UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OCT 2 3 2009

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Dear Mr. Eisenberg:

This letter is U.S. EPA's determination of applicability under § 72.6(c) of the Acid Rain regulations for Central Power & Lime Inc.'s (CP&L) cogeneration facility (Facility ID (ORISPL) 10333), in Brooksville, Florida. This determination is made in response to CP&L's petition of June 5, 2008 requesting a determination and the supplemental information provided on October 31, 2008 and June 30 and July 16, 2009. As discussed below, U.S. EPA determines that the CP&L cogeneration facility (i.e., CP&L Boiler #1) was exempt from the Acid Rain Program under § 72.6(b)(5) through December 31, 2008.

Background

Sections 402(17)(C) and 405(g)(6)(A) of the Clean Air Act include provisions discussing in detail the conditions under which a cogeneration unit is exempt from the Acid Rain Program. See, e.g., 42 U.S.C. 7651a(17)(C) (stating that a cogeneration unit is not a utility unit if it meets certain requirements concerning the purpose of its construction and the amount of electricity that it sells) and 42 U.S.C. 7651d(g)(6)(A) (stating that Clean Air Act title IV does not apply to qualifying cogeneration facility that meets certain conditions as of enactment of title IV, i.e., November 15, 1990). U.S. EPA interprets these provisions, and §§ 72.2 and 72.6 of the Acid Rain Program regulations implementing these provisions, to provide that a cogeneration unit meeting the requirements for generator nameplate capacity and used to produce electricity for sale is a utility unit and thus subject to the Acid Rain Program, unless the unit meets the requirements for an exemption as set forth in § 72.6(b).

CP&L leases and operates the cogeneration facility, whose construction began in January, 1985 and which commenced commercial operation in July, 1988. According to CP&L, the CP&L facility is a qualifying facility consisting of a single coal-fired boiler (Boiler #1) with 1,542 mmBtu/hr maximum design heat input capacity that serves a generator with nameplate capacity of 125 MWe.[1] However, the facility can achieve a gross capacity of 150 MWe. Steam produced in the boiler flows to a steam turbine, after which process steam is extracted, and the remainder of the steam returns to the boiler reheater and then flows back to the turbine. The process steam is sold to a manufacturer for the production of cement pursuant to a steam sales agreement dated December 15, 1988. See Central Power & Lime Inc. at 2 (July 15, 2008); and June 5, 2008 petition at 3 (explaining that the cement manufacturing facility was originally Florida Crushed Stone Company, which conveyed its assets to a subsidiary (with the same name) that is now owned by CEMEX).

Until November 2005, all electricity produced by the CP&L cogeneration facility was wheeled by Progress Energy Florida, Inc. (Progress Energy) for sale to Florida Power & Light (FP&L) pursuant to a power purchase agreement (1984 agreement). The agreement was entered into as of September 10, 1984, amended on December 10, 1990, and expired on October 31, 2005. Under the 1984 agreement, FP&L was required to pay monthly capacity charges calculated using specific formulas. Under the formulas, if the facility's capacity factor was at least XX%,[2] the monthly capacity charges were generally calculated as the sum of a Base Capacity Credit (a fixed amount that increased annually through 2005) per MWe and an Operation and Maintenance credit (a fixed amount that increased annually through 2005), which sum was multiplied by Committed Capacity and a factor related to the facility's capacity factor.[3] In addition, the 1984 agreement required that FP&L generally pay an energy charge per MWhr of 97.5% of the lesser of FP&L's as-available avoided energy cost or the average cost of coal burned at a specified FP&L facility. See id.

On December 10, 1990, an amendment (1990 amendment) was made to the 1984 agreement to provide for higher energy payments for periods during October 1, 1990 through April 1, 1992 when the facility had an on-peak energy factor of at least 82.5%. According to CP&L, the on-peak energy factor was never met, and the provision (i.e., the 1984 amendment) never applied.

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[1] The CP&L facility was certified as a qualifying cogeneration facility by the Federal Energy Regulatory Commission on November 15, 1982. Florida Crushed Stone Co., 21 FERC ¶ 62,258 (1982).

[2] The monthly capacity factor was a percentage of the facility's Committed Capacity, which under the 1984 agreement could be set by CP&L between 100 MWe and 150 MWe. During the term of the 1984 agreement, Committed Capacity was generally 133 MWe but was increased to 136 MWe for February 2003-October 2005.

[3] Under the price formulas, the capacity payment was higher when the capacity factor exceeded XX%.

