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Climate Change Program Evaluation Branch
California Air Resource Board
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Sacramento, California 95812 Via Email: scliff@arb.ca.gov

Subject: Comments of Waste Management on 2013 Proposed Regulation Amendments to Cap & Trade Regulations as pertains to Legacy Contracts

Submitted via website: http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=cap-trade-draft-ws&comm_period=1

Dear Dr. Cliff:

Introduction

On behalf of Waste Management (WM) and its subsidiary Wheelabrator Technologies, WM provides the following comments on amendments to the Cap & Trade Regulation (the "C&T" or the "Regulation") released and discussed at the Workshop convened on July 18, 2013. WM's comments focus on proposed Section 95894, "Allocation to Legacy Contract Generators for Transition Assistance", and associated definitions of "Legacy Contract" and "Legacy Contract Emissions." As discussed below, Section 95894 and the associated definitions should be clarified to account for non-standard QFs that were not addressed in CPUC Decision number D.10-12-035. The transitional assistance formula in Section 95894 should be revised to account for actual emissions through the duration of the legacy contract. We have attached herein the "Cap and Trade Regulation Amendment Request" form with these comments and submitted the form as directed to Mr. David Allgood. The form contains specific language we propose be added and selected deletion of language in the proposed amendments.

I. The ARB Should Clarify Section 95894 And The Associated Definitions To Provide Transitional Assistance To Non-Standard Qualifying Facility Contracts.

The proposed definition for "Legacy Contracts" excludes contracts with IOUs that are "already

addressed under the Combined Heat and Power Program Settlement" (CHP Program Settlement). It is unclear whether this definition would exclude any QF/CHP facility having a power purchase agreement, regardless of the fact that their contract provisions were not the subject nor considered in QF/CHP Program Settlement language. Based on the definition of "Legacy Contract Emissions", it appears that any QF would be considered "addressed" by the CHP Program Settlement and ineligible for relief if the California Public Utilities Commission (CPUC) included its emissions in the calculation of cost under the Qualifying Facilities and CHP Program Settlement. WM is concerned that this language is unclear and does not account for the complexities of the CHP Program Settlement. More important, the draft language does not address the unique issues faced by Non-Standard QF Contracts (explained below), which were not addressed under the CHP Program Settlement.

There is a small set of qualifying CHP facilities with Non-Standard Qualifying Facility (QF) contracts (Non-Standard QF Contracts) that are in need of a means to allow recovery of C&T compliance costs. Wheelabrator's Norwalk Energy (Norwalk) power plant is one such CHP facility. Facilities like Norwalk have Non-Standard QF Contracts that were entered into or amended long before the legislature considered, or the public was in any way aware of, a potential C&T program in California.

These Non-Standard QF Contracts were bilaterally negotiated by the CHP facilities and the IOUs as far back as the 1980's, and included non-standard performance obligations in exchange for non-standard short run avoided cost (SRAC) pricing provisions. The existence of these non-standard performance obligations negates the ability to accept the standard legacy amendment under the CHP Program Settlement. These non-standard CHP facilities were financed and are operated based upon the non-standard pricing terms. These facilities also entered into obligations under additional agreements with third parties, including the State of California, based upon the non-standard pricing terms. Importantly, the Non-Standard QF Contracts do not address recovery of C&T compliance costs.

As part of the CHP Program Settlement, CHP facilities with *standard* legacy QF contracts were offered an amendment (the Legacy Amendment). The Legacy Amendment included short-run avoided cost (SRAC) pricing options for QFs paid under standard SRAC pricing, which under the legacy contacts are adjusted, from time to time, by the CPUC. Integrated into each standard SRAC pricing option were differing levels of recovery of C&T compliance costs.

Because Non-Standard QF Contract holders have non-standard SRAC pricing terms, not subject to adjustment by the CPUC from time to time, they were not in a position to execute the Legacy Amendment as a means of recovering C&T compliance costs; to do so would have required them to forfeit their non-standard pricing terms that were the result of negotiations requiring the CHP facility to forego certain benefits provided them under standard contract provisions. As a result, acceptance of the Legacy Amendment would mean that a non-standard QF, like Norwalk, would operate at a loss. Thus, the Legacy Amendment offered no means of recovery of C&T compliance costs for CHP facilities with Non-Standard QF Contract pricing. Non-Standard QF Contracts are not "addressed" by the CHP Program Settlement, and the regulatory amendments should be clarified to account for the unique circumstances of Non-Standard QF Contracts.

II. The Regulatory Amendments Should Provide Legacy Contracts With Greater Ability To Renegotiate Their Contracts By Removing Freely Allocated Allowances From A Counterparty That Receives Free Allowances For The Electricity From The Facility.

Small generators like Norwalk have little bargaining power in comparison to their large utility customers. Attempts to negotiate with the utility were met with a single offer to accept the QF Settlement that had been rejected before for the reasons stated above. This has left Norwalk, like other Non-Standard QF CHP facilities, shouldering the full cost of compliance and facing deleterious operating expenses.

Attempts to resolve this problem for unique facilities like Norwalk have been unsuccessful. The CPUC directed parties (ALJ Ruling of May 8, 2013) to invoke alternative dispute resolution provisions in their agreements with the IOUs to settle the cost recovery issue. However, this direction failed to appreciate that Non-Standard QF Contracts typically have no such provision; thus there is no basis to pursue dispute resolution. Furthermore, in meetings and correspondence with Non-Standard QF Contract holders, the IOUs were unwilling to provide for any relief beyond what is offered in the Legacy Amendment.

