INDEPENDENT
ENERGY
PRODUCERS
ASSOCIATION

May 21, 2013

**Comments of the Independent Energy Producers Association
On CARB's Proposed Adjustments to the Cap-and-Trade Program's
Treatment of Universities, 'but For CHP' and Legacy Contracts**

The Independent Energy Producers Association (IEP) submits these comments on CARB's Workshop on Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, 'But for CHP', and Legacy Contracts, convened on May 1, 2012. In our comments, IEP provides general comments regarding the policy direction related to legacy contracts established by the CARB Board (Resolution 12-33) and the context in which those directions may be most effectively implemented. Following this discussion, IEP provides comments on specific issues related to CARB staff's presentation on May 1, 2012.

General Comments:

The CARB Board's direction to staff was 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."[1] Thus, unlike obligated entities that have a reasonable means for passing through the costs of their GHG compliance through the competitive market, so-called Legacy Contract holders by definition have no reasonable means of recovering the cost of its AB 32 compliance obligation. This raises some important policy considerations.

Transition Assistance for Legacy Contracts Must Extend for Duration of Existing Contract. Irrespective of whatever compliance obligation is imposed by CARB, once identified as a "Legacy Contract" holder, an acknowledgement has occurred that "transition assistance" is required as a matter of fairness and equity. This transition assistance must, accordingly, extend for the duration of the existing contract (until expired or re-negotiated) or else the transition assistance fails its objective.

Transitional Assistance for Legacy Contracts Is Distinct From Transitional Assistance for Universities, "but for" CHP Operations, etc. By definition, Legacy Contracts are distinct from other types of operations, including Universities, "but for" CHP operations, etc. In the context of transition assistance, the assistance for legacy contracts must meet 100% of the obligated entities AB 32 compliance obligation for the duration of the existing contract (as noted above); otherwise, these business units risk ceasing operations due to an inability to recover the costs intrinsic to their hourly operations. On the other hand, the transition assistance for Universities, "but for" CHP operations, etc., is quite distinct. These entities require assistance, but they likely do not face the risk of shut-down if AB 32 compliance costs are not recovered.

[1] California Air Resources Board Resolution 12-33.

1215 K Street • Suite 900 • Sacramento, CA 95814 • office: 916-448-9499 • fax: 916-448-0182 • email: iep@iepa.com

Thus, CARB could design transitional assistance for Universities and "but for" CHP operations that does not fully recover 100% of their compliance obligation (e.g. by using a benchmark methodology or reducing transition assistance over time at the rate in which the Cap & Trade allowance are reduced).

Approaching the two conditions differently makes perfect sense. Unfortunately, the staff May 1 Presentation conflates the two and, in doing so, confuses the issues and the remedies necessary to move forward.

QF Facilities May Be Defined as Legacy Contract Holders In Limited Circumstances. The legacy contract issue arises in the context of a limited number of generators operating under a pre-AB 32 contract that do not directly or indirectly provide for GHG cost recovery. IEP has been urging CARB to address this issue throughout the entire development of the Cap and Trade Regulation. While IEP appreciates CARB staff's willingness to continue working on a solution with ***some*** of these contract holders, a comprehensive resolution, that addresses what we believe to be a very small subset of electric generators, still needs to occur in order to be consistent with the CARB Boards' resolution.

In this context, the following points need to be made to help define the universe of affected generators. First, some electric generators known as Qualifying Facilities ("QFs") may be impacted. While it is generally understood that the CPUC-approved QF Settlement addressed compensation for GHG costs, it did so only for those QFs subject to the Settlement Agreement. Some QFs may not have executed the Settlement Agreement for perfectly rationale commercial reasons. For example, some QFs may be operating pursuant to a "non-standard" QF contract in which case the QF Settlement was not tailored to their unique circumstances. Prior to AB 32, it was not an uncommon experience that individual QFs would negotiate and/or renegotiate their "standard form" QF contracts with the utility in a manner that would provide mutually beneficial outcomes for both parties. In these renegotiations, a QF may have willfully given up some of its rights to deliver energy to the utility in exchange for different pricing arrangements (consistent with PURPA). In situations such as these, both parties will have made concessions in a manner to retain the balance of risks/rewards in the original contract.