In anticipation of the October 31, 2005 expiration of the 1984 agreement CP&L entered into a new power sales agreement (2005 agreement) with Progress Energy effective on August 23, 2005 that had a term that ended on December 31, 2010. However, on December 21, 2006, CP&L exercised an option in the 2005 agreement and notified Progress Energy that CP&L was terminating the 2005 agreement effective December 20, 2007. A new agreement (2007 agreement) with Seminole Electric Cooperative, Inc. (Seminole) was executed August 3, 2007 with a term that commenced December 21, 2007 and ends December 31, 2009.[4] However, CP&L also exercised a termination option in the 2007 agreement and terminated the 2007 agreement effective December 31, 2008.

U.S. EPA received from CP&L a petition dated February 23, 2005 requesting that U.S. EPA make an applicability determination under § 72.6(c) to determine if the CP&L facility was subject to the Acid Rain Program, particularly in light of CP&L's entry into the 2005 agreement with Progress Energy. In response, U.S. EPA issued an applicability determination that CP&L Boiler #1 was exempt from the Acid Rain Program under § 72.6(b)(5), which applies to a qualifying facility that meets certain requirements and has a qualifying power purchase commitment. In that determination, U.S. EPA held that, under § 72.6(b)(5), both the requirement to be a qualifying facility and the requirement to have a qualifying power purchase commitment must be met as of November 15, 1990 and on an ongoing basis thereafter in order for a unit to continue to be exempt. U.S. EPA also found that the CP&L facility had a qualifying power purchase commitment (the 1984 agreement) and that this was not changed by the 1990 amendment, which was never implemented. Further, U.S. EPA determined that, in that case, the changes made in 2005 to the 1984 agreement's terms and conditions should not be treated differently because they were structured as a replacement (through the 2005 agreement), rather than an amendment, of the 1984 agreement. In addition, U.S. EPA compared pricing under the original 1984 agreement with that under the 2005 agreement and found that, when the agreements were applied to the unit's operation in the first half of 2006, the 2005 agreement provided for lower total revenues than 1984 agreement and that the 2005 agreement therefore did not change the terms and conditions of the 1984 agreement in a way that allowed Acid Rain Program compliance costs to be passed through to the electricity purchaser (Progress Energy). U.S. EPA concluded that the CP&L facility continued to have a qualifying power purchase commitment and that CP&L Boiler #1 was exempt from the Acid Rain Program under § 72.6(b)(5) through December 20, 2007 (the effective date of the 2005 agreement's termination). Central Power & Lime at 5-16.

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[4] The 2007 agreement actually comprised two confirmation letters dated August 3, 2007 (each with an underlying agreement) with identical price- and quantity-related terms, one confirmation letter under which Bear Energy, LP, an affiliate of CP&L sold to Seminole and the other confirmation letter under which CP&L sold to Bear Energy, LP. The effect of these two confirmation letters (and underlying agreements) was that CP&L sold to Seminole, with Bear Energy, LP as an intermediary that received no net revenues. See June 5, 2008 petition at 6; and October 31, 2008 supplemental information.

In the instant case, U.S. EPA is considering new circumstances where, during December 21, 2007 through December 31, 2008, the 1984 and 2005 agreements were replaced by a third agreement, the 2007 agreement. Under the 2007 agreement, CP&L received a fixed capacity payment of $XX kw/month, based on a maximum scheduled output of XX MW, subject to adjustment to the extent monthly availability was less than XX%. June 5, 2008 petition at 7 and Attachment 1 at 5. In addition, CP&L was paid a variable payment equal to the sum of the commodity price, variable operating and maintenance costs (O&M), and transportation fee, and, since CP&L was not directly connected to Seminole's system, CP&L had to bear any cost of line loss with regard to sales to Seminole. June 5, 2008 petition, Attachment 1 at 2. For the period beginning December 21, 2007 through December 31, 2008, the sum of the commodity price and variable O&M was $XX MW/hr. The transportation fee was based on actual transportation fees charged by CSX Transportation, Inc. (CSX) for delivery of coal to CP&L divided by tons of coal delivered. The 2007 agreement capped the transportation fee at $XX/MWh. According to CP&L, the maximum transportation fee has been charged since the commencement of the 2007 agreement, as the monthly average transportation rate charged by CSX for the delivery of coal exceeded the maximum fee authorized under that agreement. Summing the average commodity price, variable O&M, and transportation fees for the period of December 21, 2007 through December 31, 2008 resulted in average variable payment revenue to CP&L of $XX per MWh. June 5, 2008 petition at 7. Finally, Seminole was required to buy electricity from CP&L between a minimum quantity of XX MWe and a maximum of XX MWe. If Seminole did not take all available electricity, CP&L had the right to sell the remaining electricity into the wholesale market on a non-firm basis in accordance with any transmission agreements between CP&L and Florida Power Corporation (also known as Progress Energy). However, CP&L did not enter into any such transmission agreement during the term of the 2007 agreement. Id.

