

EAST COAST POWER L.L.C.
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May 22, 2006

Mr. Franz Linz, Steering Committee Member
Regional Greenhouse Gas Initiative
New York Department of Environmental Conservation
625 Broadway, 14th Floor
New York, NY 12233

Mr. Christopher Sherry, Steering Committee Member
Regional Greenhouse Gas Initiative
New Jersey Department of Environmental Conservation
Division of Science Research and Technology
P.O. Box 409
Trenton, New Jersey 08625

Re: East Coast Power L.L.C. Comments on the Draft Regional Greenhouse Gas Initiative ("RGGI") Model Rule dated March 23, 2006

Dear Mr. Linz and Mr. Sherry:

East Coast Power L.L.C. ("East Coast Power") appreciates the opportunity to submit comments on the draft model rule that will implement the Regional Greenhouse Gas Initiative program in seven states in the Northeast and Mid-Atlantic region. East Coast Power owns and operates a 940-megawatt natural gas-fired cogeneration facility (the "Linden plant") located in Linden, New Jersey. East Coast Power supports the RGGI program and the goal of developing market-based programs to slow, eventually stop, and ultimately reverse the growth of emissions of greenhouse gases. In these comments, East Coast Power addresses what it believes is an unintentional detrimental effect of the RGGI model rule on power plants that supply power to utilities under long term power purchase agreements ("PPAs").

In preparing the final model rule, East Coast Power encourages the RGGI member states to consider the following two points:

- (i) Independent power producers ("IPPs") selling power to offtaking utilities under long term PPAs that were entered in the late 1980s or early 1990s do not have a mechanism to pass through environmental compliance costs to the power purchasers. Unlike utilities that may pass through such compliance costs in electricity rates charged to consumers, IPPs will need to bear the brunt of these costs until their

long term PPAs expire. Under the long term PPAs, the offtakers have purchased the power, and the generator does not control when and how often it will operate to meet that load demand. East Coast Power recommends that the power offtakers be responsible for securing any shortfall in CO2 allowances necessary to true-up CO2 emissions associated with the power dispatched pursuant to a long term PPA. To implement this approach, East Coast Power recommends that a separate CO2 compliance account be created for “Dispatch Owners.” During the term of the PPA, a portion of the CO2 allowances allocated to a CO2 budget source shall be transferred to the Dispatch Owner’s compliance account in a pro rata share equal to the CO2 emissions attributable to the average “dispatch load” during the baseline period. Any shortfall of CO2 allowances during the true-up period for the Dispatch Owner’s account to cover CO2 emissions associated with the dispatch load shall be the sole responsibility of the Dispatch Owner and not the Owner of the IPP.

- (ii) Dispatch Owners should not be given a role on par with an IPP’s legal or equitable title owner in selecting a CO2 budget unit’s authorized account representative or complying with a plant’s monitoring, recordkeeping and reporting requirements under the model rule. While a power offtaker “owns” the power being generated, it typically has no role in the actual ownership of the plant or in the day-to-day operations of the plant other than giving instructions on when to dispatch power. The definition of “Owner” under the draft model rule should be revised to eliminate a “purchaser of power from a CO2 budget unit under a life-of-the-unit, firm power contractual arrangement.” Instead, East Coast Power recommends that a separate definition of “Dispatch Owner” be used to define the obligations of long term power offtakers, including the obligation to cover any shortfall in CO2 allowances attributable to the dispatched power under a long term PPA.

