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

January 20, 2017

Via Electronic Submittal: https://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtrade16&comm_period=1

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

Re: Panoche Energy Center LLC Comments on 1st 15-dayAmendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation Released December 21, 2016.

On behalf of Panoche Energy Center LLC ("PEC"), we appreciate the opportunity to comment on the 1st 15-Day Amendments package, released on December 21, 2016, to the Cap and Trade Regulation (Regulation) proposed August 2, 2016. These proposed amendments are significant as they will shape the entire Cap and Trade program for the next decade or more.

PEC respectfully asks ARB to amend the Regulation to continue Legacy Contract Relief for entities without an industrial counterparty as proposed by ARB staff in June 24, 2016[1]. We also request that allowances not be granted to entities where a cost burden pass through does not exist. These recommended changes will ensure California's Cap and Trade Program continues to be consistent with the principles of AB 32, and will recognize that PEC has acted in good faith as a Legacy Contract holder and within the bounds of the Regulation for the past five years. Our amendments provide suggested changes to the proposed allocation methodology that are included in the 15-day package.

HISTORY

PEC is a large natural gas peaking plant with a tolling agreement ("PPA") for the exclusive sale of electric power to Pacific Gas & Electric Company ("PG&E"). The PPA was executed, prior to AB 32 in March 2006 which, in part, qualified PEC as a "Legacy Contract" PPA. Another element of PEC's "legacy contract" is that it does not include a mechanism to recover the cost of its GHG emissions. Additionally, under the PPA, PG&E controls when and how much the facility runs, and thus controls the quantity of GHG and criteria pollutant (smog-forming) emissions the facility emits. At PG&E's sole discretion, the price of carbon was

[1] https://www.arb.ca.gov/regact/2016/capandtrade16/appf.pdf

removed from PEC's variable energy dispatch price effective January 1, 2014 which has resulted in PEC's actual dispatch (and associated emissions) being much higher than its anticipated dispatch. This disconnect, lack of a carbon price in PEC's variable energy dispatch price, is in direct conflict with the program's foundational policies. Fundamentally, because *PEC cannot pass the costs associated with its GHG emissions along to PG&E*, those costs (the intended AB 32 "carbon price signal") are not included in PG&E's bids into CAISO for PEC's energy production ("dispatch price"). The ratepayers are not seeing the cost burden of PEC's emissions, in conflict with the Program design. Without a price of carbon included in PEC's dispatch price, the facility has operated far more, resulting in:

(1) increasing local air pollution,

(2) the complete undermining of the regulatory "price signal" intended to be sent to consumers,

(3) increasing use of scarce water resources,

(4) increasing costs for PG&E ratepayers, and

(5) increasing costs of operation.

Another key element of the Legacy Contract regulation is that counterparties work to resolve the Pre-AB 32 contractual issues. Since the Cap and Trade Regulation's original adoption, PEC has continually sought in good faith to secure a just and reasonable contract amendment with its counterparty *on terms consistent with other Public Utilities Commission approved Legacy Contract settlements.* PEC has repeatedly approached its counterparty to negotiate a resolution directly and through the offices of the Public Utilities Commission, ARB, private channels, and others, all to no avail. The structure of ARB's Legacy Contract Relief granted to PEC did not incentivize and may have dis-incentivized our counterparty from negotiating a settlement in good faith. Over the past five years, PEC has only sought an equitable and reasonable renegotiation of the terms of the Legacy Contract, but this has not been achieved due to our counterparty's complete lack of good-faith effort. Additionally, the proposed cessation of Legacy Contract relief would harm PEC and its bondholders, including public pension funds, and all other stakeholders (including PG&E ratepayers), except for PG&E who would continue to run PEC's facility without AB 32 compliance costs. The 15-day package proposes to continue this inequity. PEC opposes the ARB's proposed allocation to PG&E on the basis of potential and significant environmental quality impacts.

ARB has made it clear that their preferred solution is a contractual fix between the two counterparties such that going forward the cost of the program would be included in the price of the facility's electricity. But early on ARB recognized that such a fix required good faith renegotiations, and absent of this a regulatory solution was required. This is the situation we find ourselves in now. Unless ARB addresses this issue immediately within the regulatory arena, or the compliance costs are rightfully passed along to PG&E's ratepayers for the emissions created when it runs PEC's facility, this situation will continue unabated for years to come. Such a situation should undoubtedly trigger an Adaptive Management Review.

PROPOSED SOLUTION

Both Attachment A and C ignore this continuing Legacy Contract issue. We request that ARB address this issue in the next 15-day package and before this inequity is permanently codified.

ARB's proposed Electrical Distribution Utility allocation methodology is presented in Attachment C of the 15-day package[2] with the actual allocation number provided in Attachment A (Section 95892). Attachment C states the following as fact in the background discussion:

> *"Electricity generators and importers face a compliance obligation for the GHG emissions associated with the energy they generate or import into California, and they may pass that cost on to the electrical distribution utilities (EDU) that supply the electricity to end-users."*

The first statement is not true for Legacy Contract holders, such as PEC, which is precisely why ARB included allocation provisions in prior versions of the regulation.

> *"In developing the Regulation, ARB recognized that allocation to EDUs should "reflect the 'cost burden' associated with Program emissions costs that is anticipated to be borne by the ratepayers for each distribution utility" (ARB 2010B). Cost burden is the effect on ratepayers of the incremental cost of power to serve load due to the compliance cost for GHG emissions caused by the Program."*

Whereas, the second statement has been the foundation for PEC's policy argument for the last five years—the cost of producing the electricity should be passed along to the EDU in question, in this case that EDU is PG&E. PEC's PPA does not contain a variable GHG emission cost component to cover the intermittent nature of its operations that coincide with a peaking power plant.