EPA Determination

In the July 15, 2008 applicability determination, U.S. EPA made certain findings about the regulatory status of CP&L Boiler #1 that continue to apply. Because it burns coal and serves a generator with nameplate capacity exceeding 25 MWe that produces electricity for sale, CP&L Boiler #1 is a "unit" and, unless otherwise exempt, is a "utility unit" and therefore subject to Acid Rain Program requirements. Further, because it has equipment used to produce steam that is used sequentially, CP&L Boiler #1 is also a "cogeneration unit." See Central Power & Lime at 4; see also 40 CFR 72.2 (definitions of "unit", "utility unit", and "cogeneration unit"); and 72.6(b)(4) and (5) (exemptions for certain cogeneration units). Moreover, according to CP&L, CP&L Boiler #1 continues to be a qualifying facility. June 5, 2008 petition at 3.

Under § 72.6(b)(4)(i), a cogeneration unit constructed before November 15, 1990 is exempt from the Acid Rain Program if it meets certain conditions concerning electricity sales. The unit must have been constructed for the purpose of supplying annually no more than the greater of 219,000 MWh or one-third of its potential electrical output capacity to a utility power distribution system for sale. Further, the unit must supply such electricity, on a rolling three-year annual average basis, in an amount not exceeding the greater of 219,000 MWh or one-third of its potential electrical output. U.S. EPA found in the July 15, 2008 applicability determination that

the CP&L facility had electrical sales to FP&L under the 1984 agreement exceeding the MWe-hr electrical sales threshold and so CP&L Boiler #1 could not be exempt under § 72.6(b)(4)(i) from the Acid Rain Program. See Central Power & Lime at 4.

Section 72.6(b)(5) provides another exemption from the Acid Rain Program for certain cogeneration units. Under that provision, the unit must be a qualifying facility that has a qualifying power purchase commitment, effective as of November 15, 1990, to sell at least 15% of its total planned net output capacity and consists of one or more units with total installed net output capacity not exceeding 130% of total planned net output capacity. If the unit initially meets these requirements, but subsequently is no longer a qualifying facility or no longer has a qualifying power purchase commitment, it is no longer exempt under § 72.6(b)(5). U.S. EPA found in the July 15, 2008 applicability determination that CP&L Boiler #1 initially met the requirements for an exemption under this section because the unit is a qualifying facility with total installed net capacity equal to total planned net output capacity and was subject, as of November 15, 1990, to the 1984 agreement requiring FP&L to buy, at formula-based prices (in the form of capacity and energy charges), 100% of the electricity produced by the unit. See id. at 4-5.

As discussed above, after November 15, 1990, the 1984 agreement was amended in December 1990 and then replaced, first by the 2005 agreement and then by the 2007 agreement. Under the Acid Rain Program regulations, a "qualifying power purchase commitment" is defined as a "power purchase commitment" effective on November 15, 1990 (e.g., a power sales agreement such as the 1984 agreement) "without regard to changes to that commitment" so long as: (1) either the identity of the electricity purchaser remains unchanged or the identity of the steam purchaser and location of the facility remain unchanged, as of the commencement of commercial operation; and (2) the "terms and conditions of the power purchase commitment are not changed in such a way as to allow the costs of compliance with the Acid Rain Program to be shifted to the purchaser." 40 CFR 72.2 (definition of "qualifying power purchase commitment"). In the July 15, 2008 applicability determination, U.S. EPA found that the 1990 amendment and the 2005 agreement did not change the terms and conditions of the 1984 agreement in a way that would allow the costs of compliance with the Acid Rain Program to be shifted to the purchaser. U.S. EPA concluded that the CP&L facility therefore continued to have a qualifying power purchase commitment through December 31, 2006, when the 2005 agreement was terminated. See Central Power & Lime at 11-16.

In the instant case, U.S. EPA evaluated the 2007 agreement taking the same approach and using the same criteria. CP&L Boiler #1 is still a qualifying facility, and, if the facility continued to have a qualifying power purchase commitment, the unit continued to be exempt from the Acid Rain Program under § 72.6(b)(5). CP&L claims that CP&L Boiler #1 continued to be exempt under § 72.6(b)(5), asserting in its petition that the replacement of the 2005 agreement covering CP&L Boiler #1 by the 2007 agreement "falls squarely within the EPA's decision" made in the July 15, 2008 determination and that the 2007 agreement is therefore also a qualifying power purchase commitment.

For the following reasons, U.S. EPA finds that the 2007 agreement, like the 2005 agreement, changed the terms and conditions of the 1984 agreement in a way that did not allow the pass-through of costs of compliance with the Acid Rain Program to the purchaser (Seminole).[5] U.S. EPA therefore concludes the CP&L facility continued to have a qualifying power purchase agreement and that CP&L Boiler #1 continued to be exempt under § 72.6(b)(5) through December 31, 2008, when the 2007 agreement was terminated.