I. Background on Long Term Power Purchase Agreements

The Linden plant consists of six gas combustion turbines operating in combined cycle mode with three steam turbines. The Linden facility is a cogeneration plant that produces both electricity and steam. The steam from the Linden plant is sold to an adjacent refinery for use in its process. Cogeneration offers increased efficiency of energy conversion and can provide significant energy savings when compared to the electricity and heat supplied by conventional power plants. Linden units 1-5 supply approximately 645 megawatts of electricity to a New York utility company under a long term PPA that was entered in 1989. Any excess power from those units is sold into the New York City Zone J regional energy market. Linden unit 6 is an “inside the fence” unit that sells approximately 135 megawatts of power to a New Jersey refinery owner under a second long term PPA, which was entered in the late 1990s, and the balance of

power from that unit is supplied to the PSEG/PJM regional power market. Linden units 1-5 went into commercial operation in 1992, and Linden unit 6 began commercial operations in 2002. About 20 percent of the total Linden unit 1-5 fuel is used to supply steam to the adjacent refinery.

As a power plant with a long term PPA for units 1-5, East Coast Power does not control the dispatch of these units. The offtaking utility determines when the units will run and how much power it will use. Under the long term PPA for units 1-5, East Coast Power is compensated by (i) a fixed capacity payment that is tied to dispatch availability of the units to generate power when called upon by the offtaking purchaser, (ii) a variable energy price that is linked to the amount of electricity that is actually dispatched by allowing a pass through of the costs of fuel to generate that electricity, and (iii) certain operation and maintenance expenses indexed to the CPI. Under East Coast Power's essentially fixed price PPA for units 1-5, environmental compliance costs, including the costs to cover any emission allowance shortfalls, may not be passed through to the offtaking utility.

East Coast Power's unit 1-5 PPA contains power purchase arrangements that are standard for the independent power production industry. In adopting the Public Utilities Regulatory Policy Act of 1978 (PURPA) (16 U.S.C. §2601, P.L. 95-617 (1978)), Congress mandated that utilities enter into long term electricity offtake contracts with IPPs, but they did not mandate that the offtaking utilities cover an IPP's environmental compliance costs. Offtaking utilities were required to pay IPPs a price for the power based on the utility's "avoided cost" of constructing a new generating station to supply the power or to obtain it from another source. The calculation of "avoided cost" does not include the costs to comply with new environmental regulations. Congress addressed this issue in the federal Acid Rain Program enacted as part of the Clean Air Act Amendments of 1990 by providing IPPs operating under long term PPAs entered before November 15, 1990 with an exemption from complying with the Acid Rain Program. As a result, Linden units 1-5 are exempt under the Acid Rain Program.¹

II. Offtaking Utilities Under Long Term PPAs Should be Responsible for the Costs of any CO2 Allowance Shortfalls Associated With Mandatory Dispatch Requirements

Unlike utility companies, IPPs do not have a mechanism to pass through environmental compliance costs to the ultimate consumers of the electricity. Utility companies typically may recoup environmental compliance costs from ratepayers. IPPs selling their power to utilities pursuant to long term "life-of-the-unit" PPAs do not have the option of passing such compliance costs directly to the ratepayer and the PPAs do not offer a contractual procedure to allocate such costs to the wholesale offtaker. IPPs operating without long term contracts typically sell their merchant power at market-based

¹ Linden unit 6 is different because it entered into a long term PPA with a non-utility in the late 1990s and there were no PURPA mandated requirements. The Linden unit 6 contract does allow a pass through of certain environmental compliance costs.

rates into a regional power pool. In the regional power market, merchant IPPs can potentially factor environmental compliance costs into the offer price of the power that is bid into the market.

By incorporating a definition of “life-of-the-unit, firm power contractual arrangement” into the draft RGGI model rule, the RGGI states appear to acknowledge that IPPs with long term power purchase contracts are at a disadvantage vis-à-vis merchant plants or power plants owned by utilities because IPPs subject to long term PPAs have no mechanism to recoup their environmental compliance costs. By including such power purchasers under the definition of “Owner,” the draft RGGI model rule also seems to suggest that long term offtakers should bear a responsibility for any shortfall in CO2 allowances associated with a CO2 budget unit’s dispatched power. As explained below, we recommend creating a new category of “Dispatch Owner” instead of equating long term power purchasers with legal or equitable title owners of a power plant under the definition of “Owner.” Utilities purchasing power under long term PPAs are the entities that control how often the generating plants are dispatched, which directly correlates to fuel consumed and the resulting CO2 emissions.

