May 21, 2013

Comments of the California Cogeneration Council on
CARB's Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, 'But For' CHP, and Legacy Contracts

Thank you for the opportunity to comment on the Air Resources Board's (ARB) presentation on May 1, 2013 regarding, "Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, 'But For" CHP, and Legacy Contracts. The California Cogeneration Council (CCC) represents a number of combined heat and power (CHP) facilities that have legacy contracts with their thermal/retail electricity host, and are unable to recover GHG emission compliance costs due to the provisions in these agreements. CCC member companies also include CHP facilities located at universities that are owned by third-party entities. While we do not represent any CHP facilities that may be eligible for the "But For" CHP exemption, we provide observations regarding the staff proposal.

General Comments

The staff power point presentation does not provide enough information regarding each of the staff proposals for stakeholders to respond with detailed and informed comments. The CCC proposes that the ARB either provide a written summary of each draft proposal, or provide proposed draft amendments to the regulation for review (prior to releasing such amendments in the July 2013 complete package of amendments). ARB staff should then hold separate working group meetings on each topic area, to work through the written proposals. Solutions regarding (i) the treatment of universities, (ii) "But For" CHP, and (iii) legacy contract issues, are separate and distinct, and going forward these groups should meet separately to develop solutions.

Legacy Contract Staff Proposal

There was considerable confusion at the May 1st workshop regarding the definition of "legacy contract" and exactly what "legacy" agreements were subject to the staff proposal. It is the understanding of the CCC that ARB intends "legacy contracts" in this context to include contracts between a 3rd party CHP facility and the thermal and/or retail electricity host. If there is another type of contract envisioned, then the ARB needs to spell that out clearly. Slide #27 of the ARB presentation is confusing and it is not clear if all scenarios are included in this diagram.

Several stakeholders at the workshop spoke out regarding legacy contracts between the CHP facility and an investor owned utility (IOU) that do not allow for the pass through of the cost of GHG compliance. The ARB staff indicated that this is an issue being addressed at the California Public Utilities Commission (CPUC) and is not subject to the May 1st staff proposals for legacy contracts. The CCC agrees that these two issues should remain separate due to the

fact that the CPUC has jurisdiction over power purchase agreements between the IOUs and qualifying facilities (QFs), and the ARB does not. However, the ARB should coordinate and work with the CPUC staff to address this outstanding issue once and for all, as directed by Resolution 12-33. The Administrative Law Judges (ALJs) in the GHG proceeding (R.11-03-012) published a ruling on August 7, 2012, calling for comments from affected parties regarding compensation for generators with bilateral contracts with utilities that lack specific terms and conditions assigning GHG cost responsibility. Comments and reply comments were filed on August 22nd and September 5th, respectively.

On May 8, 2013, ALJ Hecht published a ruling addressing four motions related to pre-AB 32 contracts. The ruling specifically speaks to motions filed by the Panoche Energy Center but does not refer to any of the comments and reply comments filed in August and September 2012. The ruling includes a section commenting on Commission policy regarding GHG costs in legacy contracts, urging renegotiation, and if there is a dispute between the parties, the contract dispute resolution process should be implemented. The reality is that many of these non-standard QF contracts do not have dispute resolution provisions. Consequently, a community of generators without GHG cost recovery, and who are unable to renegotiate their bilateral contracts with their counter party, are still awaiting a solution. These facilities are faced with the uncertainty as to whether or not the state will provide assistance, while at the same time facing substantial GHG compliance costs, and no ability to pass through these costs to the buyer of the electricity.

Specific Comments:

1. ***Proposed Eligibility Criteria***

As discussed at length at the workshop, the CCC strongly opposes the criteria that eligibility ceases when the ownership of the facility is transferred or sold (Slide #25). The reality is that generation assets in the energy industry are bought and sold multiple times. Many facilities have several owners and any one of those owners may sell their interest to another party. The transference of ownership **does not** open a host agreement for renegotiation of contract terms. Consequently it is inconceivable that a change in ownership would render a legacy contract ineligible for transition assistance. The only criteria identified in Resolution 12-33 (relevant excerpt below) was that the legacy contract must have been entered into prior to AB 32.

> WHEREAS, entities with legacy contracts that were entered into prior to AB 32 may not have an appropriate mechanism for recovery of carbon costs associated with the Cap-and-Trade Regulation;
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> BE IT FURTHER RESOLVED that the Board directs the Executive Officer to develop a methodology that provides transition assistance to covered entities that have a compliance obligation cost that cannot be reasonably recovered due to a legacy contract. The Executive Officer shall work with the California Public Utilities Commission (CPUC) to ensure consistency in the way the legacy contracts are addressed. Staff shall return to the Board with proposed regulatory amendments in mid-2013.

