Pacific Gas and Electric Company

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Steven Cliff, Ph.D.
Chief - Climate Change Market Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

Re: Pacific Gas and Electric Company's Comments on the Air Resources Board's May 1, 2013 Workshop: Universities, "But For" Combined Heat and Power and Legacy Contracts

Dear Dr. Cliff:

Pacific Gas and Electric Company (PG&E) welcomes the opportunity to submit these comments on the Air Resources Board's (ARB) May 1, 2013 workshop to discuss proposed adjustments to the cap-and-trade program's treatment of universities, "but for" combined heat and power ("CHP"), and legacy contracts.

I. INTRODUCTION

PG&E's detailed comments on the workshop are set forth below. The following summarizes the key issues:

- Legacy Contracts
  - The Definition of Legacy Contracts Should Exclude PUC Jurisdictional Contracts
  - A Contract Should Be Considered A Legacy Contract Only if Executed Prior to August 15, 2005
  - Compliance Obligations Associated with Legacy Contracts Should Not Be Transferred to Natural Gas Suppliers
- Public Data on "But for" CHP Facilities Should Be Released

II. DISCUSSION

A. Legacy Contracts

The Definition of Legacy Contracts Should Exclude PUC Jurisdictional Contracts

PG&E supports ARB's position at the May 1 workshop that investor-owned utility (IOU) contracts are not within scope of ARB's discussion on legacy contracts. As stated in an October 2012 letter from the ARB Executive Officer, "legacy contracts for which the Public Utilities Commission (PUC) has jurisdiction should be resolved by the parties through the existing processes at the PUC"[1]. PG&E requests the definition of legacy contracts in the 2013 amendments to the Cap-and-Trade Regulation (e.g. § 95802. Definitions) explicitly exclude PUC jurisdictional contracts to ensure all parties understand ARB's intent.

Despite comments made by some stakeholders during the course of the May 1 workshop, contract processes included in PUC-jurisdictional contracts are working and are not slow. The PUC has provided clear policy guidance indicating that the dispute resolution processes in PUC-approved legacy contracts should be used to resolve the treatment of AB 32-related costs. This process has and is working successfully to resolve remaining legacy contract disputes in a manner that is equitable for both parties. Generators are obtaining the answers or solutions to the questions or issues they have raised through the processes agreed to by both parties, either dispute resolution or renegotiation. For example, PG&E and several counterparties have successfully amended legacy contracts to reallocate AB 32-related costs. If ARB assisted a party who was unwilling to come to the table, such action would unduly favor a party who intentionally bypassed a well-established process within the PUC-approved contract, rather than work reasonably within that process.

Generators and PG&E entered into legacy contracts at time when AB 32 was making its way through the California legislature and was the subject of public discussions. IOU legacy contracts were reviewed, vetted, and approved by the PUC. In D. 12-04-046, the PUC has stated it does not want to second guess negotiations, nor undermine the balance of benefits and risks in commercial transactions. Furthermore, the 5/8/2013 *Administrative Law Judge's Ruling Addressing Motions Related to Pre-Assembly Bill 32 Contract Information* states:

> It would be inappropriate to amend a contract to require utilities and their ratepayers to pay those compliance costs a second time if they were accounted for in the original contract. For these reasons, it remains appropriate for parties to legacy contracts to renegotiate those contracts, and it is unlikely that the Commission will impose specific contract modifications. **As noted above, a dispute about whether a given contract already includes GHG costs either explicitly or otherwise raises a factual question**

[1] October 23, 1012 letter from Executive Officer James Goldstene to Bob Lucas, California Council for Environmental and Economic Balance

> **that is more appropriately determined for each contract through the contract's dispute resolution processes.** [emphasis added]

As ARB's Executive Officer noted in his October 23, 2012 letter, ARB will defer to the PUC process for resolution of IOU legacy contracts. We urge ARB to continue to affirm this policy direction and to deny any requests from parties to these contracts seeking outcomes outside of the PUC-approved dispute resolution processes.

A Contract Should Be Considered A Legacy Contract Only if Executed Prior to August 15, 2005

ARB should amend the date before which an executed contract qualifies as a legacy contract from September 2006 to August 15, 2005. CPUC Decision 12-12-002[2], dated December 20, 2012, cites August 15, 2005 as the date the potential for future GHG costs was first introduced:

> In its comments, PEC requests removal of the discussion concerning the August 15, 2005 threshold date for considering whether parties to power purchase contracts could have foreseen the imposition of a carbon price in the electric sector[3]. The August 15, 2005 version of AB 32 marked the first reference to a firm cap on emissions in AB 32. That version proposed adding Section 42877(a)(1) to the Health and Safety Code, which would have required the Secretary of the California Environmental Protection Agency to implement a "greenhouse gas emissions cap for the electrical power, industrial, and commercial sectors" by January 1, 2008. While this date is not singularly dispositive, it is relevant and may be considered along with other factors affecting the OMEC PPA and other similarly situated contracts. Thus, we decline to modify the proposed decision as requested.
>
> However, had this contract been executed after AB 32 was amended to include language regarding broad limits on GHG emissions (see AB 32 as amended on August 15, 2005; http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_0001-0050/ab_32_bill_20050815_amended_sen.pdf), it would be less appropriate to allow these costs to be passed through as proposed, without some adjustment in the contract price or some other term to compensate ratepayers for assuming this additional cost.

CPUC Decision 12-04-046[4], dated April 4, 2012, also states, "Contracts negotiated and executed when AB 32 was working its way through the legislature should have taken the potential impacts of AB 32 into consideration. Even those negotiating contracts shortly before then might also have reasonably foreseen that this issue could arise."