The IOUs have been given allowances based on their expected costs of emissions. A portion of these *freely* allocated allowances are attributable to the power generated by CHP facilities with Non-Standard QF Contacts. So while facilities like Norwalk are left without any means of cost recovery, the IOUs nevertheless receive allowances attributable to those emissions. In addition, the policy masks the price impact of GHG compliance costs associated with procuring power from CHP facilities with Non-Standard QF Contracts.

Without relief, CHP facilities like Norwalk will hold all liability for C&T compliance costs, which will threaten the viability of their operations and those who rely upon those operations. In the case of Norwalk, where the State of California is provided thermal and electrical energy from the CHP facility, the State's Metropolitan Hospital Complex will bear the risk of plant closure due to increased operating costs under the Regulation.

The ARB has begun the process of providing for the ability to reallocate allowances to the proper party by proposing Section 95891(f) that allows the Executive Director to subtract the allocation adjustment from certain legacy contract counterparties. The ARB should implement similar provisions in Section 95892, such that a utility that fails to renegotiate a legacy contract will lose any allowances that were allocated to the utility based on the expected costs of emissions attributable to the Non-Standard QF Contract. These allowances should then be directly allocated to holders of Non-standard Legacy Contracts to the extent needed to properly account for emissions.

III. The ARB Should Revise Section 95894 To Allocate Allowances To Legacy Contracts Based On Verified Emissions.

The ARB proposes to allocate 2015 vintage allowances for transition assistance to a limited number of legacy contract holders to be used prior to 2015, for 2013 and 2014 emissions. We

ask for clarification with regard to how this allocation will be effectuated. The proposal is not clear.

While we have no issue with basing the number of allowances on existing data, we believe it would be more appropriate to use verified 2013 emissions rather than 2012 emission data as proposed. The ARB will have 2013 data prior to the 2014 allocation and should use that most recent information in its allocation.

IV. The ARB Should Revise Section 95894 To Allocate Allowances Through The Full Duration Of A Legacy Contract.

We strongly urge the ARB to continue with its allocation to Non-Standard QF Legacy Contract-holders for the life of their contracts. In the case of Norwalk, that amounts to an additional two-and-a-half years. Failure to provide relief can result in early shutdown of the facility due to the significant cost of compliance. Conversely, the facility can begin negotiations for a new PPA earlier than expected, but at a significant disadvantage in bargaining power and with the same result of a shutdown. Moreover, cost exposure for GHG emissions post-2015 will limit the ability of a Legacy Contract holder to plan maintenance and capital improvements.

Revisions to Section 95892 (as noted above) are needed to equalize negotiations. However, we urge the ARB to provide *now* for adjusting allowances post-2015 should the agency refuse to provide relief to legacy contract holders through the short, remaining life of their contract. In this manner, the parties are not left guessing what will happen or when it will happen. Nor will the parties be in a position of petitioning the ARB to "take away" allocations that are not appropriately given in the first place.

V. Inclusion Of The Natural Gas Sector In The Cap-and-trade Program Will Not Provide A Mechanism For Recovery Of GHG Compliance Costs.

We believe that the ARB may be improperly forecasting that the addition of natural gas suppliers to the C&T program will have the effect of increasing the natural gas index upon which SRAC and price formulas are calculated. In this manner, so the reasoning goes, a generator is compensated for the cost of compliance post-2015 by an increase to his pricing formula due to the increase in the natural gas index.

But this reasoning assumes that natural gas suppliers will *feel* the impact of the C&T and prices will be affected. They will not. The ARB proposes to give natural gas suppliers free allowances for those emissions generated by operations below the 25,000 metric tons CO2e threshold, and make natural gas suppliers indifferent to energy generation using natural gas that emits greater than 25,000 metric tons CO2e. Facilities that emit greater than 25,000 metric tons CO2e, like Norwalk, most certainly will feel the impact of the Regulation unless relief is provided. But the Regulation will have little or no impact on natural gas suppliers and the price of natural gas – at least not for the short remaining life of a legacy contract.

VI. Conclusion

Ideally, recovery of the costs associated with a new regulation would be clearly established in the contract. Unfortunately, this has not been the case. Utilities had been given time to renegotiate contracts with small generators like Norwalk Energy, but inherent in that opportunity is an assumption that both parties are equal in their contract negotiating position. That is not the case. Utilities hold a significantly more powerful position in contract renegotiations with small generators which have no other viable energy customer than the utility with which they have an executed contract while
the utility has an array of other generation options.

We urge ARB to equitably resolve the issue of cost recovery by assigning allowances to the Norwalk facility and other similarly situated power plants without cost recovery. The ARB should directly allocate allowances to generators with Non-Standard QF Legacy Contracts based on their actual compliance obligation as determined by the annual verified emissions for a given compliance period for the remaining life of the existing contract. Newly proposed Section 95891(f) should serve as a model for encouraging counterparties to renegotiate. Section 95892 should be revised to reduce an electric utility's free allocation if the utility does not renegotiate the legacy contract. Specific language changes to the proposed amendments accompanying this comment letter in the allotted "Cap and Trade Regulation Amendment Request" form.

Thank you for this opportunity to provide initial comments. We look forward to working with you to resolve this important issue.

Sincerely,

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