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September 25, 2013

The Honorable Mary D. Nichols, Chairman  
California Air Resources Board  
1001 "I" Street  
Sacramento, CA 95812

***Re: Comments of OLS Energy Chino, LLC on CARB's Proposed Amendments to the Cap-and-Trade Regulation***

Dear Madame Chairman:

OLS Energy Chino, LLC ("OLS") submits these comments on the proposed amendments to the California Cap-and-Trade Regulation ("Proposed Amendments"), as set forth in the September 4, 2013 Proposed Regulation Order, which will be considered by the California Air Resources Board ("CARB") on October 24, 2013. Terms beginning with a capital letter not otherwise defined herein have the meanings set forth in the Proposed Amendments.

**I. Introduction**

OLS appreciates CARB's efforts to address the concerns of combined heat and power ("CHP") Qualifying Facility ("QF") generators that are subject to contracts that do not provide a means to recover greenhouse gas compliance costs in accordance with Cap-and-Trade Program requirements ("GHG Compliance Costs"). The definition of "Legacy Contract" included in the Proposed Amendments currently under consideration is an improvement over the definition included in the July 15 Discussion Draft of the Proposed Amendments. However, this definition still requires further refinement. Specifically, OLS is concerned that the text included in the definition of "Legacy Contract" which states "[f]or purposes of this regulation, legacy contracts exclude contracts *that gave rise to a Legacy PPA Amendment . . .*" does not make explicit that CHP QF generators that did not actually execute a Legacy PPA Amendment do not fall into the exclusion from relief granted under the new Section 95894. As explained in the comments that OLS submitted on August 2, 2013 on the July 15 Discussion Draft of the Proposed Amendments ("OLS Comments of August 2, 2013"), OLS and similarly situated CHP QF generators should be granted relief because they are subject to contracts that do not provide a means to recover GHG Compliance Costs. They neither have had, nor will have, a meaningful opportunity to amend those contracts. As specifically set forth below, the proposed language should be amended to make it explicit that legacy QF contract holders who executed Legacy PPA Amendments are excluded from the relief being provided.

In addition, OLS and similarly situated CHP QF generators operating under Legacy Contracts require transition assistance beyond the end of 2014. Providing transition assistance only for 2013 and 2014 will result in serious financial hardship for OLS and certain other CHP QF generators who have no leverage to renegotiate their Legacy Contracts. Moreover, until the issuance of the July 15 Discussion Draft of the Proposed Amendments, it was understood that CARB intended to grant relief through the duration of Legacy Contracts. Nonetheless, in recognition of the concerns of CARB staff set forth in the “Staff Report: Initial Statement of Reasons”, OLS proposes a compromise position: that transition assistance be provided to Legacy Contract generators through the second compliance period (2015-2017).

## **II. Background**

OLS operates a 30 megawatt (“MW”) CHP QF generating plant located in Chino, California (“Chino Facility”), on the grounds of the California Institute for Men’s correctional and rehabilitation facility (“CIM”). Since 1988, the Chino Facility has provided CIM with steam and power under a 30-year contract, which expires in 2018. In addition, the Chino Facility supplies Southern California Edison Company (“SCE”) with 26 MWs of capacity and energy under a 30-year power purchase agreement that also expires in 2018 (“Chino PPA”).

In 1998, SCE and OLS amended the Chino PPA to replace the standard short run avoided cost (“SRAC”) pricing provisions contained therein with unique pricing provisions negotiated and agreed-upon by the parties. The pricing amendment was executed to address issues specifically related to the Chino Facility and served as the basis for investment and finance decisions undertaken by OLS. As such, since 1998, energy sales between OLS and SCE have been governed by a QF contract with atypical pricing provisions (“Non-Standard QF Contract”).

As part of the Qualifying Facility and Combined Heat and Power Program Settlement Agreement, dated October 8, 2010, adopted by the California Public Utilities Commission (“CPUC”) in Decision 10-12-035, CHP facilities with standard legacy QF contracts were offered an amendment (“Legacy PPA Amendment”), which included SRAC pricing options for QFs paid under standard SRAC pricing. In contrast to the Non-Standard QF Contracts, SRAC pricing under the standard legacy QF contracts is subject to adjustment by the CPUC from time to time. Integrated into each of the Legacy PPA Amendment standard SRAC pricing options were differing levels of recovery of GHG Compliance Costs. However, OLS and a small number of other CHP facilities with Non-Standard QF Contracts were not in a position to execute the Legacy PPA Amendment because their contracts have non-standard pricing terms, as opposed to standard SRAC pricing subject to adjustment by the CPUC from time to time. Executing the Legacy PPA Amendment would have required OLS and these other similarly situated CHP QF generators to forfeit their non-standard pricing terms. Because those non-standard pricing terms were the basis upon which OLS and these other generators had financed their CHP facilities, the losses that they would have incurred as a result of executing the Legacy PPA Amendment would have rendered the GHG cost recovery associated with the Legacy PPA Amendment meaningless, and OLS and these other generators would have been unable to meet their financial and operating obligations.

### **III. Recommended Changes to the Proposed Amendments**

#### **A. The Definition of “Legacy Contract” should be Further Amended to Make Explicit that Generators that did Not Execute Legacy Amendments are Not Excluded from Transition Assistance**

The definition of “Legacy Contract” included in the Proposed Amendments should be revised to make clear that the exclusion of contracts “that gave rise to a Legacy PPA Amendment, as defined in the Combined Heat and Power Program Settlement Agreement Term Sheet pursuant to CPUC Decision D-10-12-035, with a privately owned utility as defined in Public Utilities Code section 216 (referred to as an Investor Owned Utility or IOU)” applies only to contracts for which a Legacy Amendment was actually executed. As explained above, OLS and a small number of other CHP facilities with Non-Standard QF Contracts were not in a position to execute, and therefore did not execute, the Legacy PPA Amendment. The text “gave rise to a Legacy PPA Amendment” may be too vague for such generators to obtain relief, because it is not clear what “gave rise to” is intended to cover.

