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SUBMITTED VIA ELECTRONIC SUBMISSION

April 13, 2012

Hon. Mary D. Nichols, Chairman
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: PE-Berkeley, Inc.'s Comments to CARB's Draft Amendments to the California Cap-and-Trade Regulation to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

Dear Madame Chairman:

These comments are offered to the California Air Resources Board ("CARB") by PE-Berkeley, Inc ("PEB"), a 22.47 MW cogeneration power plant located in Berkeley, California, and Olympus Power, LLC, an independent power company which is both an equity investor in, and the asset manager of, this facility. PEB supplies thermal energy to the University of California-Berkeley and electric power to Pacific Gas & Electric (PG&E) under long-term but separate agreements. Compared to other cogeneration (i.e., combined heat and power or "CHP") facilities, a larger percentage of the power generated at PEB is in the form of steam compared to electricity.

I. Introduction

Consistent with Quebec's Regulation,¹ PEB strongly encourages CARB Staff to provide relief for CHP facilities, such as PEB, with fixed price long-term contracts for steam with no mechanism for recovering such costs. We believe a harmonized approach to this issue is necessary to appropriately integrate these cap-and-trade regulatory programs. Significantly, the intellectual integrity of the California Cap-and-Trade Regulation² dictates a consistent approach to similarly situated projects, in particular, with respect to the equitable treatment of stranded assets. Absent the necessary relief, PEB will bear a disproportionately higher cost of compliance as compared to certain Quebec entities.

¹ Regulation respecting a cap-and-trade system for greenhouse gas emission allowances, available at <http://www.mddep.gouv.qc.ca/changements/carbone/reglementPEDE-en.pdf>. (the "Quebec Regulation").

² Cal. Code Reg., tit. 17, §§ 95800 et seq.

II. Quebec Regulation Provides Appropriate Relief to CHP Facilities

Cap-and-trade regulatory programs are designed to shift the cost of the carbon emissions to the end users, such that they modify their behavior with respect to energy consumption. However, as CARB Staff is aware, certain CHP facilities in California have entered into long-term contracts with no available pass-through mechanism for allowance costs related to steam supply.³ Quebec, on the other hand, has squarely addressed this issue by providing free allowances to (i) electricity generators, and (ii) steam suppliers who entered such contacts prior to January 2008.⁴ In doing so, the Quebec program recognizes that stranding allowance costs on such generators does not advance the goals of the program, but will cause inequitable financial harm to an otherwise environmentally-preferable source of energy. In this regard, the California Cap-and-Trade Regulation creates unrecoverable costs and economic hardship to certain CHP facilities, including PEB. Significantly, with no corresponding burden to Quebec entities, California CHP facilities will have greater cost of compliance compared to Quebec entities.

In the case of PEB, it entered into a contract to supply steam in 1987—well before carbon emissions regulations were even contemplated—and requests relief only through 2017 when its existing steam supply contract expires. As described in the attached letter,⁵ Gowlings, a well-respected Canadian law firm, has confirmed that PEB would not bear these unrecoverable costs under the Quebec program, and believes CARB Staff’s approach to this issue places certain Quebec entities at a competitive advantage.

III. CHP Facilities Are Important to the State’s Goal to Reduce GHG Emissions

PEB believes CARB Staff should make every effort to assist CHP facilities in this regard. As recognized in the Scoping Plan,⁶ CHP facilities are important to California’s goal of reducing greenhouse gas (GHG) emissions in accordance with Assembly Bill (AB) 32. Indeed, throughout the Cap-and-Trade rulemaking, CARB staff recognized the need to address this issue, and committed early on to work with stakeholders to find a solution to such long-term contracts.⁷ Most recently, in adopting the Cap-and-Trade Regulation, the Board directed CARB Staff to “monitor progress on bilateral negotiations between counterparties with existing contracts that do not have a mechanism for recovery of carbon costs associated with cap-and-trade for

³ CHP facilities will recover costs related to electric power supply as part of settlement agreement negotiated under the supervision of the California Public Utilities Commission; however, no such relief is provided to CHP facilities for the steam aspect of their operations under CARB’s Cap-and-Trade Regulation.