Eligibility for legacy contract assistance should continue until the date of expiration of the legacy contract. Note that parties will begin negotiation of new contract terms that will take effect after the legacy contract expires. Transition assistance should continue until the date of expiration, even though the new contract will be executed prior to expiration.

The CCC agrees with the staff proposal of an annual attestation. This should be in lieu of providing copies of the actual legacy contract. These contracts are confidential and sharing them outside of the parties involved in the contract is problematic, if not prohibited.

2. Calculation of Transition Assistance

Slides 26 through 36 describe options for calculating the transition assistance to be provided to legacy contract holders. None of the slides explain why a formula is necessary. Under the cap and trade regulation, the CHP facility has the compliance obligation for 100% of the emissions associated with the steam and/or retail electricity provided to the host facility, none of which the CHP facility can pass through to the host. All of these stranded costs should be covered under transition assistance, as there is no justification for less than 100% recovery of these unexpected costs.

If a CHP facility owned and operated by the same industrial entity and identified as being in a sector eligible for industrial assistance (Table 8-1 of the Cap-and-Trade regulation), a product or energy benchmark is used to determine the amount of free allowances to be assigned to the sector and ultimately the covered entity. With the declining cap and assistance factor, it is unlikely that any one facility will receive 100% assistance in the form of free allowances, to equal their overall compliance obligation. However, that facility can ultimately pass through any outstanding GHG compliance cost by absorbing it into the price per unit of product produced from that facility. In the case of the CHP facility with a legacy contract, this option is not a possibility. Consequently, the transition assistance should cover all stranded costs faced by the covered entity, associated with a legacy contract.

3. Options

While we argue above that a benchmarking formula should not be applied, if the ARB decides to pursue this methodology, the CCC recommends using Option One. Unlike the other two options, this proposal seems to be the most fair and equitable because:

(i) The methodology allocates using steam and electricity benchmarks, consistent with other benchmarks already employed in the cap-and-trade regulation
(ii) Although use of an efficiency benchmark could result in over-allocation to some facilities, by limiting the allocation amount to **actual** emissions this concern is moot.
(iii) Allows true-up to actual production.

Our concern with Option Two is that it is based on historical emissions and does not allow for potential increased demand from the host facility. As a third party CHP generator, the covered entity may have limited control over the thermal and electricity demands of the host, and in times of increased demand the CHP facility may not receive sufficient transition assistance to cover actual exposure. We strongly recommend rejecting this option based on the fact that it

cannot adequately provide for CHP facilities that are obligated to supply energy in growth scenarios.

Option Three as described on Slide # 34 is confusing. It concludes that allowances to be allocated would be equal to 25% of the electricity emissions and is silent regarding allowances that should be allocated associated with the steam. More detail is required explaining exactly the formula and factors that would be used to "proportion" MWh of electricity and MMBtus of steam. Also would this be an annual calculation that relies on reported data and allows for variations in steam and electricity output?

4. Vintage Year 2015 Allowances

While we understand the difficulty ARB has in providing 2013 and 2014 vintage allowances as transition assistance to satisfy compliance obligations in the first compliance period, this does create a real burden for facilities to carry the cost of capital as they make initial purchases for allowances and obtain reimbursement later. Indeed, for facilities that may be forced to shut down in the second compliance period, 2015 vintage allowances are too little, too late. The CCC proposes that ARB allow the handful of facilities that will be eligible for legacy contract transition assistance to use 2015 allowances as compliance instruments for the first compliance period. We are not asking that this be a program wide change affecting all covered entities, but just those identified by the ARB as being eligible for this assistance.

5. Other Considerations

On Slide 24 questions are posed regarding natural gas. The CCC members have puzzled over these questions and do not understand exactly what is being proposed. For example, ARB asks, "Could emissions be captured at the natural gas supplier in the second and third compliance periods?" The provisions of the cap and trade regulations relating to the mechanics of the natural gas sector are the subject of a June 3rd stakeholder workshop so we do not know the details of how natural gas suppliers will be discerning between covered entities and non-covered entities, and subsequently adding the cost of carbon to some bills and not others. This question simply raises too many other questions and the CCC does not believe the concept will provide a workable solution. Again, staff should provide more description regarding any such proposal so that stakeholders can provide meaningful comments.