The presumption should be that any contractual concessions and/or pricing changes occurring prior to AB 32 were "paid for" in concessions found elsewhere in the contact. Importantly, these changes may have meant that the QF Settlement Agreement had little applicability for the individual QF found in this contractual circumstance. Accordingly, CARB should not assume that, because of the QF Settlement, no QFs should be afforded treatment as a generator operating under a "legacy contract". On the contrary, the CARB should assume that an individual QF may fit the characteristics of a "legacy contract" precisely because the QF Settlement offered no reasonable commercial options in light of their contract structure mutually negotiated with the utility; yet, as a result, they now have no reasonable means to recover the costs of GHG compliance under their contract.

CPUC Has Failed to Act and CARB Now Must Step-In To Address Legacy Contracts with IOUs. In light of the recent CPUC ALJ Ruling (in R. 11-03-012) related to pre-AB 32 contracts (issued May 8, 2013), the CPUC has once again seemingly avoided the core issue regarding the fair treatment of legacy contracts which by definition do not have a reasonable means of cost recovery. The ALJ Ruling establishes a CPUC policy of (a) urging

contract re-negotiation and/or (b) dispute resolution. However, the CPUC Ruling seemingly ignores the reality that standard offer QF contracts, as well as many non-standard amended offers, do not have an Alternate Dispute Resolution (ADR) mechanism prescribed in the contract. Accordingly, the sole avenue for resolving this matter requires the QF seller to negotiate with the utility buyer, and history has already shown the CPUC how well that works. One can only conclude from the CPUC's recent action on this matter that the CPUC has wholly punted this issue and is not prepared to address the concern identified by the CARB Board and others related to a limited set of electric generators without a reasonable means of cost recovery.

From IEP's perspective, this latest CPUC ALJ Ruling requires the CARB to fully embrace this issue in all its complexities and solve it for that limited set of generators without a reasonable means of cost recovery, including those with IOU counterparties. The CPUC's inability to address this matter is particularly egregious in light of the fact that the utilities are receiving from the CARB a tremendous amount of allowances for free, including allowances associated with the emissions from these same legacy contracts. A relatively miniscule amount of these total allowances freely allocated to the utilities can and should be set aside by the CPUC for use by legacy contract holders. However, in light of their inability to do so in a timely manner, the CARB must do so in order to make this limited set of pre-AB 32 contract holders "whole" for the duration of their existing contract.

Need For Further Discussion. The staff's May 1 presentation raises a host of issues which require further discussion, elaboration, and problem-solving. The presentation inappropriately conflates the problem faced by so-called "Legacy Contract" holders with transitional assistance for Universities and "but for" CHP situations. As a result, the range of solutions fails to properly solve, particularly for the Legacy Contract holders.

Specific Comments:

Regarding the specific details of the CARB workshop on May 1, 2013 on the Proposed Adjustments to the Cap and Trade Regulation, CARB staff presented a variety of options to address a portion of the affected legacy contracts. IEP appreciates this as a step in the right direction. However, CARB's unwillingness to address contracts with IOU counterparties where renegotiation is unlikely to result in a mutually acceptable outcome, and the CPUC's inaction in dealing with these contracts, continues to leave these contract holders in limbo. In the meantime, time marches on, compliance obligations are coming due, and no resolution is in sight for these affected generators. In this regard, IEP offers the following points and recommendations to address this matter now.

1. CARB Must Address Legacy Contracts, Including Those Legacy Contracts with IOUs. Irrespective of the counter-party, Legacy Contract holders are those with pre-AB 32 contracts which do not have a reasonable means of cost recovery of AB 32 compliance costs. For these generators, the CARB now must address transition assistance, and CARB should set-aside allowances for these generators *fully* commensurate with their cap and trade compliance obligation. While IEP appreciates CARB's efforts to provide multiple options for stakeholder comment regarding the treatment of legacy contracts, we believe these proposals conflate transition assistance for Legacy Contracts with transition assistance for Universities and "but for" CHP and, as a result, none of these options address the total realm faced by Legacy Contracts nor do they provide full coverage to any of the affected electric generators.

As a practical matter, the issue has festered due to neither the CARB nor the CPUC owning the issue. However, in light of the CPUC's recent ruling, the CPUC's inability to implement a timely and effective resolution of the matter is obvious; and it appears that the resolution of this issue rests solely at the CARB.

