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Submitted Electronically to
www.arb.ca.gov/cc/capandtrade/comments.htm

October 2, 2009

Lucille VanOmmering
California Air Resources Board
1001 I Street
Sacramento, CA

Re: Comments of the **Northern California Power Agency** on the CARB Workshop on *Combined Heat and Power in a Cap-and-Trade Program*

Dear Ms. VanOmmering:

The Northern California Power Agency[1] (NCPA) appreciates the opportunity to submit these comments to the California Air Resources Board (CARB) in response to issues raised and Staff questions asked at the September 9th Workshop regarding *Combined Heat and Power (CHP) in a Cap-and-Trade Program* (Workshop). NCPA would like to use this opportunity to highlight high-level concerns regarding the treatment of CHP in a cap-and-trade program, issues that must be reviewed and resolved prior to finalizing recommendations on this topic. Since CHP is inexorably linked to an overall allowance allocation methodology, NCPA urges CARB to proceed cautiously with the development of policies regarding the treatment of CHP at this time.

Introduction

In the Scoping Plan, CARB projects that 6.7 million metric tons of greenhouse gas (GHG) emission reductions could be achieved by adding 4,000 megawatts of CHP capacity to the State by 2020. During the Workshop, Staff presented various scenarios for the treatment of CHP within a cap-and-trade program, as well as several additional inquiries to stakeholders that also implicate allowance allocation methodologies in general. During the September 24, 2009 CHP Technical Working Group Meeting, staff noted that it was still awaiting feedback from the California Public Utilities Commission (CPUC) regarding an upcoming proceeding that will address several CHP related matters, as well as the finalization of the ICF International Study on CHP Market Assessment commissioned by the California Energy Commission (CEC). Due, at least in part, to the pendency of these matters, Staff noted that the next CHP Technical Working Group meeting will not be held until the spring of 2010. These comments focus on several issues that must be considered once CARB staff resumes its CHP analysis.

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1 NCPA members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

Response To Workshop Presentations and Stakeholder Discussion

The Total Amount of GHG Reductions Attributable to CHP Should be Reviewed:

CARB must update its findings with regard to the total emissions reductions that can be achieved through the development of additional CHP facilities. The Scoping Plan projects significant emission reductions can be achieved by 2020 with the addition of 4,000 MW of CHP across the State. One of the sources utilized by CARB in making the Scoping Plan recommendation was a study conducted in 2005 by ICF International (ICF Study) for the CEC. Since the release of the Scoping Plan, the 2005 ICF Study has been revised. The revised study reflects that the market potential for CHP and technical feasibility are not sufficient to meet the Scoping Plan goal for increased CHP between now and 2020, nor will the emission reductions realized from CHP amount to anything close to the 6.7 million metric tons of GHG emissions anticipated in the Scoping Plan.[2] NCPA urges CARB to look closely at the updated ICF Study and conclude, as NCPA has done, that the emission reductions projected from CHP in the Scoping Plan must be reevaluated and revised.

A Public Process Should be Used to Determine How to Allocate CHP Across the State:

While the Scoping Plan directs 4,000 megawatts of new CHP, it does not provide any guidance about where CHP facilities should be located. NCPA believes that this issue should be addressed in a special proceeding that looks to the myriad factors that impact the efficacy of CHP development and utilization, and the allocation of allowances that may follow such facilities in a cap-and-trade program. Without question, this should not be done through an arbitrary process. Here are some considerations in this regard.

With respect to determining the share of emission reductions attributed to CHP, during the Workshop, the CPUC presented materials that addressed that agency's approach to achieving what it referred to as the investor owned utilities (IOU) "share" of the proposed reductions. While the CPUC has not determined the exact methodology for allocating the IOU share, the underlying basis for such allocation, according to the CPUC presentation, is something related to the IOUs' electric load. Such a methodology ignores the unique characteristics inherent in CHP facilities.

CHP facilities have distinctive attributes that require specific geographical and locational elements in order to make the facility cost-effective. Policymakers should not assume that CHP will be built in certain retail provider service territories without looking at critical factors. For example, many facilities must be located adjacent to or near industrial or other facilities that require electricity and create process emissions. It is also necessary to review the current penetration of CHP in each affected area. If there is significant market penetration of CHP facilities in the industrial and commercial sectors, it is highly infeasible that a large deployment of additional CHP can be expected in the timeframe expected to reduce emissions to the levels

2 See ICF International Presentation – CHP Market Assessment, presentation to the CEC Integrated Policy Report Committee Combined Heat and Power Workshop, dated July 23, 2009, p. 32.

expected by CARB in the Scoping Plan.

