Panoche Energy Center 43833 W. Panoche Road, Firebaugh CA 93622

October 22, 2018 ***Submitted Electronically***

Board Members
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

Re: Panoche Energy Center LLC Comments on September 4, 2018 Cap and Trade Rulemaking Package

Panoche Energy Center, LLC ("PEC") respectfully submits these comments to provide recommended changes to the Cap and Trade Rulemaking Package. The requested changes pertain primarily to PEC's lingering unresolved status as a Legacy Contract. The comments explain how this unresolved situation impacts not only PEC, but also other stakeholders and in turn the integrity of the Cap & Trade Program (the "Program") generally. This important issue has been buried deep within the broader functioning of the Program, but now is the time to resolve it as the adverse impacts on the broader electricity and carbon markets will only grow over time. The timing is ripe to finally resolve this issue during this current rulemaking effort.

PEC fully understands that California Air Resources Board ("CARB") would prefer a contractual solution, but that takes two willing counterparties engaging in a common effort to solve a common problem. That basic prerequisite to a bilateral solution simply does not exist here. Our renewed request for a regulatory solution is necessitated because PEC's counterparty, Pacific Gas & Electric ("PG&E"), is unwilling to find a solution aligned with the interests of the Program. Because this is a multi-year, multi-faceted and historically complex issue, PEC has prepared this letter in greater detail than previous comment letters. The goal of the extended detail is to both summarize and consolidate the facts about this regulatory, market and environmental problem in one place with the hope that a regulatory solution can be completed under this rulemaking. It must be noted that PEC has never stopped pursuing a good faith contractual solution, and in fact, has presented our counterparty numerous opportunities for settlement with conditions that PEC believes *exceed* those that have already been agreed to by PG&E and approved by the California Public Utilities Commission ("CPUC").

PEC has segregated this letter into the following topic areas:

I. PEC Overview
II. Cap and Trade Background, Legacy Contract Elements & Other Regulatory History
III. Background and Status of Counterparty Negotiations
IV. Impact of a Lack of Carbon Price Signal on PEC's Electric Energy Dispatch Price
V. Requested Relief
VI. Potential Solutions

I. <u>PEC Overview</u>

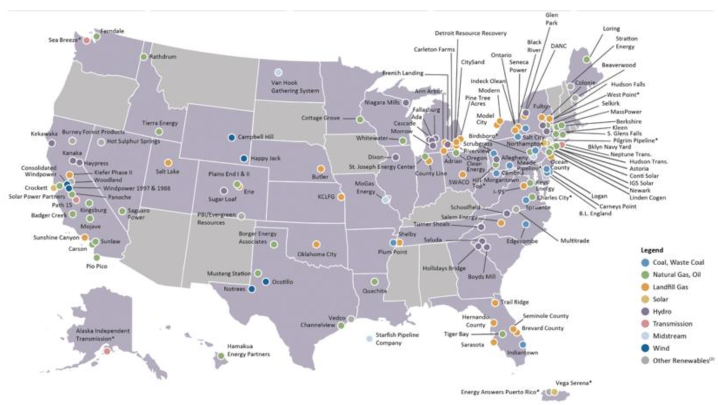
PEC is a large natural gas peaking plant located near Fresno, California. According to the Jobs and Economic Development Model, PEC contributes more than $20 million dollars per year and generates over 80 jobs for the local and California economy. PEC's quick-start capability and operational flexibility are critical in supporting grid reliability as California continues its build out of intermittent renewable generation. Those characteristics, along with PEC's proximity to fuel supply and connectivity to the grid make PEC an essential piece of California's energy infrastructure.

On March 28, 2006, PEC entered into a tolling Power Purchase and Sale Agreement ("PPA") for the exclusive sale of electric power to PG&E. PEC won a competitive bid with PG&E in an open and transparent process, overseen by the CPUC. The PPA was a standard form document at the time, and it did not explicitly address the price of carbon as AB 32[1] was only a legislative concept being debated in the California legislature. The PPA signed by PEC is almost identical to others that were executed at that time and have subsequently been amended to address the lack of language addressing carbon pricing. PEC began delivering power to the grid in June 2009.

PEC is owned by a Fund managed by Ares EIF Management, LLC ("Ares EIF"). Ares EIF is an experienced fund manager responsible for scores of traditional and renewable infrastructure projects within California and within the United States—see Figures 1 and 2, respectively. Ares EIF has three decades of contractual, regulatory and operational experience across U.S. geographies and energy infrastructure assets.

<u>Figure 1</u>

<u>Figure 2</u>



Many of the investors in Ares EIF-managed funds are pension funds and endowments, including some that reside in California. In fact, one of the largest single investors in the fund that owns PEC is Contra Costa County Employees' Retirement Association.

With greater than 30-years of experience, Ares EIF prides itself on managing the development, construction and acquisition of the critical energy infrastructure that supports grid stability and the integration of intermittent renewable technologies, and provides economic benefits to the local economy. One of the foundational principles of the California Climate Program is to incent clean energy infrastructure within the state, and Ares EIF has been a willing partner in that effort.