⁴ Quebec Regulation, Section 39; Table A of Part I of Appendix C.

⁵ Gowlings Letter to Olympus Power, LLC, Québec cap-and-trade system for GHG emission allowances (April 12, 2012).

⁶ Climate Change Scoping Plan: A Framework for Change, CARB, December 2008, 44 (recommending measure no. E-2, “Increase Combined Heat and Power Use by 30,000 GWh”).

⁷ Resolution 10-42, Attachment B, 8.

industries receiving free allowances pursuant to section 95891, and identify and propose a possible solution, if necessary.”⁸ We believe such a solution is necessary, and request CARB Staff’s immediate assistance to resolve this issue.

IV. CARB Staff Should Provide the Necessary Relief to PEB

PEB simply requests that CARB treat California CHP facilities in this regard the same as Quebec entities. We believe there are several options available to CARB to address this issue, such as providing direct allocation of allowances (for the steam portion of generation) to genuinely stranded CHP facilities that have been unable to renegotiate their contracts. CARB could also award allowances instead to genuinely stranded CHP facilities burdened with this unrecoverable cost, but not to entities receiving free allowances (who have no compliance costs due to such contracts). Of course, PEB is welcome to discussing any other relief that CARB staff may devise in order to avoid the punitive economic impact of the Cap-and-Trade Regulation to its CHP facility.

PEB appreciates the opportunity to submit these comments, and looks forward to working with CARB Staff and the Board to fully address this important issue. Please feel free to contact us with any questions or comments related to these comments.

Sincerely,



Michael Mazowita
Vice President
P.E. Berkeley, Inc.

Sean P. Lane
General Counsel and Secretary
Olympus Power, LLC

Attachment

cc: George Haley, Esq., Counsel to P.E. Berkeley, Inc.
Peter H. Weiner, Esq., Counsel to Olympus Power, LLC

⁸ Resolution 11-32, 12.



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Montréal, April 12, 2012

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BY E-MAIL AND REGULAR MAIL

Mr. Sean P. Lane
General Counsel & Secretary
Olympus Power, LLC
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Re: Québec cap-and-trade system for GHG emissions allowances

Dear Mr. Lane:

Following our telephone conversation earlier this week, we are pleased to provide you with our views with respect to the Québec cap-and-trade system for greenhouse gas (GHG) emissions allowances in light of the situation you described concerning the PE-Berkeley Inc. (“PEB”) natural gas fired, combined cycle, cogeneration facility located on the campus of the University of California, Berkeley. It is our understanding that the PEB facility can supply both electricity and thermal energy, or heat. It is also our understanding that the steam sales agreement under the existing contractual structure bars PEB from recovering the material and unanticipated steam-derived financial cost of the California Air Resources Board (CARB) GHG regulation, as currently proposed.

The Québec GHG Cap and Trade System

On June 19, 2009, the National Assembly of Québec assented to Bill 42 *An Act to amend the Environment Quality Act and other legislative provisions in relation to climate change* (“Bill 42”) which allowed the Government of Québec to put in place, by regulation, all the mechanisms required to implement a cap-and-trade system.

The explanatory notes to Bill 42 mention the following:

“In addition, it requires that certain emitters cover their greenhouse gas emissions with an equivalent number of emission allowances, whether emission units, offset credits or early reduction credits, which may be traded and banked under the cap-and-trade system. Caps on the number of emission units the Minister may grant are to be set by the Government.”

Section 46.7 of Bill 42 (today, Section 46.8 of the *Environment Quality Act*) provides that the Government of Québec may :

“Grant the available emission units, either by allocating them without charge to emitters required to cover their greenhouse gas emissions, or by selling them at auction or by agreement to persons or municipalities determined by regulation of the Government”

At the time Bill 42 was debated it was understood by representatives of the National Assembly that the allocation of emission units without charge was a mechanism of flexibility provided under the Western Climate Initiative (“WCI”) to avoid harming the competitiveness of a company as a result of the cap-and-trade system.

