ACE COGENERATION AND RIO BRAVO

March 9, 2012

DOCKET
12-IEP-1D
DATE MAR 09 2012
RECD. MAR 09 2012

California Energy Commission
Docket Office, MS-4
Re: Docket No. 12-IEP-1D
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RE: Docket No. 12-IEP-1D: Combined Heat and Power in California.

Dear Commissioners:

ACE Cogeneration, Rio Bravo Poso and Rio Bravo Jasmin (collectively "ACE/Rio Bravo") appreciate the opportunity to submit these comments in response to the February 16, 2012 IEPR Committee workshop discussion on technical and market opportunities for Combined Heat and Power ("CHP") in California. We also provide comments in support of the Committee's request for a specific proposal on how to implement a "fuel switching" pathway for the small group of California CHP facilities that currently utilize higher carbon content solid fuel sources. The ACE/Rio Bravo facilities now find themselves without a viable pathway to achieve their goals of greenhouse gas ("GHG) emissions reductions under current state policy.

ACE Cogeneration and the Rio Bravo Poso and Rio Bravo Jasmin facilities are three CHP plants in California operating under existing long-term contracts with SCE and PG&E. They are in the process of pursuing fuel conversion options to move from high carbon content solid fuels to lower carbon sources such as natural gas, biomass, solar or some combination of technologies.[1] The fuel/technology conversion investments will significantly reduce those

[1] Further detail on ACE and Rio Bravo's facilities, operations and contractual concerns is available in ACE and Rio Bravo's comments on the July 25, 2011 version of the cap-and-trade regulation, available at: http://www.arb.ca.gov/lists/capandtrade10/1532-110811_ace_and_rio_bravo_comments_on_carbs_cnt_regulation__00017266_.pdf

facilities' existing greenhouse gas emission profiles, while allowing these CHP units to continue generating reliable baseload electricity for California retail sellers and providing steam for industrial purposes. Moreover, conversion of these existing facilities will keep well-paying jobs in some of California's most economically stressed counties. ACE/ Rio Bravo request that the 2012 Integrated Energy Policy Report ("IEPR") and the aforementioned "fuel switching" pathway proposal be identified as urgent issues for those CHP facilities that currently have no ability to recover these GHG compliance costs under current state policy.

The ACE and Rio Bravo facilities were developed at a time when California was advocating for diversity across generating fuels. The CEC specifically permitted the ACE facility as an example of new, high-efficiency solid fueled facilities. Now, however, this fuel diversity is disfavored as the state seeks to reduce carbon emissions. Unlike most other generation relying on natural gas as the primary fuel, the ACE/Rio Bravo facilities will not receive a price signal from the cap and trade program that will incent fuel efficiency improvements. ACE / Rio Bravo's cap and trade burden is directly related to the carbon intensity of their fuels, and no amount of efficiency improvements will overcome the fuel carbon content. Consequently, the only means for these facilities to continue operation under a cap and trade system is to undertake significant new capital expenditures to effectuate a change of input fuels and suffer a financial loss during the transition period. In the meantime, these facilities have existing power and thermal production requirements. Put simply, the costs associated with continued operation with a GHG compliance burden plus costs associated in executing facility changes are economically infeasible, absent a transition mechanism that will support the change to lower carbon fuels.

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Under the structure of the state's new cap-and-trade regulations ("AB 32"), the GHG allowances for these facilities are not being distributed in a manner that will support a transition period for these projects to lower emitting or renewable fuels or technologies. In addition, due to the structure of the existing, CPUC-approved contractual agreements, cogeneration facility owners are not able to pass through or otherwise recover the additional, new regulatory cost burdens associated with acquiring the GHG allowances. Moreover, for the facilities like ACE/Rio Bravo that are utilizing higher carbon content fuels, the recently adopted CHP Settlement Agreement will not compensate for the regulatory cost burden, thus jeopardizing the economic viability of the facilities. That agreement was structured for natural gas facilities and is uneconomic for solid fuel generation. Similarly, based on our discussions with the investor owned utilities and the recent proposed CPUC decision, there is no ability to recover these GHG compliance costs with respect to the provision of thermal energy to unaffiliated entities under supply contracts that do not permit pass-through of GHG compliance costs.

To address these new regulatory cost burdens, a transition period is required for the small group of CHP facilities that are currently in the process of fuel/technology conversion. At the Committee's request, ACE Cogeneration and Rio Bravo provide the following "fuel switching" pathway proposal for Committee's consideration in the IEPR.

"Fuel-Switching" Pathway Proposal

California Air Resources Board ("CARB") should allow for a transition period of up to 3 years, or until the start of the second cap-and-trade compliance period that begins in 2015, to allow these facilities to complete conversion option evaluations, prepare engineering designs, obtain financing and required permits, complete construction and begin operations. During this time period, the CARB should also provide specific consideration to ensure that existing solid fuel CHP plants converting to lower or neutral GHG fuels are not adversely affected by the new greenhouse gas emission reduction rules for the reasonable time required to make such conversions.

The CPUC should also provide a means to support the resources contracted with the utilities through continuation of their existing or reinstatement of their former fixed price contracts for the reasonable time required to undertake the fuel conversion and to facilitate renegotiation of the contracts for the lower GHG emitting facilities as directed in ALJ Allen's February 21, 2012 Proposed Decision discussed in greater detail below.

The small group of solid fuel source burning CHP facilities that can demonstrate stranded costs should be given a limited window to notify the California Energy Commission, the California Public Utilities Commission, and the California Air Resources Board in writing of their intention of utilizing the proposed transition period.

Comments on the ICF International, Inc. Report - *Combined Heat and Power: Policy Analysis and 2011-2030 Market Assessment*

The ICF Report discusses a number of key drivers affecting the development of an otherwise robust CHP market.[2] Among these drivers described, are third-party owners of CHP facilities that have steam and/or retail electricity contracts with their hosts that pre-date the passage of AB 32. The ICF Report recognizes that many of these legacy contracts do not include provisions for GHG cost recovery and the host customer has no incentive to renegotiate the contract. The ICF Report reaches the conclusion that unless CARB addresses this issue, this small group of CHP facilities will face stranded costs. ACE Cogeneration and Rio Bravo agree with this assessment and have over the course of two years, submitted comments and engaged CARB on this critical issue. However, CARB has unequivocally indicated that it will not amend

[2] ICF Report at p.29

the cap-and-trade regulations to facilitate transition to lower carbon fuels and help address these stranded cost concerns.

ACE Cogeneration, Rio Bravo Poso and Rio Bravo Jasmin appreciate the opportunity to present these comments and welcome the opportunity to discuss this fuel switching pathway proposal in greater detail with the IEPR Committee.

Sincerely,

March 9, 2012

/s/

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