issue and ensure that facilities without cost recovery may fairly cover the cost of compliance.

Relief should be granted based on the following facts:

- Norwalk entered into a non-standard PPA in 1987, well before policymakers and the parties contemplated the C&T program.
- The terms of Norwalk's PPA, negotiated in good faith by the parties, resulted in a fixed heat rate in exchange for significant concession with regard to curtailment for which the utility has benefited over the past 25 years.
- The CPUC's Qualifying Facility (QF) Settlement (Commission Decision D.10-12-035) did not address non-standard QF contracts with regard to C&T, focusing instead on settlement terms appropriate for standard PPAs with SRAC formulas and market-based pricing. Generators with non-standard QF PPAs, like Norwalk, were left with no mechanism to recover compliance costs for C&T.
- Acceptance by Norwalk of any one of the QF Settlement options would have essentially abrogated the fundamental terms of the PPA and resulted in the loss of at least $1,000,000 in annual plant revenues.
- Norwalk has no provision for alternative dispute resolution (ADR) and the utility has declined to renegotiate in any meaningful manner. It is questionable whether ADR would be an appropriate avenue even if it existed for us, considering that the parties never contemplated C&T in the PPA and therefore no terms exist for interpretation and resolution.
- The utility holds all allowances attributable to the Norwalk facility, thereby giving it a windfall. Norwalk currently holds all liability for compliance, threatening its own operations and those who rely upon it.
- Norwalk faces extraordinary costs of C&T compliance, estimated to be up to $1,000,000 annually in the near term, and increasing thereafter.

- The State of California suffers as the customer for Norwalk's thermal energy given the threat of plant closure from increased operating costs due to C&T.

Wheelabrator's Norwalk Energy Power Plant Facility

Waste Management's subsidiary Wheelabrator Technologies, Inc. is an owner/operator of safe, clean and renewable power across the United States. This includes Wheelabrator's Norwalk Energy power plant -- a combined cycle generation facility that produces energy through multiple processes:

- Natural gas powers a 27-megawatt LM2500 gas turbine to produce electricity.
- The turbine's exhaust gasses are directed to a heat recovery steam generator, where it heats water.
- The steam from that process turns a second turbine, which also produces electricity.
- After the steam goes through the second turbine, it flows through a pipeline to the neighboring state hospital campus where it is used for heating.
- In addition to electricity and steam, Wheelabrator's Norwalk Energy facility also provides chilled water to the state hospital for space cooling, using three 1,500-ton chillers.

Norwalk's combined cycle technology provides maximum system efficiency while minimizing fuel consumption and environmental impacts.

Wheelabrator's 27-MW Norwalk Energy facility provides electrical power to SCE under a 30-year PPA executed on February 14, 1988, under which Norwalk supplies 88,656 MWh/year to the utility. The PPA does not provide an explicit means of cost recovery for the facility's compliance with the California C&T Program, according to SCE, and the utility has refused to compensate Norwalk for its compliance costs despite the allowances received by SCE attributable to facility emissions.

Norwalk's Non-Standard QF Legacy Contract

Norwalk operates under a contract negotiated and executed long before policymakers' contemplation of a C&T Program. Not surprisingly, the cost of securing greenhouse gas (GHG) allowances required of generators in order to comply with the C&T Program was not an issue discussed in 1987 when the parties were negotiating the PPA. Equally understandable, the PPA does not contain provisions that explicitly assign the risk of compliance cost recovery. The PPA, as originally negotiated, does not contain a specific provision for pass-through of GHG allowance costs. The lack of a provision has left Wheelabrator Norwalk without cost recovery for compliance with C&T while the utility has been granted free allowances based on calculations that include Norwalk's emissions.

Much has been made of the QF Settlement that provided options for generators with standard offer contracts to address compliance costs for C&T. At issue here, however, is the fact that the QF Settlement did not address certain CHP QF generators that executed non-standard QF contracts with unique pricing provisions that are the result of bilateral negotiations in which both parties received the benefit of their bargain. The Norwalk facility has entered into additional agreements with third parties including the State of California, and based economic and financial decisions on the terms of its PPA.

The non-standard provisions prevented facilities in Norwalk's position from executing the QF/CHP Settlement's Legacy PPA Amendment that was meant to compensate generators for their compliance costs. In fact, if Norwalk had been forced to accept the Legacy PPA Amendment, such acceptance would have abrogated the very foundation of its agreement.

It is no surprise that small generators typically have little bargaining power in comparison to their large utility customers. In fact, the PPA has no alternative dispute resolution and attempts to negotiate with SCE have been met with a single offer to accept the QF Settlement that had been rejected more than a year before for reasons stated here. This has left Norwalk shouldering the full cost of compliance and facing deleterious operating expenses.

Compliance obligations requiring the purchase of GHG allowances by electrical generators began January 1, 2013. Norwalk Energy is required to purchase these compliance instruments at auction or through a broker or other third-party. Norwalk Energy's costs of compliance are estimated to be greater than $500,000 and could reach more than $1 million annually in the near term, depending on the price of allowances.

Without a means to recover the cost of compliance with the C&T Program, Norwalk Energy faces significant hardship that could force closure of the facility and result in the loss of valuable electricity generation serving California consumers. For this reason, we ask the ARB to address the issue of cost recovery for facilities with non-standard QF contracts and ensure continued operation of important CHP power plants that meet the policy goals of the State of California.

