**BEFORE THE PUBLIC UTILITIES COMMISSION**
**OF THE STATE OF CALIFORNIA**

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| Order Instituting Rulemaking to Integrate and Refine Procurement Policies and Consider Long-Term Procurement Plans | Rulemaking 10-05-006<br>(Filed May 6, 2010) |

# COMMENTS OF STARWOOD MIDWAY LLC ON THE MOTION OF THE INDEPENDENT ENERGY PRODUCERS ASSOCIATION


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October 10, 2011

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Pursuant to the Rule 11.1 of the Rules of Practice and Procedure of the California Public Utilities Commission, Starwood Midway LLC ("Midway") submits the following comments on the *Motion of the Independent Energy Producers Association for Expedited Determination of Issue,* filed September 23, 2011 ("IEP Motion"). Midway supports the IEP Motion and urges the Commission to adopt its recommendations.

## I. PROCEDURAL BACKGROUND

The Joint Administrative Law Judges' Ruling Clarifying Venue for Consideration of Costs Related to Procurement of Greenhouse Gas Allowances, issued on August 4, 2011 ("Ruling"), clarified that greenhouse gas GHG compliance costs associated with contracts executed between independent generators and utilities prior to the passage of AB 32, which do not provide for pass-through of such costs related to the procurement of generation resources that emit GHG and the need to obtain GHG emission allowances for their operation under the cap and trade provisions of Assembly Bill ("AB") 32, as implemented by the California Air Resources Board ("CARB") would be addressed in this docket.[1]

[1] *Ruling*, at p. 6.

## II. DESCRIPTION OF ISSUE

Some contracts that were entered prior to the passage of AB 32, including Midway's do not include contractual provisions to explicitly cover the cost of complying with the cap and trade provisions of CARB's regulations implementing AB 32. Since the auctions of GHG emission allowances will begin in the second half of 2012, affected generators such as Midway need a clear understanding of how to achieve compliance so that they may continue to operate after compliance obligations take effect on January 1, 2013. A letter addressed to the CARB by Midway describing the issue facing Midway is attached as Attachment 1 to these comments. As the IEP Motion concludes, "it is critical for the Commission to begin the process leading to a decision on this issue as soon as possible."[2]

## III. MIDWAY URGES THE COMMISSION ACT ON THE IEP MOTION AS SOON AS POSSIBLE.

The IEP Motion asks the Commission "to set a schedule for an expedited determination of the treatment of GHG compliance costs associated with contracts executed between independent generators and utilities prior to the passage of AB 32 that do not include a mechanism for recovery of such costs."[3] Midway strongly supports the IEP Motion.

Respectfully submitted,

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DOUGLASS & LIDDELL

Attorneys for
**STARWOOD MIDWAY LLC**

October 10, 2011

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[2] IEP Motion, at p. 3.

[3] Ibid.

# ATTACHMENT 1

STARWOOD
POWER MIDWAY, LLC

September 27 , 2011

Clerk of the Board
California Air Resources Board
1001 "I" Street
PO Box 2815
Sacramento, CA 95814

Re: Comments on the Second Modified Text for the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation

Dear Sir or Madam:

On behalf of the Starwood Power Midway LLC (Midway), I am submitting comments to the California Air Resources Board ("CARB" or the "Board") for the record, regarding the Second Modified Text of the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation. Midway continues to be concerned that the proposed modifications to the regulation to implement the state's greenhouse gas cap-and-trade program under A.B. 32 still do not adequately address challenges faced by independent power producers with long-term power purchase agreements under which the costs of compliance cannot be recovered.

Midway is a 120 MW simple-cycle natural gas peaking electrical generating facility located within western Fresno County and has a long-term contract to sell electric capacity and energy to Pacific Gas & Electric ("PG&E"). There are no provisions within the terms of the contract that allow Midway to pass through or recover AB32 costs.

Midway would like to reiterate what was stated in our previous communications on this matter. In its present form the Cap and Trade Regulation is fundamentally unfair to holders of power purchase and sales agreements with electric utilities that were entered into before AB32 was enacted ("Long-Term Contracts"). Because the Long-Term Contracts do not specifically provide for pass-through of GHG costs, the language of the Cap and Trade Regulation exposes the generators holding the Long-Term Contracts to substantial financial injury if the utilities refuse to assign GHG emission credits or allowances to them. Any hope of utility cooperation that could cure the above-mentioned shortcoming suffered a significant blow within days of the close of the comment period on the Cap and Trade Regulation. It is our understanding that some Fossil generator holders of the Long-Term Contracts (specifically tolling agreements) that have recently inquired have been bluntly notified by their utility counterparties that there will be no consideration whatsoever given to pass-through of GHG costs. It is therefore already quite clear that, absent corrective action by CARB, the imbalance of the economic interests of the parties to the Long-Term Contracts under the current Cap and Trade Regulation will have the predicted consequence of causing an increase in GHG emissions.

Additionally Midway supports the Independent Energy Producers Association recent filing made to the CPUC concerning this threat and although this may seem to be this may be a small issue in the larger scheme of AB32 implementation, for those of us impacted by this situation it is very serious. The uncertainty of what the impact of GHG compliance will be is causing apprehension as to the planning for operations and maintenance of these existing facilities. If we remain unable to recover the costs of GHG compliance, are not allocated any allowances and have to perform under our existing long term contracts, it is possible that we could eventually default on loan covenants and in the end cease to operate. We ask that the CARB staff assists in getting a solution in place for the small group of projects affected by this issue. The situation will not just go away.

Starwood Power-Midway, LLC urges that CARB seek to amend Section 95834 of the Cap and Trade Regulation to require utilities to enter into a "beneficial holding relationship" to cover the GHG emissions obligation of generators providing power and energy to the utilities under the Long-Term Contracts. A beneficial holding relationship should be deemed to exist pursuant to Section 95834(a)(1)(A) for any Long-Term Contracts that have

POWER MIDWAY, LLC

not been clarified or renegotiated as of January 1, 2012 to address GHG costs. Utility parties to the Long-Term Contracts should be required to purchase and hold allowances for the eventual transfer to generator parties for the sole purpose of supplying generators with credits or allowances sufficient to cover GHG emissions obligations under the Long-Term Contracts. An alternative approach would be to waive compliance on a case-by case-basis for as long as utilities withhold allowances or credits from generator owners that hold Long Term Contracts that can demonstrate financial hardship and good faith efforts to comply with the Cap and Trade Regulation.

In the absence of direct allocation of allowances to generator-holders of Long-Term Contracts, CARB should either amend the Cap and Trade Regulation as described here or grant limited waivers of Section 95834 under defined circumstances as it relates to specific Long-Term Contracts. Thank you for your prompt attention to this notification of a predicted problem become real, and proposed solutions to correct a serious flaw in the Cap and Trade Regulation. We again urge CARB to directly address this issue through regulation. The equitable solution would require an electric distribution facility to hold and surrender allowances for an LTCG's GHG compliance requirements as long as the LTCG is under a pre-A.B. 32 long-term contract with the electric distribution facility. Such an arrangement would be consistent with CARB's concept and regulatory construct of "beneficial holding relationships". Without relief provided by regulations, the new costs associated with A.B. 32 compliance will have a substantial negative impact on the financial viability of our facility as well as a limited number of other LTCGs.

We appreciate you considering these concerns as you move forward with finalizing the regulations. We are happy to discuss these issues with you in greater detail or answer any questions you may have. I can be reached via email at jj.fair@caleak.com or at 619-606-1318

Sincerely

JJ Fair
Vice President
Starwood Power Midway.

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