II. Cap and Trade Background, Legacy Contract Elements & Other Regulatory History

Cap and Trade Background

CARB's Cap and Trade Program, first launched in late 2012, is a market-based mechanism designed to discourage the emissions of greenhouse gases. It is a key component in the broader AB 32 Scoping Plan master policy framework to reduce GHGs.[2] It is an independent regulation, enforceable through the number of carbon permits, or "allowances" issued by CARB. But, it really isn't that simple. It is a complicated scheme which relies on a basic economic premise that if something costs more, entities will have an incentive to reduce that which is more expensive, i.e. the "Cost of Carbon" will be avoided at economically optimal levels.

[1] http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_0001-0050/ab_32_bill_20060927_chaptered.pdf
[2] https://www.arb.ca.gov/cc/scopingplan/scopingplan.htm

Because the total volume of available permits – the "cap" in cap and trade – declines each year. That raises the price for each permit, in theory, giving companies a financial incentive to reduce their emissions.

CARB has attempted to simplify the explanation of the program. The following excerpt is pulled directly from CARB's Cap and Trade homepage:

"The AB 32 Scoping Plan identifies a cap-and-trade program as one of the strategies California will employ to reduce the greenhouse gas (GHG) emissions that cause climate change. This program will help put California on the path to meet its goal of reducing GHG emissions to 1990 levels by the year 2020, and ultimately achieving an 80% reduction from 1990 levels by 2050. Under cap-and-trade, an overall limit on GHG emissions from capped sectors will be established by the cap-and-trade program and facilities subject to the cap will be able to trade permits (allowances) to emit GHGs."

"Cap-and-trade is a market based regulation that is designed to reduce greenhouse gases (GHGs) from multiple sources. Cap-and-trade sets a firm limit or cap on GHGs and minimize the compliance costs of achieving AB 32 goals. The cap will decline approximately 3 percent each year beginning in 2013. Trading creates incentives to reduce GHGs below allowable levels through investments in clean technologies. With a carbon market, ***a price on carbon is established for GHGs***. Market forces spur technological innovation and investments in clean energy. Cap-and-trade is an environmentally effective and economically efficient response to climate change.[3] (emphasis added)

California is committed to cutting carbon emissions another 40 percent by 2030[4], a pretty ambitious goal, and analysts believe emissions permit prices will climb so high that they will make companies get more serious about reducing their carbon footprint.[5] Appendix D of the current regulatory package acknowledges this: "Staff is not aware of any data or analyses that indicate allowance prices would not continue to steadily increase over time."[6]

This policy mechanism, a "price on carbon", has generally already been applied throughout the California economy, with the vast majority of all fuels and industrial emissions covered by it, and thus incented to be reduced. There are a very limited number of entities for which the price of carbon cannot be incorporated into their operations due to existing contractual relationship. These entities have been defined as "Legacy Contract Holders" under the Cap and Trade regulation. This determination by CARB is an acknowledgement that even though the program is generally working, in an economy as big as California's, and with a program as broad in scope, there are a few outliers that must be addressed on a case-by-case basis. These remaining entities are engaged in bi-lateral contracts which preceded the AB 32 construct and cannot be superseded by the regulation.

In enacting and implementing the Program, CARB rightfully recognized, in September 2013, that PEC, along with a handful of other similarly situated entities, were stuck between a regulatory requirement to cover the cost of compliance of the new program and a contractual obligation which did not provide an avenue to recoup compliance costs. <u>It was the recognition of this issue that CARB created the term Legacy Contract.</u>

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[3] https://www.arb.ca.gov/cc/capandtrade/capandtrade.htm
[4] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB32
[5] https://www.Californiacarbon.info
[6] https://www.arb.ca.gov/regact/2018/capandtrade18/ct18398.pdf

Legacy Contract Elements
The definition of a Legacy Contract (located in Section 95894 of the Cap and Trade Regulation) has three required criteria, which PEC has historically satisfied and continues to satisfy. In the spirit of completeness, the criteria are provided here.

1) **The Contract Must have been Entered Into Prior to Enactment of AB 32.** *The legacy contract was originally executed prior to September 1, 2006, remains in effect, and has not been amended since that date to change the terms governing the price or amount of electricity, the GHG costs, or the expiration date*; (PEC: TRUE)
2) **A Contract that Does Not have the Ability to Recover the Cost of Carbon.** *Each legacy contract does not allow the covered entity to recover the cost of legacy contract emissions from the legacy contract counterparty purchasing electricity*; (PEC: TRUE)
3) **Legacy Contract Holders Must Demonstrate Efforts to Resolve Contractual Issues with Counterparty.** *The operator of the legacy contract made a good faith effort but failed to renegotiate the legacy contract with the counterparty to address recovery of the costs of compliance with this regulation.* (PEC: TRUE)

PEC in good faith signed the PPA on March 28, 2006, invested significant capital and committed to supplying needed energy capacity to PG&E, predating ***all of the following:***