Second, the amount of CHP – both existing and proposed – needs to be reviewed in light of an entity's existing portfolio mix. An entity that already has a fairly "green" portfolio that intends to further increase the amount of renewable energy in that portfolio could end up with *greater GHG emissions* if forced to add CHP facilities. Similarly, it is simply not technologically feasible to add a CHP facility just anywhere, and certain territories may simply be unable to sustain a CHP facility. Accordingly, simply mandating the development of CHP in arbitrary amounts will not enable the development of those facilities.

In terms of determining the emission reduction potential of CHP units, it is important to consider the uniqueness of CHP facilities. Unlike energy efficiency, CHP does not come in various forms that can literally be utilized by all electricity customers and provide emission reduction benefits in virtually all cases. Unlike renewable resources, CHP projects are located close to the load source. Given the uniqueness of the CHP resource, NCPA respectfully cautions CARB about applying policies that are suitable for energy efficiency and renewable resources to CHP allocation determinations without careful scrutiny and consideration of unintended consequences that may negatively impact California's ability to reduce GHG emissions.

NCPA believes that a mandate that each service territory develop a specified number of CHP facilities based solely on some percentage of retail sales or peak load ignores these critical considerations. In order to maximize the effectiveness of the emission reductions to be achieved through the use of CHP facilities, the economic and environmental potential within each service territory must be evaluated before allocating the development of CHP in those areas. Accordingly, NCPA supports a public process for allocation of CHP responsibilities, and not arbitrary allocation based on load.

Determining an Allowance Allocation Methodology is a Prerequisite to Addressing CHP:

Final treatment of CHP in a cap-and-trade program cannot be determined until after CARB has made decisions regarding the allocation of allowances (as well as the use of set-asides and early reduction allocations). CARB, for example, cannot make a decision to incentivize CHP through set-asides and other options at this juncture. It must first make a determination of what incentive options are available and then demonstrate that these facilities are able to achieve the emissions reductions anticipated.

Response to Staff Inquiries to Stakeholders

Treatment of Small Industrial Sources ("but for" facilities):

Staff asked whether small sources that would not otherwise exceed the threshold for capped sources should have a special categorization. While a special category may be necessary, it is important that the structure of that category not be designed in a way that further reduces the number of entities in the first compliance period. In the Staff proposal presented during the Workshop, it was noted that natural gas used in these affected facilities would be a source of

emission allowances. However, since natural gas is not included in the first compliance period, the affected facilities would also be excluded from the first compliance period. This would contract the market for entities in the first compliance period since the result would be an even smaller pool of compliance entities in the first compliance period.

Allowance Holders Under Multiple Owners:

Allowances should be held by the affected entity with the compliance obligation. Accordingly, any freely allocated allowances should be assigned to the entity that will be required to surrender allowances at the end of the compliance period, regardless of what sector they are in.

Distribution of Allowances for CHP:

As a general rule, allowances to CHP should be distributed on a facility specific basis. For example, if the facility is being utilized to serve retail load via sales to the grid, then the allowances should go the entity that is responsible for emission reductions, which may not necessarily be the CHP facility. This issue must be further explored in the context of specific facilities as well as in light of the overall allowance allocation methodology adopted by CARB.

Incentivizing CHP:

Staff has asked stakeholders to comment on what additional options staff should consider to incentivize the use of CHP by capped facilities. NCPA believes that the more salient inquiry should be to what extent CHP needs to be incentivized. Staff must determine if there is a need to offer incentives for the development of either small or large CHP facilities, and if so, why the incentives are necessary. If the incentives are necessary due to the fact that CHP is not being developed because other options are available to effect emission reductions at the same or greater rate, then it may be that CHP is not the viable emission reduction option first anticipated.

Conclusion

Unlike many elements of the Scoping Plan and the proposed cap-and-trade program, the treatment of CHP within a cap-and-trade program is highly dependent on the resolution of important prerequisites. Accordingly, NCPA urges Staff to analyze the most recent data available regarding the likely penetration of CHP and review not only the total amount of GHG emission reductions attainable through this tool, but the related issues addressed above before finalizing recommendations on this matter. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or scott.tomashefsky@ncpa.com.

Sincerely,
MCCARTHY & BERLIN, LLP

C. Susie Berlin
Attorneys for the Northern California Power Agency