Therefore, OLS respectfully requests that CARB modify the Proposed Amendments by changing the second sentence in the definition of “Legacy Contract” as follows (additions are shown with double-underline and deletions with strikethrough):

For purposes of this regulation, legacy contracts exclude contracts ~~that gave rise to~~with respect to which a Legacy PPA Amendment, as defined in the Combined Heat and Power Program Settlement Agreement Term Sheet pursuant to CPUC Decision number D-10-12-035, ~~was executed~~ with a privately owned utility as defined in the Public Utilities Code section 216 (referred to as an Investor Owned Utility or IOU).

This modification makes clear that CHP QF generators who were not in a position to execute and therefore did not execute a Legacy PPA Amendment, such as generators with Non-Standard QF Contracts, will not be precluded from the relief granted by the new Section 95894. That result is fair and reasonable, because these CHP QF generators are subject to contracts that do not provide a reasonable means to recover GHG Compliance Costs, and they neither have had, nor will have, a meaningful opportunity to amend those contracts.

#### **B. Transition Assistance should be Provided at Least through the Second Compliance Period**

Transition assistance should be provided to CHP QF generators with Legacy Contracts at least through the second compliance period (2015-2017). Indeed, prior to the release of CARB’s July 2013 Discussion Draft of the Proposed Amendments, it was understood that CARB intended to grant relief through the duration of the Legacy Contracts. Specifically, in the public meeting of September 20, 2012, CARB staff explained that entities that signed contracts prior to January 1, 2007 and whose legacy contracts were not significantly amended after that date would be eligible for allocation, *and that “[a]llocation would end when the existing legacy contract ends*

*or is significantly amended.*”<sup>1</sup> Further, as discussed in the OLS Comments of August 2, 2013, earlier drafts of the Proposed Amendments and information provided at the May 1, 2013 CHP workshop also created an expectation that transition assistance allocated to Legacy Contract Generators would be provided until the earlier of the expiration of the Legacy Contract and the date of an amendment of the Legacy Contract, if any. However, like the July 15 Discussion Draft of the Proposed Amendments, the current draft limits transition assistance to 2013 and 2014, leaving OLS and similarly situated CHP QF generators without a means to recover their GHG Compliance Costs after 2014.

CARB staff’s shift in position, providing relief only until the end of 2014, appears to be based on an unrealistic expectation that counterparties will, in the future, be willing to amend Legacy Contracts. In its Initial Statement of Reasons, CARB staff states that limiting the transition assistance to the first compliance period “maintains the incentive for legacy contract generators to renegotiate while providing appropriate transition assistance for these generators in accordance with Board Resolution 12-33.”<sup>2</sup> CARB staff also raises a concern that “many legacy contract generators have already renegotiated with counterparties in such a way that the generator may have received less than full compensation for GHG costs”, and that providing a full allocation for the entire contract period for all legacy contract generators “would have the perverse result that those who renegotiated could have received less favorable treatment than those who did not renegotiate.”<sup>3</sup> While OLS understands staff’s concern that parties who renegotiated their contracts should not in effect be penalized for having done so, OLS emphasizes that renegotiation simply is not a possibility for OLS and certain similarly situated generators. OLS did not “hold out” in negotiations with SCE; rather OLS simply had and continues to have no leverage or trade-off to offer SCE. Thus, SCE had and continues to have no reason to renegotiate its contract in any manner that would provide relief to OLS. Thus, although CARB “believes that allowance allocation limited to the first compliance period is sufficient to provide transition assistance while simultaneously providing the parties additional time to renegotiate the contracts”<sup>4</sup>, additional time for renegotiation is extremely unlikely to result in SCE agreeing to provide any relief to OLS. Once transition assistance expires following 2014, OLS will have no means to recover its GHG Compliance Costs.

As explained in the OLS Comments of August 2, 2013, the Chino PPA was amended many years prior to the passage of AB 32. As such, OLS should not be penalized because its power purchase agreement with SCE does not have a provision that would enable OLS’ recovery of GHG Compliance Costs. Therefore, OLS believes that OLS and similarly situated CHP QF generators should be provided transition assistance for the duration of their Legacy Contracts. However, in recognition of CARB’s concern that providing a full allocation for the entire contract period for all Legacy Contract generators may create a disfavorable result for parties who did renegotiate their contracts, OLS proposes a compromise position: that transition assistance be provided through the second compliance period. To effect that proposal, OLS thus

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<sup>1</sup> CARB September 20, 2012 Meeting Transcript, at p. 106, lines 10-16 (emphasis added); available at: <http://www.arb.ca.gov/board/mt/2012/mt092012.pdf>.

<sup>2</sup> Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms – Staff Report: Initial Statement of Reasons (Sept. 4, 2013) at p. 18.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

respectfully requests that Section 95894(d)(1) of the Proposed Amendments be revised to add calculations for the provision of allocations through the second compliance period (2015-2017).

#### **IV. Conclusion**

In accordance with the specific recommendations set forth above, OLS respectfully requests that CARB (i) revise the definition of “Legacy Contract” included in the Proposed Amendments and (ii) revise Section 95894(d)(1) to add calculations for the provision of allocations through the second compliance period (2015-2017).

Sincerely,

Date: September 25, 2013

/s/ Jerry R. Bloom

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