- *September 2006* **-** AB 32 was a signed into law, thus requiring GHG reductions statewide for the first time;
- *December 2008* **-** The Original AB 32 Scoping Plan, which suggested putting a price on carbon as a foundational policy choice of the state, was approved;
- *June 30, 2007* **-** The policy recommendations of the Market Advisory Committee which debated implications of power sector obligation assignment;[7]
- *2007-2010* **-** The regulatory debate and decision as to where the allowance allocation should land for carbon emissions from the power sector—power plants or Utilities;
- *2011-Present* **-** The numerous CPUC proceedings on power sector carbon structure for Investor Owned Utilities, of which PEC's counterparty is one;[8]
- *2009-Present* **-** The Cap and Trade Regulation was presented identifying the compliance structure of the Program, including obligated parties, allocations, reporting and Legacy Contract relief;
- *December 2011* - The adoption by the CARB Board of the Cap and Trade Program (the "Program")
- *January 2013* **-** The beginning of the obligation to pay for carbon emissions (January 2013).

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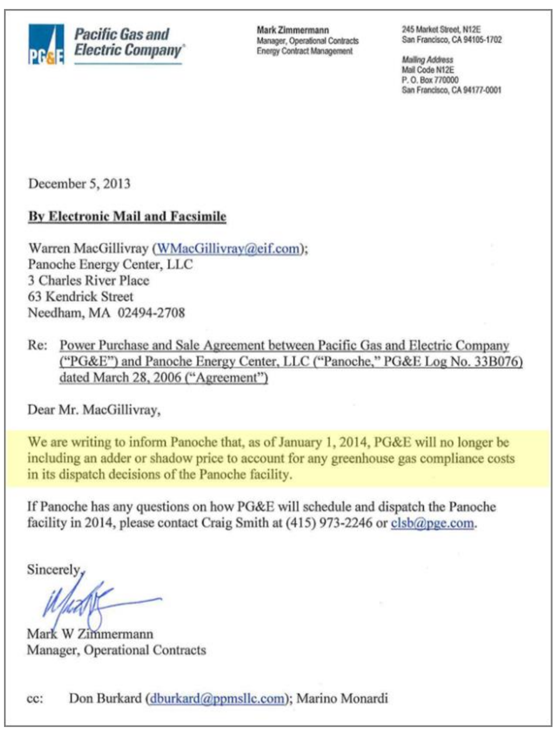
[7] https://www.energy.ca.gov/2007publications/ARB-1000-2007-007/ARB-1000-2007-007.PDF "California faces special challenges in reducing emissions from the electricity sector because of the quantity of imported electricity generated from coal. The Committee recognizes and appreciates the leadership already shown by the California Public Utilities Commission and the California Energy Commission in seeking appropriate means of regulating these out-of-state emissions. To address emissions associated with imported electricity within a state-based cap-and-trade program, the Committee recommends a "first-seller approach." Under this approach, the entity that first sells electricity in the state is responsible to meet the compliance obligation established under the greenhouse gas cap-and-trade program. For electricity generated within California, the owner or operator of the in-state power plant is the first seller and would be required to surrender emissions allowances. For power imported from outside the state, the first seller is most often an investor-owned or municipal utility or a wholesale power marketer who sells the electricity to an in-state, load-serving entity, another power marketer, or a large end-user."
[8] http://www.cpuc.ca.gov/General.aspx?id=5920

Other Regulatory History
CARB amended the Program to provide "Transitional Assistance" to Legacy Contracts in an effort to allow for the renegotiation of their contracts. The assumption of CARB staff was that such renegotiation would be done with willing counterparties and could be accomplished within the timeframe provided.[9]

Many significant and directly applicable events have transpired since CARB first adopted the Legacy Contract provisions to the Program. <u>*All of the following have occurred after PEC was determined to be a Legacy Contract*</u>:

- SDG&E and Otay Mesa settled their Legacy Contract issue as SDG&E accepted the full greenhouse gas compliance obligation (approved by CPUC in December 2012);
- PG&E agreed to amend the Legacy Contract for the Starwood Midway Project, a facility that is literally adjacent to PEC, by accepting the price of carbon for a contractual adjustment as more fully discussed below (approved by CPUC in January 2013);
- The Cap and Trade regulation has been amended seven times;
- The CARB Board has on multiple occasions acknowledged the need to solve the Legacy Contract issue, and the need to resolve it;
- PG&E specifically removed the price of carbon from PEC's dispatch profile as stated in the letter sent to PEC in December 2013 (displayed in Figure 3);
- PEC's operations have increased dramatically since the disparity in carbon price bidding was initiated by PG&E; and
- PEC has offered seven (7) separate proposals to PG&E for resolution, as more fully described later in this document.