IEP Recommendation:

IEP recommends that CARB take full responsibility for supplying Legacy Contract holders, including Legacy Contracts with IOU counterparties, with sufficient allowances to match their compliance obligation. The compliance obligation will be known, based on the Mandatory Reporting submitted by these entities. Thus, from IEP's perspective, no need exists to "benchmark" the compliance obligation for legacy contract holders and, thus, risk either over- or –under allocating allowances (which is an issue raised by staff in their alternative proposals). CARB can either (a) allocate the allowances to the obligated entities or, alternatively, (b) set-aside allowances within a CARB managed account sufficient to make the obligated entities whole for their respective compliance period(s) for the duration of their existing contract. This latter approach has the advantage of simplifying the administration while ensuring that the allowances are used for the purposes for which they are set aside.

Importantly, CARB should ensure that these allowances are available to be used by the affected generators in time for the first annual surrender obligation (November 2014). This will give generators some certainty that the compliance costs associated with their pre-AB 32 contract, which does not allow for a pass through of GHG allowances, will be covered.

2. Future Vintage Allowances Allocated to Legacy Contract Holders for 2013/2014 Emissions Should Be Eligible for Use Prior to the Vintage Year of the Allowance. CARB staff proposes to allocate 2015 vintage allowances, which cannot be used for compliance prior to 2015, for the 2013 and 2014 emissions associated with the legacy contracts that qualify for an allocation.[2]

Generators operating under legacy contracts which do not provide a means for GHG cost recovery are in need of an allowance allocation because, by definition, they cannot recover the costs of entering the market and buying allowances for their emissions. These generators need allowances that they can use for their first annual surrender obligation which is due November 1, 2014. CARB's proposal to allocate allowances to these generators, which cannot be used until 2015, defeats the purpose of providing these generators with an allocation. If a generator is forced to shut down due to the costs of obtaining GHG allowances that it has to incur now, being awarded allowances that cannot be used until 2015 makes little difference.

IEP Recommendation:

Given that CARB will require legacy contract holders to apply and submit contracts to the CARB to determine their eligibility for an allocation, it seems reasonable that CARB will

[2] CARB Staff Presentation on Proposed Adjustments to the Cap-and Trade Program's Treatment of Universities, 'But For' CHP and Legacy Contracts, slide 23.

have a good record of who these legacy contract holders actually are. Accordingly, IEP recommends that CARB allocate future vintage allowances (e.g. 2015 vintage allowances for 2013/2014 emissions) with the stipulation that these allowances can be used only by the identified legacy contract holders for compliance prior to the vintage year of the allowance. Allowing only these electric generators to submit future vintage allowances for compliance prior to the allowance vintage date will relieve these entities from having to go out and buy allowances for their 2013 and 2014 emissions, for which they currently have no means of cost recovery.

3. The Cap Decline Factor Should Not Apply to Allocations Granted to Electric Generators Operating Under a Legacy Contract. Allocations granted to eligible Legacy Contract holders should not be subject to the cap decline factor. The measurement for distributing allowances to these legacy contract holders should be based on their emissions and the duration of the contract. These generators will not be able to recover the costs associated with obtaining allowances for their emissions regardless of the rate the cap declines. They will continue to face GHG costs that they cannot recover through the duration of their contract, or until the contract is amended.

IEP Recommendation:

Legacy Contract holders should be allocated allowances such that their AB 32 compliance costs are covered in full. These contract holders should not be subject to a deduction based on the cap decline factor.

4. Specific Comments on Options 1, 2, and 3 Related to Legacy Contracts. IEP does not see how any of these options cover, in full, the emissions associated with electric generators operating under legacy contracts. Options 1 and 2 have the potential to under allocate, which will require electric generators to obtain allowances in the marketplace. In addition, while IEP has generally been a supporter of proportionality, Option 3 seems to overly complicate how a proportional allocation should occur and may also have the potential to leave the generator coming up short. These options miss the point of providing a free allocation, which is supposed to alleviate generators from incurring GHG compliance costs associated with their pre-AB 32 contract.

The fact of the matter is that legacy contract holders do not have an ability to recover the GHG compliance costs associated with their existing legacy contract(s). These generators need to be allocated enough allowances to *fully* cover these costs. To the extent that some allowance costs can be passed through or the CPUC provides some sort of allocation to these generators, those should be netted out of what CARB freely allocates.

IEP thanks the CARB for this opportunity to submit comments on the Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, 'But For' CHP and Legacy Contracts.

Respectfully Submitted,

Steven Kelly
Policy Director
Independent Energy Producers Association
1215 K Street, Suite 900
Sacramento, CA 95814
(916) 448-9499
steven@iepa.com

Amber Riesenhuber
Policy Analyst
Independent Energy Producers Association
1215 K Street, Suite 900
Sacramento, CA 95814
(916) 448-9499
amber@iepa.com