PG&E's counterparties, and presumably other generators, were sophisticated commercial parties with experienced commercial, regulatory and legal teams and were well aware of the potential

[2] http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M041/K695/41695122.PDF
[3] PEC's petition for modification was rejected by the PUC
[4] http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_DECISION/164799.PDF

for GHG costs prior to the date of the actual passage of AB32. The CPUC agrees with this assessment; we urge ARB to provide a consistent conclusion.

Compliance Obligations Associated with Legacy Contracts Should Not Be Transferred to Natural Gas Suppliers

At the May 1 workshop, staff shared its decision to provide a full administrative allocation to any unresolved non-IOU legacy contracts. Staff also indicated that it is considering a separate approach to address the few unresolved legacy contracts that may remain in the second and third compliance periods. This approach, which PG&E adamantly opposes, would transfer the GHG compliance obligation from generators with unresolved legacy contracts to natural gas suppliers.

PG&E does not have a position on whether renegotiation or an administrative allocation is the superior policy solution for remaining non-IOU legacy contracts. However, pursuing a supplementary solution of transferring the compliance obligation to the natural gas supplier would require implementation of a very complicated and administratively onerous remedy to address a dwindling number of contracts. Questions remain as to how ARB could calculate a generator's emissions associated with burning natural gas to serve a customer with which it has a legacy contract. This becomes particularly challenging when a generator serves several customers or in the event several generators serve a variety of overlapping customers. Therefore, a separate solution for the second and third compliance period is unnecessary and overly burdensome to natural gas suppliers not a party to a legacy contract. Moreover, this solution would place the natural gas supplier in the middle of a contract arrangement and dispute to which it was not originally a part

ARB's proposal could expose natural gas suppliers to additional regulatory and commercial risks by increasing their compliance obligations, requiring arduous changes to billing systems, introducing implementation challenges (e.g., smoothly transferring the GHG obligation back to generators once the legacy contracts are resolved), and further limiting procurement flexibility due to holding limit constraints. The determination of who bears GHG costs is best addressed by negotiation between the parties. Dispute resolution provisions in these contracts should be followed through to their fullest extent, and not superseded by ARB action, which could discourage renegotiation.

Furthermore, it is worth noting that fluctuations in emissions from facilities with legacy contracts could put natural gas suppliers at risk of non-compliance. No auction will be held between the date ARB is scheduled to notify natural gas suppliers of their compliance obligation (October 1[5]) and the annual compliance obligation demonstration date (November 1[6]). In the event historical emissions from legacy contracts do not accurately forecast future output, the natural gas supplier could be faced with a sudden, unanticipated increase in its compliance obligation. All of the natural gas suppliers' customers would then have to bear the cost of procuring additional

[5] Section 95852(5)(c)(4)
[6] Section 95856(d)(1)

compliance instruments to cover emissions associated with legacy contracts or be faced with non-compliance. A similarly undesirable situation could occur in the event a supplier of natural gas purchases compliance instruments on behalf of a generator with a legacy contract that is then resolved. While the natural gas supplier could sell these instruments into the market, there is a possibility it could receive a lower price than was originally paid. Once again, the natural gas supplier's customers would be forced to bear the cost.

As noted above, a different approach for compliance periods two and three would place additional, unwarranted risks and administrative burdens on natural gas suppliers. PG&E maintains that the need to take on these risks and set up these systems is unduly burdensome, particularly in light of the small number of legacy contracts likely to remain past the first compliance period.

B. Public Data on "But For" CHP Facilities Should Be Released

PG&E neither supports nor opposes the ARB staff proposal for "but for" CHP exemptions under the cap-and-trade program. Historically, California's energy policy perceived CHP as an efficient technology and promoted it as a preferred electric generation resource. However, as California continues towards an ever-cleaner energy supply, there is a need to place greater attention on the ability of individual CHP units to reduce GHG emissions relative to separate heat and power. As a general principle, any preferential treatment for CHP should be tied to the measured GHG performance of the system in question.

CHP reduces GHG emissions if the CHP facility uses less fuel than the fuel needed to produce an equivalent amount of energy through separate heat and power production (e.g., steam produced using a boiler and electricity purchased from the electric grid). If deployed and operated in an inefficient way, CHP, unlike renewable generation, has the potential to increase GHG emissions, and perhaps to do so over a prolonged time due to the lifespan of such units. As more renewable power is added to the grid, the GHG benefits from fossil-fuel CHP systems will likely diminish.

Currently, there is no public data source that accurately reports GHG performance or efficiency information of operational California CHP facilities. ARB has data collection efforts under the Mandatory Reporting Regulation (MRR) that could fill this need for transparency related to CHP GHG performance. Last September, in proposed amendments to the MRR, PG&E submitted comments to ARB requesting that the GHG benefits or disadvantages from the CHP facilities in that dataset be calculated, aggregated, and presented publicly.[7] We encourage ARB to use this opportunity to undertake this exercise and report specifically where the CHP facilities deemed to be eligible for the "but for" exemptions operate in relation to separate heat and power production. A list of "but for" facilities exempt from their Cap-and-Trade obligations should be made public for these reasons. Further, this information may have contractual implications as

[7] PG&E's Comments on the Proposed Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions, September 10, 2012, Section D & E- page 3-7 http://www.arb.ca.gov/lists/ghg2012/3-091012_mrr_comments_final.pdf

well – and may help prevent windfall profits (for example, with contracts that include GHG costs associated with emissions costs that will not actually be incurred).

In addition, PG&E requests that ARB requires generators, in their reporting, to demonstrate that steam output is being productively utilized.

III. Conclusion

Thank you for the opportunity to submit these comments. We look forward to continuing our work with ARB and other stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

Judi K Mosley

cc: Claudia Orlando, via email
Holly Stout, via email
Greg Mayeur, via email
Elizabeth Scheehle, via email