<u>Figure 3</u>



Pacific Gas and Electric Company

Mark Zimmermann
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P. O. Box 770000
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December 5, 2013

<u>By Electronic Mail and Facsimile</u>

Warren MacGillivray (WMacGillivray@eif.com);
Panoche Energy Center, LLC
3 Charles River Place
63 Kendrick Street
Needham, MA 02494-2708

Re: <u>Power Purchase and Sale Agreement between Pacific Gas and Electric Company ("PG&E") and Panoche Energy Center, LLC ("Panoche," PG&E Log No. 33B076) dated March 28, 2006 ("Agreement")</u>

Dear Mr. MacGillivray,

We are writing to inform Panoche that, as of January 1, 2014, PG&E will no longer be including an adder or shadow price to account for any greenhouse gas compliance costs in its dispatch decisions of the Panoche facility.

If Panoche has any questions on how PG&E will schedule and dispatch the Panoche facility in 2014, please contact Craig Smith at (415) 973-2246 or clsb@pge.com.

Sincerely,

Mark W Zimmermann
Manager, Operational Contracts

cc: Don Burkard (dburkard@ppmsllc.com); Marino Monardi

[9] https://www.arb.ca.gov/regact/2013/capandtrade13/capandtrade13.htm

PEC has diligently worked with the staff and policy makers at CARB for six years. In addition to efforts at CARB, we have also sought solutions from the CPUC and the California Independent System Operator ("CAISO"). PEC has participated in no less than half a dozen Cap and Trade Rulemakings, attended countless meetings with staff and Board Members, submitted multiple comment letters, testified several times and continually engaged our counterparty, PG&E, in a good faith effort to seek a contractual resolution.

The CARB Board has remained engaged on this issue and as recently as last July adopted Resolution 17-21 directing staff to provide "reasonable" relief for the remaining Legacy Contracts.[10] PEC appreciates the fortitude and commitment of the Board to this issue.

This current rulemaking package reinstates the Transition Relief for Legacy Contract Holders Without an Industrial Counterparty (PEC's type of Legacy Contract). PEC is appreciative of the Board for their direction under last Fall's Resolution to staff, but believe the staff proposal is inadequate to either solve the underlying impediment to resolution (i.e., an unwilling counterparty to a contract that doesn't contain a mechanism to pass along the price of carbon), nor does it supply a remedy to the many harms that are more fully laid out in the impacts section below. With the Third Compliance Period already underway, Legacy Contracts like PEC are completely exposed to the regulatory obligations of the Program now. The proposed relief, starting in 2021 and based on the 2012 emissions baseline, is neither timely nor adequate.

III. Background and Status of Counterparty Negotiations

PEC has made numerous proposals to solve this issue directly with PG&E, all of which aimed to take full responsibility for PEC's carbon cost obligation ***assuming an energy dispatch price that includes the cost of carbon***. PEC believes that many of these offers have exceeded what PG&E accepted (and the CPUC approved) in other transactions, by as much as 160%.

However, it takes two motivated parties to renegotiate a contract. Here, PG&E has an active **disincentive** to negotiate with PEC, in order to preserve its ability to exercise market power in a seemingly manipulative manner. PG&E profits from that manipulation through the regulatory loophole allowing for PEC to be dispatched without a cost of carbon included in its dispatch price (the "Status Quo"), thereby making the prospect of an equitable renegotiation nearly impossible. The only "positive" results of the current contract appear in PG&E's bottom-line. They retain a systemic and substantial advantage to the market *by avoiding paying legitimate costs that are borne by all other market participants.* The Status Quo will only lead to PG&E realizing increased revenues as PEC's projected capacity factor is expected to continue to increase if the cost of carbon is not included in PEC's dispatch cost (see Figure 6).

This is where the CARB staff proposal has proven to be ineffective over the years. CARB's previous regulatory relief assisted Legacy Contract holders like PEC by offsetting some of the compliance costs, but such relief did not provide a reason for counterparties to negotiate in good faith. By regulation, PEC had to continue to work toward a solution, although no such requirement was placed on PG&E. Without regulatory motivation, the profit motive of the Status Quo dominated every negotiation in contravention of the spirit of the Program.

In an effort to find a solution that PG&E would accept, PEC sought to compare its settlement proposals against those that were already agreed to by PG&E and approved by the CPUC, primarily the approved amendment to the PPA for the Starwood Midway Project ("Starwood Midway"). The Starwood Midway resides adjacent to PEC, and its PPA was also a Legacy Contract that is substantially similar to the PEC PPA at issue here. In fact, in PG&E's application to the CPUC requesting approval of the Amendment they argued that the Amendment merits approval because it "provides substantial benefits for PG&E's customers compared to the potential

[10] https://www.arb.ca.gov/board/res/2017/res17-21.pdf

outcomes of regulatory or adversarial proceedings that would be risked in the absence of a negotiated compromise, and demonstrates that parties to a pre-AB 32 PPA can successfully agree to realign their obligations for AB 32 costs or "GHG compliance costs" so that regulatory intervention is unnecessary." [11]

With that goal in mind, PEC made CPUC public information requests to review the approved amendments for Starwood Midway. In each case, PG&E intervened to prevent PEC from accessing the amendment. Nonetheless, PEC was able to verify its benchmarking via publicly available information on the FERC EQR website. After a thorough analysis of the Electric Quarterly Report website, PEC determined that the Starwood Midway PPA amendment effectively exchanged approximately $3/kW-yr of fixed capacity payments in exchange for its counterparty (PG&E) to assume responsibility for its carbon cost obligations. We encourage CARB to compel production of the approved PPA settlements to verify this analysis.