The Linden power facility, like other IPPs operating under long term PPAs, is facing potentially significant costs to buy CO2 allowances to fully cover the plant’s CO2 emissions associated with generating the power from units 1-5 to satisfy the dispatch requirements of its long term contract with a New York utility. Accordingly, East Coast Power recommends that utilities purchasing power from IPPs under long term PPAs be responsible for any resulting CO2 allowance shortfall associated with satisfying the dispatch requirements. Similar to the situation where a utility can pass on its environmental compliance costs to the consumers of the power, this approach would make the wholesale purchaser of the IPP’s dispatched power responsible for the costs necessary to cover a shortfall in CO2 allowances allocated to the plant during the term of the PPA.

This approach is also consistent with RGGI’s policy goals of using market forces to promote greater efficiencies and drive reductions in CO2 emissions. Here, if there is no mechanism for East Coast Power to equitably share the costs of complying with RGGI, then the dispatching offtaker will be selling power into the retail markets at rates that do not reflect the actual cost of carbon. In such a situation, we would expect that the Linden plant would likely be dispatched at higher load levels since the Linden power would not include a carbon cost. Such an approach would not appear to affect the electricity consumption habits of the wholesale offtaking utility and the retail ratepayers.

By way of example, a natural gas fired IPP plant may consume 20% of its needed fuel to generate steam, use 60% of the fuel to generate power for dispatch by a utility under a long term PPA, and consume another 20% of its required fuel to generate power for merchant sales into the regional power market. Assuming the IPP plant emits an average of 1 million tons of CO2 during the baseline years of 2003-2005 to generate steam and power, such emissions can be allocated according to the respective amounts of fuel used to generate the necessary steam and power. We would recommend that a

separate CO2 compliance account be created for “Dispatch Owners” and CO2 allowances attributable to the average dispatch load during the baseline period could be transferred by the CO2 budget source to the Dispatch Owner’s compliance account. Any resulting shortfall of CO2 allowances in the Dispatch Owner’s account to cover CO2 emissions connected with the generation of the dispatched power shall be the sole responsibility of the Dispatch Owner. The applicable state agency enforcing the RGGI provisions would, in turn, look solely to the Dispatch Owner for any failure to cover a shortfall in CO2 allowances associated with the dispatched power. Under this example, East Coast Power would remain responsible for any shortfall in CO2 allowances to cover its emissions associated with steam generation and merchant power generation.

Under the above example, the CO2 budget source would be allocated 750,000 allowances to cover its CO2 emissions associated with supplying steam and power.² Of these allocated allowances, the CO2 budget source would transfer 60% or 450,000 allowances to the Dispatch Owner’s compliance account. Assuming the CO2 budget source again emits 1 million tons of CO2 and 60% of the resulting emissions are associated with the dispatched power, the dispatch owner would be responsible for purchasing an additional 150,000 CO2 allowances to cover the allowance shortfall. The CO2 budget source would retain 300,000 allowances for its 40% share of emissions resulting from steam generation and merchant sales. The plant in turn would be responsible for a 100,000 allowance shortfall associated with the fuel combusted to generate steam and merchant power.

III. The Definition of “Owner” Should be Limited to the Holder of a Legal or Equitable Title or a Leasehold Interest in a CO2 Budget Unit

In addition to the legal or equitable title holder or the holder of a leasehold interest, the definition of “Owner” under the draft model rule includes a “purchaser of power from a CO2 budget unit under a life-of-the-unit, firm power contractual arrangement.” As defined under the model rule, a “life-of-the-unit, firm power contractual arrangement” would cover most long term PPAs. Most of these contracts were entered for terms of 20, 25 or 30 years, and often include one or more renewal terms. East Coast Power strongly recommends that a “purchaser of power from a CO2 budget unit under a life-of-the-unit, firm power contractual arrangement” be removed from the definition of “Owner.”