Correcting the Problem

We urge the ARB to provide generators that executed bilateral contracts with utilities prior to passage of AB 32 with relief from the cost of GHG compliance. Since the utilities received allowances based on their expected costs of compliance, it is fundamentally unfair for the generator to bear the costs of its compliance obligation without an available mechanism for recovering those costs. The ARB may provide relief by one of several mechanisms.

First, the ARB may provide GHG compliance cost recovery by directing the parties to adopt an "adder" to the natural gas price used in the PPA pricing formula. This adder could be fashioned after the QF Settlement Legacy PPA Amendment, Option A, which reads as follows:

> *GHG Allowance Price* ($/MMBtu) = Allowance Cost ($/MT) x 117lbs of GHG per MMBtu / 2,204.6 lbs per MT
>
> Where:
>
> *Allowance Cost* ($/MT) = The cost of one Allowance, determined using the GHG Auction clearing price from the latest GHG Auction that has taken place during the calendar quarter immediately preceding the date that Buyer's payment is due to Seller.

In effect, the ARB will direct that the PPA be amended to add the aforementioned adder to compensate the generator for the cost of C&T compliance.

Alternatively, the ARB can directly allocate allowances to the generators based on their actual compliance obligation as determined by the annual verified emissions for a given compliance period.

Furthermore, we agree with the Independent Energy Producers Association (IEPA) that the ARB's proposal to allocate allowances that cannot be used until 2015 to generators holding legacy contracts defeats the purpose of providing these generators with an allocation. As IEPA correctly points out, future allowances will make little difference to a generator that is forced to shut down due to the costs of obtaining GHG allowances now. Instead, the ARB should allocate future vintage allowances (e.g. 2015 vintage allowances for 2013/2014 emissions) and stipulate that the allowances be used only by the facility for compliance prior to the vintage year of the allowance.

We also support IEPA in its argument that allowances should be provided throughout the life of the PPA and that the Cap Decline Factor should not apply to generators like Norwalk that have a non-standard QF contract or others with a Legacy contract. Norwalk has no alternative means of recovering its C&T compliance costs than that to be provided by the ARB. There is no factual nor policy basis for granting partial recovery of compliance, and therefore we urge the ARB to provide relief without application of the Cap Decline Factor for the life of the PPA.

The ARB Proposed Options for Calculating Emissions Related to Legacy Contracts

The ARB proposed three options for discussion with regard to determining how it would verify emissions and cover the costs of compliance associated with electric generators operating under legacy contracts. We find all three options lacking due in large part to the ARB's insistence on bifurcating emissions due to thermal generation and those due to electricity sold to a utility. The proposals are either overly simple, leading to allocating too few allowances, or overly complicated, leading to miscalculation of either too few or too many allowances. Instead, the ARB should recognize and fashion simpler solutions, such as those we recommend, to ensure that legacy contracts – whether non-standard PPAs or thermal contracts – should be allocated enough allowances to cover *fully* their emissions.

Conclusion

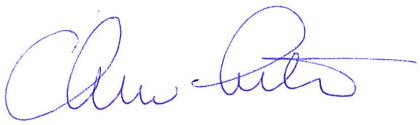
California utilities and industrial entities that are required to participate in the C&T Program are provided with the vast bulk of their allowances at no cost even when they have a reasonable means of market-based and/or rate-based recovery. Furthermore, in those circumstances when a Utility Owned Generator (UOG) enters into an auction to purchase allowances to meet its compliance obligation, the expenditures it makes as an electric generator revert back on a dollar-for-dollar basis to the same utility in its function as a load-serving entity. The result is that a utility and its retail customers are indifferent to the compliance costs associated with a UOG's operations.

As a small generator, the Norwalk Energy facility has lacked the power to bargain effectively with its utility customer that has neither incentive nor interest in renegotiating the PPA unless the deal struck puts Norwalk in a worse financial position and at even greater risk of closure than it faces now. There also is an issue of fairness. The number of allowances available in the C&T Program is based on emissions generation, including the generation of those greenhouse gases emitted by Norwalk Energy. Because Norwalk Energy does not receive any allowances based on its emissions, the utility receiving those allowances based on the utility's "expected costs of compliance" will receive a windfall. We believe that regulations and policy that supplies utilities with this windfall is unconscionable.

Ideally, compensation for GHG related costs should be clearly established in the contract. Unfortunately, this has not been the case. Utilities had been given time to renegotiate contracts with small generators like Norwalk Energy. Inherent in that opportunity was an assumption that both parties would be equal in their contract negotiating position. But in fact, utilities hold a significantly more powerful position in contract renegotiations with small generators, which have no other viable energy customer than the utility with which they have an executed contract while the utility has an array of other generation options. It is now time for the ARB to step in and resolve the issue of cost recovery by assigning allowances to the Norwalk facility and other similarly situated power plants without cost recovery.

Thank you for this opportunity to provide initial comments. We look forward to working with you to resolve this important issue.

Sincerely,



Charles A. White, P.E.
Director of Regulatory Affairs/West

cc: Jennifer Kalafut, Advisor to Commissioner Carla Peterman, CPUC, Jennifer.Kalafut@cpuc.ca.gov

Stephen Kelly, IEPA, steven@iepa.com

Steven Cliff, ARB, scliff@arb.ca.gov

Peggy Taricco, ARB, ptaricco@arb.ca.gov

Claudia Orlando, ARB, corlando@arb.ca.gov