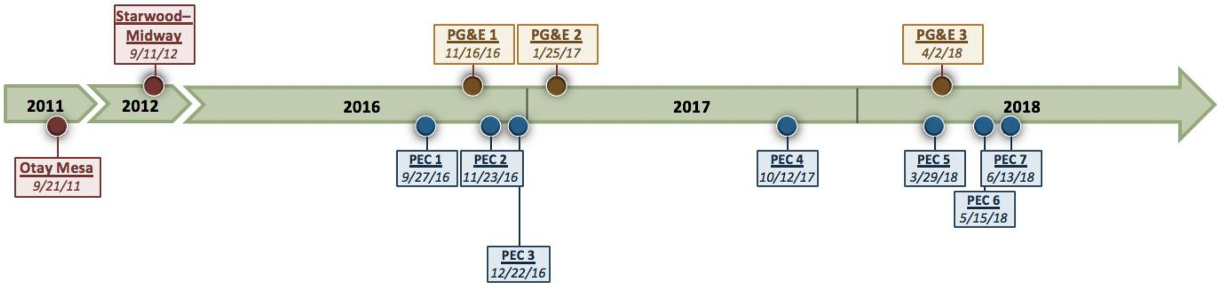
PEC's efforts at a good faith resolution with PG&E have included the following proposals over the course of several years:

- Settlement proposals that were benchmarked against other CPUC-approved amendments (exchanging a reduction in fixed PPA Capacity Payments in exchange for PG&E taking over responsibility for the variable carbon costs associated with PEC's dispatch), including one proposal that was ~160% higher than already approved amendments according to PEC's research noted above;
- A settlement that provided a larger fixed capacity payment reduction than CPUC-approved amendments during the current PPA term, in exchange for a low-cost PPA extension that would provide economic benefit to both PEC and PG&E;
- An "outside of the box" offer to terminate the current PPA, negating need for Legacy Contract relief;
- A settlement structured to have a one-time payment sufficient to retire enough CT allowances to cover PEC's dispatch for the term of the PPA (assuming the inclusion of carbon in the dispatch bids)

These efforts can be seen in Figure 4 which highlights the sequence of attempts PEC has made to solve this issue.

[11] See Application 12-09-016 (Filed September 26, 2012) "Pacific Gas and Electric Company (PG&E) seeks approval of an amendment (Amendment) to the Power Purchase Agreement (PPA) between Starwood Power-Midway, LLC (Starwood) and PG&E. The PPA was approved by Decision (D.) 06 11-048.

Figure 4



PEC has clearly acted in good faith to settle the legacy contract dispute and provided seven offers to PG&E with several different creative solutions, each one providing compensation based on values associated with a properly-dispatched, carbon price included, peaking power plant. Each time, these proposals were rejected, ignored, or countered with values associated with the Status Quo operations. Until such time as PG&E is forced to negotiate in a manner in which the good of the Program is the goal, such an agreement isn't possible, and therefore CARB must provide PEC with additional transition relief due to the fact that as currently structured the Program is causing direct economic harm to PEC by virtue of allowing PG&E to continue to dispatch the Project with no carbon price signal.

IV. Impact of a Lack of a Carbon Price Signal on PEC's Electric Energy Dispatch Price

The Program clearly expects there to be a uniform price on the electrical energy bid into the market to provide the necessary price signal to consumers[12]. Furthermore, PEC understands that CAISO *assumes* that a carbon price will be included on ALL electrical energy bid into their system. Such a uniform market signal ensures that California's electricity grid operates in a manner that is both efficient and equitable for all market participants. If one entity's electric energy bid includes a carbon price, and another does not, it skews the electricity market in a number of negative ways. Generators that bid electric energy into the market with no carbon price in their electric energy bid skew the market clearing price for electric energy lower.

The impacts of this issue are broad and stretch beyond just the PEC facility. The impacts are also unsustainable and will lead to permanent economic damage and contribute to long-term environmental degradation.

Since the day PEC's counterparty, in its sole discretion, strategically removed the price of carbon from PEC's electric energy dispatch price, PEC has been exposed and the market price for power has been impacted. Such a price is expected to be passed through to consumers in a market signal. *It is this fundamental policy component that is missing under the current arrangement.* As such, there are environmental, energy market, carbon market and broader policy impacts of having a single entity not playing by the same rules as everyone else. As the Scheduling Coordinator, PG&E confidentially controls the energy dispatch of the PEC power plant. How they dispatch, why they dispatch, and when they dispatch PEC is not transparent, and appears to be without oversight on this issue. The negative impacts listed below are NOT the result of any decisions made by PEC, nor the CPUC, CARB, CAISO or the Local Air District. Those impacts fall solely on PG&E.