While a power offtaker “owns” the power being dispatched, it typically has no role in the actual ownership of the plant or in the day-to-day operations of the plant other than giving instructions on when to dispatch power. Companies owning IPP facilities have traditionally been responsible for selecting “responsible officials” under the Title V air operating program and “authorized account representatives” under the Acid Rain Program and the NOx SIP Call Rule. Under these federal programs, utilities and other offtakers under long term contracts have not been given a role on par with a plant’s legal

² The above example assumes an allocation of allowances totaling 75% of the CO2 emissions during the baseline period and a 25% holdback of allowances for public benefit purposes.

title owner in selecting such individuals. It is easy to foresee disputes arising between an offtaking utility and an IPP in selecting a CO2 budget unit's authorized account representative ("AAR") and the subsequent management of the allowance account. The AAR and the alternate AAR are the only individuals authorized to control a plant's CO2 allowance account, and they are responsible for ensuring that the CO2 budget unit has obtained a CO2 emission permit and secured sufficient allowances to satisfy the true-up obligations at the end of the compliance period.

If a legal dispute does arise involving the selection of an AAR or any action, inaction, or submission by an AAR, the parties are directed to resolve any such conflict between themselves, which could involve lengthy and costly lawsuits. The interests of a long term power offtaker and the legal or equitable title holder will not necessarily be aligned, and defining long term offtakers as "Owners" would not accomplish the goal of making the long term offtakers responsible for the CO2 emissions associated with the power dispatched under life-of-the-unit contracts. As drafted, the model rule does not specifically state that a power purchaser under a long term PPA is responsible for any shortfall in CO2 allowances associated with the emissions from the dispatched power.

The current definition of "Owner" would also arguably require offtakers under long term PPAs to play a role in confirming that the plant complies with monitoring, recordkeeping, and reporting requirements under the model rule. These are functions that are traditionally managed by a legal or equitable title holder or holder of a leasehold interest, and involving a third party offtaker in a plant's day-to-day compliance decisions appears to be well beyond what the RGGI Steering Committee intended.

In addition to removing a power purchaser under a long term PPA from the definition of "Owner," East Coast Power recommends that the Steering Committee create a separate definition of "Dispatch Owner" to specify the obligations of the owner of the dispatched power. These obligations would include a new section obligating offtakers under long term PPAs to be responsible for securing the necessary CO2 allowances to cover an allowance shortfall attributable to the dispatched power. By creating a separate CO2 allowance compliance account for Dispatch Owners, the offtaking utility would need to appoint its own AAR to manage the account. This approach would clearly delineate the responsibilities of an IPP Owner vis-à-vis a Dispatch Owner.

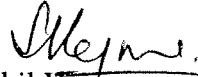
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We believe that the RGGI model rule should provide a mechanism to ensure that IPPs will not unfairly bear a disproportionate share of the costs to comply with RGGI because they are left without options to recover environmental compliance costs through most existing long term PPAs. Accordingly, we request that the utility offtakers be responsible for any shortfall in CO2 allowances that need to be purchased to cover the CO2 emissions associated with generating the dispatched power. We also recommend that the model rule be revised to eliminate long term power purchasers from the definition of "Owner" and a new definition of "Dispatch Owner" be created.

In the event that the RGGI Steering Committee does not agree with the recommended approach in these comments, we would be happy to discuss other alternative solutions with the Committee.

Again, we appreciate the opportunity to submit comments on the draft RGGI model rule. If you have any questions about the above comments, please contact me at 203-357-4485 or Roy S. Belden at 203-357-6820.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'Sushil Verma', with a horizontal line drawn underneath the name.

Sushil Verma

Vice President, East Coast Power L.L.C.

cc: Richard Guy
Roy S. Belden