The EDU allocation numbers and methodology laid out in Attachments A and C continues the cost-burden approach. That approach is summarized in this sentence *"Cost burden would be calculated by estimating emissions for each year from 2021–2030 associated with generation from natural gas resources"*. PEC's PPA for natural gas fired generation extends past the current 2020 EDU allocation and the plant's operation will be directly impacted by the allocation scheme presented in this 15-day package. PG&E will be receiving allocations for PEC's fossil fuel fired generation, but PEC will still not be able to pass along the compliance costs of the program. If the price of carbon is not associated with this generation, it will be dispatched at a higher rate than a plant of its thermal efficiency should, resulting in increased local air pollution. This increase in criteria and toxic pollutants will occur in an area identified as disadvantaged by the State.[3] ARB staff presented a workable solution to address this situation, in the public workshop preceding the August 2, 2016 release of the regulatory package. This solution proposes to treat the few remaining Legacy Contract holders without an industrial

[2] https://www.arb.ca.gov/regact/2016/capandtrade16/attachc.pdf
[3] http://oehha.ca.gov/calenviroscreen/report/calenviroscreen-version-20

counterparty the same as other non-power plant Legacy Contract holders.[4] The subsequently published proposed amendments failed to include that staff's recommended solution (without opportunity for public input), and now proposes to completely eliminate "Legacy Contract" status and regulatory relief for the remaining entities such as PEC. This 15-day Amendment Package continues this inequity and exacerbates the policy problem facing ARB. **PEC's costs are being calculated in PG&E's 'cost-burden' without PG&E actually having those costs.** If adopted without change, the current draft amendments would leave the PEC facility completely exposed to the price of AB 32 compliance, stranding those costs with PEC, and would continue the ongoing environmental and economic consequences described above.

There is still an opportunity for ARB to correct this situation, and a way to move forward with a specifically tailored, holistic solution. In light of the unsuccessfully Legacy Contract renegotiations, PEC requests that ARB amend the regulatory language to include the June 24, 2016, staff workshop proposal in a future 15-day amendment package[5].

In addition to PG&E receiving allocations for the emissions associated with PEC's facility without a cost-pass through obligation, ARB erred in its assignment to PG&E for having Natural Gas cost burden associated with the replacement of Diablo Canyon's zero GHG electricity. PG&E has committed to the following[6]:

> "Pacific Gas & Electric (PG&E), International Brotherhood of Electrical Workers Local 1245, Coalition of California Utility Employees, Friends of the Earth, Natural Resources Defense Council, Environment California, and Alliance for Nuclear Responsibility (together, the parties) have developed a joint proposal to retire PG&E's Diablo Canyon Power Plant at the close of its current operating license period and replace it with a portfolio of greenhouse gas (GHG)-free resources."

This commitment should be applauded, but it should not entitle PG&E to an additional and very large set of allowance allocation. ARB's allocation methodology comparison, starting on page 4 in Attachment C clearly states "The proposed method accounts for retirements of coal plants and the Diablo Canyon nuclear facility by assuming that these facilities are replaced by natural gas-powered electricity after they retire." *This assumption is not accurate and further reflects PG&E obtaining significant allowances without the accompanying cost burden—4,925,396 tons worth.* PEC is opposed to this allocation as unwarranted and inconsistent with the cost-burden approach used for other electrical allocations.

There are no legal impediments that prevent ARB from implementing PEC's request. Because the staff proposal was included in the Initial Statement of Reasons for the proposed amendments, modifying the proposed amendment to include staff's proposal in a future 15-day package complies with law. Likewise, the recent Court of Appeal decision in litigation between

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[4] Staff's presentation at the June 24, 2016, workshop (slide 35) https://www.arb.ca.gov/cc/capandtrade/meetings/062416/arb_and_caiso_staff_presentations_updated.pdf, is included in Appendix F to the Initial Statement of Reasons – https://www.arb.ca.gov/regact/2016/capandtrade16/appf.pdf.

[5] Numerous references to a second 15-day amendment package in Attachment A: https://www.arb.ca.gov/regact/2016/capandtrade16/attacha.pdf

[6] https://www.pge.com/includes/docs/pdfs/safety/dcpp/MJBA_Report.pdf

PG&E and PEC and the earlier arbitration award, both acknowledge the limited contractual scope of that dispute, and explicitly state that nothing written in those decisions in any way limits ARB's power to resolve the issue of PEC's stranded costs in order that the PEC facility be run consistent with CARB policy to protect the environment and the public.

The prior regulatory relief, set to be eliminated, and the current proposed amendments (failing to address PEC's issue and providing unwarranted allocations to PG&E) provided no incentive for PG&E to address this situation, while the environment, the citizens of the San Joaquin Valley (a disadvantaged community), PG&E's ratepayers, and PEC's bondholders are would be negatively affected. There are no winners under the current proposal, only losers.

To avoid these impacts, and for the reasons described in this letter, ARB should not adopt the amendments as proposed, but instead should either incorporate the June 24, 2016, staff workshop proposal constructed specifically to address the problem outlined below or take other actions to ensure the fundamental policies of the program are upheld without undue burden on Legacy Contract holders.

PEC urges ARB to act now. We have actively engaged at all levels of the ARB process and sought in good faith to find a solution for the better part of five years, now it is up to ARB to step in and fix this problem before additional local pollution is emitted as a direct result of its implementation. With at least one future 15-day amendment package remaining, ARB still has a chance to bring this conclusion. 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

cc: Mary Nichols – Chairman
ARB Board Members
Richard Corey – Executive Officer
Edie Chang – Deputy Executive Officer
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Rajinder Sahota – ISD Assistant Division Chief
Jason Gray – Branch Chief
Mary Jane Coombs – Manager
David Allgood – CARB Staff
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