Without a price on carbon–the broad market signal that is intended to normalize all power contracts—the following unintended consequences occur:

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[12] "If California is going to reduce its emissions to 1990 levels by 2020, we need to find a way to ensure we are going to meet this target and do it in a way that sends a signal to businesses that aren't currently involved in any existing regulations that there's a value in reducing carbon. *The way to do that is to put a price on carbon emissions*." As stated by Chairman Mary Nichols in Climate Action Reserve interview in 2010. (https://www.standardcarbon.com/2010/12/qa-with-mary-nichols-chair-of-the-california-air-resources-board/)

1) **Environmental Impacts to the San Joaquin Valley**
    - Increased localized air pollutant emissions in a severely Disadvantaged Community
    - Increased usage of limited Groundwater
2) **Local Economic Impacts**
    - Unsustainable economic pressure on PEC which could result in permanent loss of high paying energy jobs
    - Associated loss of local economic tax base from permanent shuttering of the facility
3) **Long-term Economic Impacts**
    - Potential chilling effect on clean energy investments in California
4) **Electric Market Impacts**
    - Uneconomic dispatch of a California power plant
    - Misuse of a peaking power plant built to supplement RPS
    - Setting the reference price for the entire power market based on faulty inputs to the system (lack of inclusion of GHG costs)
5) **Increased Natural Gas Usage**
    - Increased operational pressures on infrastructure
6) **Cap and Trade Implications**
    - Manipulation of the Starwood Midway dispatch
    - Carbon market distortion
    - Potential of Program to bankrupt critical renewable energy infrastructure
    - Potential for CARB Adaptive Management review of the issue due to increased Environmental Justice community emissions
    - Windfall profits due to the Program's design
7) **Impact to PEC Owners and Project Bond Holders**
    a. Retirement funds, pension funds, and others could be materially harmed financially

All of these impacts are negative, but they could all be remedied with the inclusion of a GHG price in PEC's dispatch cost, resulting in PEC operating like the Program was intended. The fact that this happening in the San Joaquin Valley is disconcerting.

At the March 2017 Board meeting, CARB staff committed to identifying additional emission reductions for meeting PM2.5 standards in the San Joaquin Valley (Valley). One direct and immediate measure would be to assure a carbon price signal is used in all Valley power plants, like PEC. The SIP document also highlights one of CARB's biggest air quality objectives, to electrify the transportation sector and the agricultural sector where possible. <u>Facilities like PEC need to be able to operate in the manner that they were intended, as a fast-response peaker plant for renewable energy support, to maximize the benefits of these electrification policies.</u> Having a simple cycle peaker plant run *in place of* a more efficient combined cycle power plant due to the Cap and Trade Program's unintended consequences, is in conflict with the two items being proposed on October 25th.

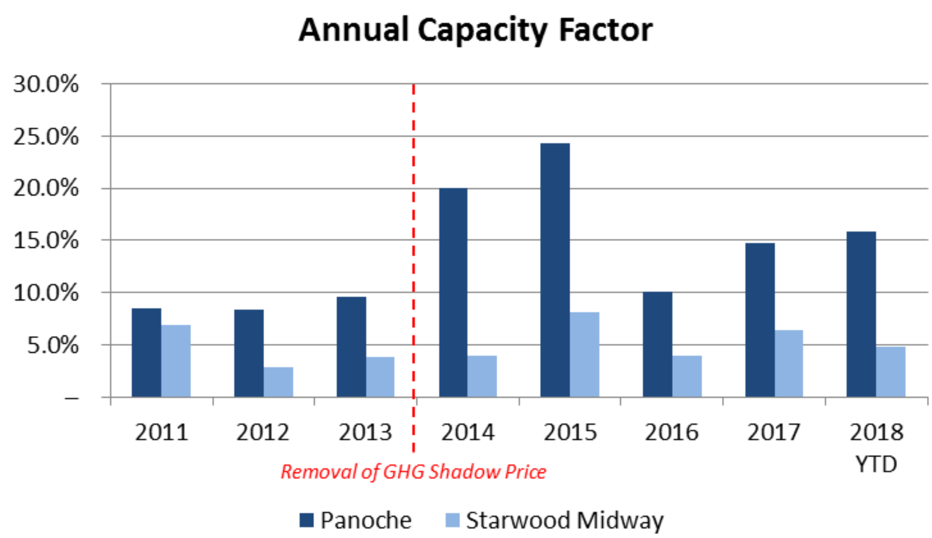
PEC has provided public comment on numerous occasions and have previously met with CARB's Cap and Trade Adaptive Management Staff on this issue, testified at the Joint Board/EJAC meeting to inform the Board and those committee members, and generally tried to make it known that these negative environmental consequences were occurring.[15] This needs to be addressed as the absence of a carbon price signal has negative environmental impacts on disadvantaged communities.

In summary, PEC has dispatched at materially higher capacity factors after the removal of the AB 32 shadow price from its dispatch cost, leading to numerous unintended consequences. As a comparison, Starwood

[15] April 26, 2017 meeting https://www.arb.ca.gov/cc/ejac/meetings/meetings.htm

Midway's dispatch (which PG&E also controls) has remained in line with an expected capacity factor for a peaking facility during this same timeframe. Figure 5 compares PEC's annual capacity factor to Starwood Midway's over the last several years to illustrate this.