At the workshop stakeholders raised the issue that the emissions associated with "steam" needed to include emissions associated with other thermal products such as chilled water and hot water that the 3rd party CHP is delivering to the host under the legacy contract. Slide 26 of the staff presentation proposes the following basic formula:

$$A = MTCO_2e_{Electricity,\ legacy} + MTCO_2e_{Steam,\ legacy}$$

Where:
A = Allowances allocated
$MTCO_2e_{Electricity,\ legacy}$ = emissions associated with electricity sold without cost pass through
$MTCO_2e_{Steam,\ legacy}$ = emissions associated with steam sold without cost pass through

The overall objective should be to ensure all emissions associated with products sold by the 3rd party CHP to the host are accounted for in the methodology to allocated allowances for transition assistance. The term, "steam" may not capture all types of thermal products that could be the subject of the contractual agreement between the 3rd party CHP and the host. Therefore the use of the term "steam" in the context of transition assistance for legacy contracts should be broadened such that,

$MTCO_2e_{Steam, legacy}$ = emissions associated with steam or other thermal products sold without cost pass through.

Assistance to Universities Proposal

The CCC agrees with the staff approach to include both private and public universities in the "university proposal" and understands that there are eleven eligible university campuses, according to the ARB data. The CCC supports ARB's proposal that allowances be allocated using an energy-based methodology based on a fuel benchmark, and that an average three year historical fuel use baseline determine annual allocations going forward. The proposed university allocation equation on slide #12 appears to be a workable approach.

The CCC is concerned, however, that third party owned CHP facilities are not included among the eleven facilities identified by the ARB for such relief. We believe that these facilities qualify for legacy contract transition assistance, and, while we have no intention that any facility should "double-dip" in terms of transition assistance, we are concerned that third party CHP is not a category clearly identified for relief in the proposal for universities. Unless legacy CHP facilities located on university grounds are granted relief in the form of a direct allocation from ARB, in a manner that is entirely independent of the discretion of such university, and at least equal to the relief granted to the non-university CHP facilities, then such facilities should, at their election, be eligible to receive, in the alternative, the relief available under the legacy contract program.

In addition, we are also concerned with what might happen to third party CHP facilities after the energy supply agreement with the host ends. Clearly any transition assistance policy that provides ongoing compliance relief to the universities following the expiration of an energy supply agreement must be crafted in such a way that it does not provide the university with unintended subsidization or leverage in any subsequent negotiation of new or extended agreements. It seems that the potential exists for the policy being proposed by ARB to subsidize a university takeover of the ownership and operation of the existing CHP at the end of the term of the agreement with the 3rd party provider, or to shutdown the 3rd party CHP facility and endeavor to site and construct its own proprietary facility. At a time when the Governor is promoting development of 6,500 MW of new CHP, this proposal seems to encourage the opposite outcome, i.e. the dismantling of existing facilities and discouraging private investment.

The CCC agrees with the ARB that this proposal does not take into account potential expansion or installation of new CHP at a campus. This is problematic and highlights the fact that while efficient CHP provides state-wide emissions reductions, it means increased onsite compliance obligation for an entity. Further discussion is needed to determine how to incentivize these

types of GHG emissions reduction strategies, while not creating yet another barrier to the development of efficient CHP.

Proposed Treatment of "But For" CHP

The CCC does not have any member facilities that would qualify for the "But For" CHP exemption, however, we do support the ARB staff proposed methodology. The CCC recommends that the regulation amendments clarify that these facilities will not be classified as "covered entities" under the cap-and-trade program in the second and third program periods, if the intention is that they will bear the cost of carbon through the increased cost of fuel beginning in 2015.

As discussed at the workshop, we are uncertain why eligible facilities should have to apply for the exemption. Perhaps ARB could notify the facility that it may be eligible for the exemption if they submit the required documents.

Recommendations

The CCC recommends that in the next phase of development, the ARB provide written documentation of the staff proposals and convene the affected stakeholders for working group meetings to review the details of the methodologies and to develop draft language to amend the cap and trade regulation. While the May 1st workshop was an opportunity for stakeholders to hear major concepts, stakeholders cannot provide constructive comments until they see detailed proposals.

Thank you for the opportunity to comment on the staff presentation, and the CCC looks forward to working with ARB staff to develop language to give effect to Resolution 12-33.

Sincerely,

Beth Vaughan
Executive Director