It was also understood that a “good number” of emission units would be allocated without charge taking into account several factors. An example was given of an enterprise that uses the best known technology at the time of implementation and will be unable to reduce its emissions. The allocation without charge was also intended to ensure a certain harmonization between jurisdictions in order not to penalize certain companies.

The representatives of the National Assembly were conscious of the fact that the Bill 42 gave the Government of Québec the general power to establish a cap-and-trade system including the granting of emission allowances without charge and that the details of how the system works would be later specified in regulation. At the time, the representatives noted that industry was present, participated in the debates and did not object in principle to Bill 42.

On December 14, 2011 the Government of Québec adopted the *Regulation respecting the cap-and-trade system for greenhouse gas emissions allowances*, O.C. 1297-2011, published in the *Gazette Officielle du Québec* on December 16, 2011, that came into force on January 1st, 2012 (the “**Regulation**”).

Although the Regulation came in force on January 1st, 2012, its true effects will only begin a year from now on January 1st, 2013 when the WCI cap-and-trade system will also come into effect. The cap-and-trade system foreseen under the Regulation will begin with an initial phase consisting of three compliance periods. These will be preceded by a transition year (the year 2012) to allow emitters and participants to register with the system, take part in pilot auctions and exchange GHG emission allowances on the market. No reduction or capping of GHG emissions will be required during this transition year. In fact, the capping and reduction of GHG emissions will begin officially on January 1st, 2013. Some 75 operators, primarily in the industrial and electricity sectors, whose annual GHG emissions equal or exceed the annual threshold of 25,000 tons of carbon dioxide equivalent will be subject to the capping and reduction of their GHG emissions.

Regulation

Title III of the Regulation pertains to emission allowances. By way of comparison with the PEB facility, we believe that Section 39 and following of the Regulation are of interest and particularly Section 39 that provides that an emitter operating a designated establishment and pursuing an activity referred to in Table A of Part I of Appendix C of the Regulation is eligible for allocation of emission units without charge. Among the Table A designated activities eligible for the allocation without charge of GHG emission units, the following activity is noteworthy:

“Electric power generation sold under a contract signed prior to January 1st, 2008, that has not been renewed or extended after that date in which the sale price is fixed for the duration of the contract with no possibility of adjusting the price to take into account the costs relating to the implementation of a cap-and-trade system for greenhouse gas emission allowances.”

The reference units for the purpose for the cap-and-trade system relative to industrial sectors set forth in Table B of Appendix C of the Regulation designate namely, the electricity sector for the production of electricity and the production of steam.

Comparison with the PEB situation

In light of the above, if your PEB facility were in Québec, under the Regulation, it would benefit from the allocations of emission units without charge in light of the fact that its contracts were executed prior to 2008 and current contractual structure bars PEB from recovering the material and unanticipated financial costs resulting from the coming into force of the cap-and-trade system described above.

We note that the WCI Partner jurisdictions' recommendations are designed to maintain and enhance competitiveness. To this end free distribution of emission allowances in certain industries has been identified as an approach to "promote competitiveness and minimize leakage".¹ The WCI also recognizes the need for harmonization between partners to "ensure consistent programmatic outcomes and a level playing field for covered sources".²

There appears however to be an advantage in favour of Québec-based facilities operating under the Province's cap-and-trade system as compared, in PEB's case, to what is presently proposed under the CARB GHG regulation. Such a result would be contrary to WCI's goal to harmonize linked programs and avoid penalizing certain entities.

Should you wish to know more about the Québec cap-and-trade system, please feel free to contact the undersigned.

Yours sincerely,

GOWLING LAFLEUR HENDERSON LLP



Paul Granda

¹ Western Climate Initiative, *Design for the WCI Regional Program*, July 2010, page 14.

² *Ibid.*, page 24.