Figure 5[16]



V. Requested Relief

This is not a new issue for CARB Board Members, as last year you passed Board Resolution 17-21 acknowledging that a solution is still needed for remaining Legacy Contract Holders without an Industrial Counterparty[17] like PEC. PEC is still hopeful that a contractual solution can be found, but time is of the essence. PEC requests that CARB act now with regard to its ongoing status as a Legacy Contract Holder without an Industrial Counterparty.

PEC supports the Board's stated commitment to address this issue in any of the ways listed in the following section, and welcome other creative solutions. But in any event, PEC requests the following amendments to the September 4 staff proposal to be adopted into the current rulemaking:

1. Allowances should be granted for the Third Compliance Period (2018-2020) for Legacy Contract Holders without an Industrial Counterparty that previously received legacy contract transition assistance (2013-2017).

2. Allowance allocation calculations should be based on actual dispatch and not a static historic baseline.

Facilitating a solution is important to ensure the Program continues to be consistent with the principles of AB 32[18] as it moves toward SB 32's[19] goals under the direction of AB 398[20]. PEC commits to continue to work

[16] www.snl.com
[17] https://www.arb.ca.gov/board/res/2017/res17-21.pdf
[18] http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_0001-0050/ab_32_bill_20060927_chaptered.html
[19] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB32
[20] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180AB398

toward a solution that upholds the integrity and success of the Program. As such, PEC's additional potential solutions are proposed in the following section.

VI. Potential Solutions

No less than three distinct potential contractual solutions have been proposed by PEC to our counterparty in the past year. Each proposal sought a remedy to solve the policy issue facing CARB—ensuring a price of carbon in the power generated at PEC. CARB is aware that PG&E, as PEC's Scheduling Coordinator, controls 100% of PEC's dispatch and has been doing so, since January 1, 2014, without a price of carbon on PEC's dispatch causing it to run more than true market economics would dictate. As the price of carbon is mandated to increase under the Program, this situation will only get worse through the remaining life of PEC's Legacy Contract, which runs through 2029, if it is not addressed by CARB.

PEC believes that there are two simple means of solving the issue with PG&E:

1) **Capacity Price Reduction:** As agreed to in other settlements discussed above (e.g. Starwood Midway), PG&E takes on the carbon compliance obligation in exchange for a reduction in the PPA capacity payment rate to PEC.

2) **One-Time Payment:** PG&E takes on the carbon compliance obligation in exchange for a PEC acquiring and retiring enough credits into PG&E's account for the projected remaining emissions during its PPA term, assuming the cost of carbon is included in PEC's dispatch price.

However, as noted previously, there is not an incentive for PG&E to settle via either of these solutions under the current regulatory construct. As such, CARB is needed to compel PG&E to solve the issue in a manner that considers the goals and principles of AB 32 as the top priority, rather than the interests of PG&E's customers/shareholders. PEC believes that the following would incentivize PG&E to settle the issue in such manner:

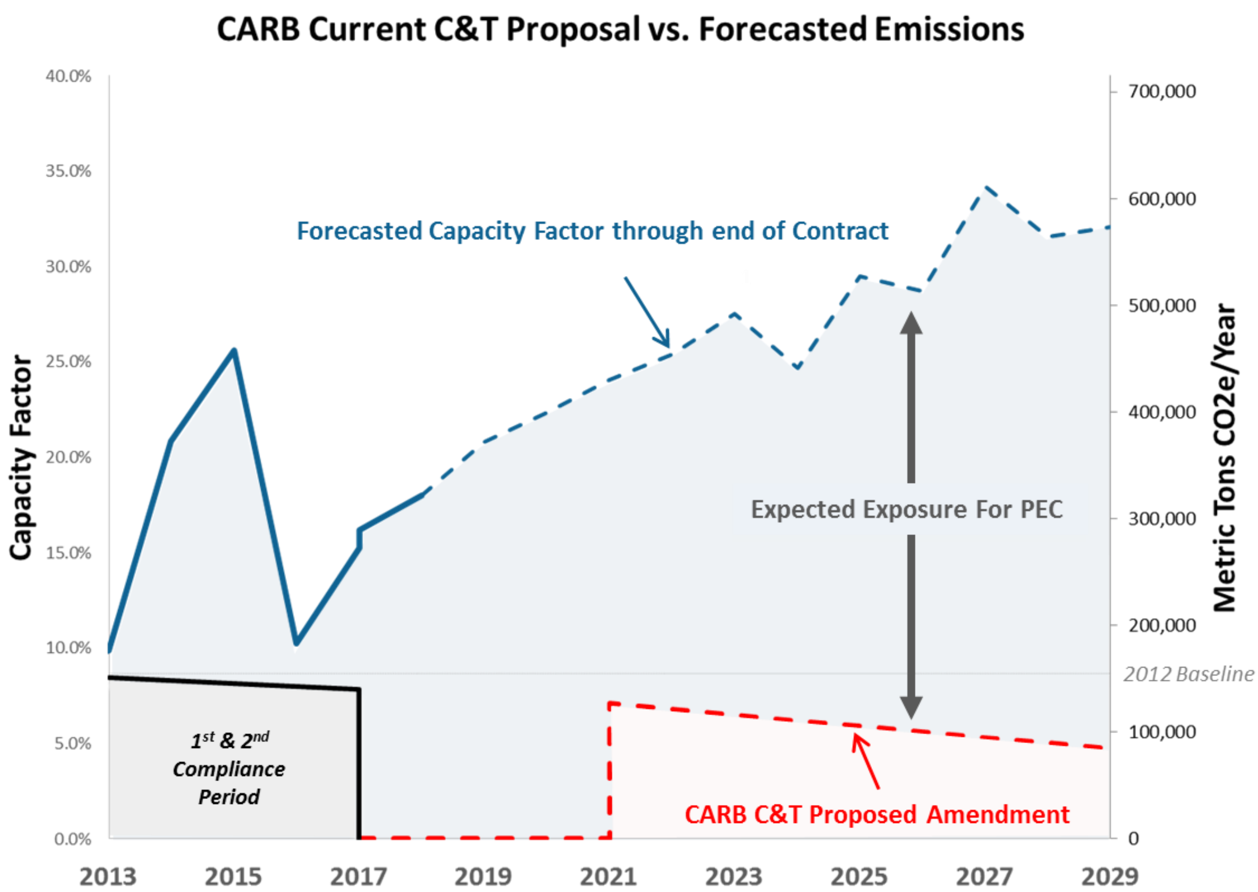
1) **Diablo Canyon Incentive(s):** SB 1090 has been signed into law and requires PG&E to fulfill its earlier commitment to replace Diablo Canyon's zero-GHG emission profile power with equally zero-emission renewable power. Considering that CARB policy dictates that renewable power costs are not eligible for allowance allocation and the allocation of credits to PG&E associated with the shutdown of Diablo Canyon was given to cover the emissions costs associated with natural gas replacement power, CARB is now free to simply reallocate the millions of tons of allowances provided to PG&E to entities that are truly exposed to increased costs directly related to the Program. PEC would be a minor player in such a scenario and the vast majority of the ~$2 billion of allowances granted to PG&E could go back into the Greenhouse Gas Reduction Fund.

2) **Abbreviated Transition Assistance:** CARB grants PEC's Requested Relief and compels PG&E to settle the longstanding Legacy Contract matter by adopting the already CPUC approved Legacy Contract amendments for PEC. This should be a very brief process provided PG&E is willing to play ball.

3) **Hybrid Solution:** Much like our offer to PG&E above where PEC acquires and retires sufficient emissions credits to cover PEC's dispatch (with a carbon price included) for the duration of its Legacy Contract, PEC could acquire and retire those credits into the state account and CARB could create a direct requirement under the Program that requires a price on carbon for all power produced in the state. This would accomplish a price signal on all power and hold PEC accountable for its carbon costs produced during the term of its Legacy Contract.

As described in the PEC Overview section, PEC contributes more than $20 million dollars per year and generates over 80 jobs for the local and California economy, while playing a critical role in maintaining the grid's reliability. As can be seen in the Figure 6 below, the viability of PEC is truly at stake if none of the above (or another potential solution) is pursued by CARB.

Figure 6[21]



Summary

PEC remains committed to finding a contractual solution, but in the absence of this, CARB must protect the integrity of the Program and reinstate relief for Legacy Contract holders without an Industrial Counterparty. Without such relief, the Program would continue to harm PEC, its bondholders, its ultimate owners (which include public pension funds in the State of California), and all other stakeholders including PG&E ratepayers and the citizens of the San Joaquin Valley.

Transition Assistance from CARB is still necessary to offset the unrecoverable cost burden of the Program on the PEC facility. Nothing has changed with respect to PEC's Legacy Contract status or ability to recover these costs. Therefore, so long as the Legacy Contract between PG&E and PEC remains unamended, PEC's power will continue to be dispatched into the California market without a cost of carbon attached.

[21] Based on third party consultant's dispatch that assumes carbon is not included.

The Board has acknowledged that a solution is still needed. PEC supports continued efforts in this direction and looks forward to working, in parallel, with both our counterparty on a contract resolution, and with CARB on a regulatory solution. The timing of these dual-track efforts will most certainly cross as any PPA amendment would still need CPUC approval. Therefore, the regulatory solution is still needed. PEC fully understands that upon a CPUC-approved Legacy Contract amendment, the provisions of the regulatory solution would no longer continue.

We have actively engaged at all levels of the CARB process and we look forward to resolving this issue. If you have any questions, please contact me at (781) 292-7007, or Robin Shropshire at (406) 465-2231, rshropshire@ppmsllc.com.

Sincerely,

/s/

Warren MacGillivray