As discussed above, a power purchase commitment that was in effect as of November 15, 1990, but that is subsequently changed, continues to be a "qualifying power purchase commitment" if certain criteria are met. In particular, the terms and conditions of the agreement in place as of November 15, 1990 must not be changed in a way that allows the costs of compliance with the Acid Rain Program to be shifted to the purchaser.

Consistent with the approach taken in the July 15, 2008 applicability determination, U.S. EPA maintains that, in the specific circumstances of this case, the changes made in 2007 to the 1984 agreement's terms and conditions should not be treated differently because they were structured as a replacement (through the 2007 agreement), rather than an amendment, of the 1984 agreement. First, the 1984 agreement governed the actual construction and operation of the CP&L facility, which was constructed and operated, and charged electricity rates, under that agreement. In short, the CP&L facility had, as of November 15, 1990, a "power purchase commitment" (§ 72.2 (defining "power purchased commitment") and thus had a "qualifying power purchase commitment" (§ 72.2 (defining "qualifying power purchase commitment" initially as the commitment in place on November 15, 1990)). Second, the 1984 agreement expired on October 31, 2005, and the 2005 agreement became effective on August 23, 2005. After October 2005, the CP&L facility stopped producing electricity until December 2005, when sales under the 2005 agreement began. Subsequently, the 2005 agreement was terminated effective December 20, 2007, and the 2007 agreement was entered into effective December 21, 2007. Thus, there was no time, during the period from the commencement of commercial operation in July 1988 through the December 31, 2008 termination of the 2007 agreement when the electricity was produced for sale outside of one of this series of agreements. Third, like the 1984 agreement and the 2005 agreement, the 2007 agreement set the capacity and energy charges electricity purchases from the CP&L facility, rather than allowing for capacity and energy to be sold on an ongoing basis at current market prices (or, to the extent applicable, at prices as currently set by the State public utility commission). Consequently, the CP&L facility has never produced electricity that could be sold on an ongoing basis at current market prices or current regulated prices and has not had the same ability to pass through costs to the purchaser as a unit lacking a power purchase commitment. Compare Rensselaer at 3-4 and 5 (describing facility's

[5] Since the commencement of commercial operation, CP&L has provided steam from the same boiler at the same location and to the same cement manufacturing facility. U.S. EPA therefore maintains that there is a "commonality between the facility exempted and the facility as installed" (58 Fed. Reg. 15634, 15640 (Mar. 23, 1993) and, while the identity of the electricity purchaser has changed since the commencement of commercial operation, the alternative requirement that the identity of the steam purchaser and location of the facility remain unchanged is met.

ability to sell electricity on an ongoing basis at current market price through NYISO and holding that facility therefore has ability to shift Acid Rain Program compliance costs to purchaser). Under these circumstances, there seems to be no substantive difference between changing the 1984 agreement through an amendment that revises the terms and conditions and changing the 1984 agreement through replacement by the 2007 agreement that makes such revisions.

In support of this view, U.S. EPA notes that the definition of "qualifying power purchase commitment" allows for extensive, albeit not unlimited, changes to the original commitment. The electricity purchaser can be changed so long as the identity of the steam purchaser and facility location do not change.[6] Moreover, the scope of terms and conditions that are changed and the degree of these changes are limited only by the requirement that these changes must not allow (i.e., provide an opportunity) for pass-through, to the electricity purchaser, of costs of complying with the Acid Rain Program. If these substantive criteria for allowing changes to the original commitment are met, U.S. EPA believes that whether the changes to the original commitment are styled as an "amendment" of the commitment or a "replacement" of the commitment should not be determinative. Indeed, since the language of the "qualifying power purchase commitment" definition allows the original commitment to be completely changed so long as the limits on electricity/steam purchaser changes and cost pass-through are observed, U.S. EPA believes that the language of the definition is flexible enough to bear U.S. EPA's approach concerning replacement agreements.

Having concluded that the fact that CP&L replaced its 1984 agreement is not alone determinative of whether the CP&L facility still has a qualifying power purchase commitment, U.S. EPA applied the limit on cost pass-through to determine whether the facility continues to have such a commitment. As discussed above, the 1984 agreement set price formulas for the capacity and energy provided by the CP&L facility for July 1988 through October 2005, the 2005 agreement set prices for such capacity and energy for November 2005 through December 20, 2007, and the 2007 agreement set prices for capacity and energy from December 21, 2007 through December 2008. In evaluating the price changes established by the 2007 agreement, U.S. EPA considered an analysis provided by CP&L comparing gross revenues for 2008 from actual (for the first 9 months) and projected (for the remaining months) electricity sales under the 2007 agreement with what gross revenues would have been for 2008 from electricity sales under the 1984 agreement, assuming the same level of operations. This analysis showed that the 2007 agreement resulted in annual gross revenues about 25% below what would have been realized under the 1984 agreement.[7]

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[6] See n.5.

[7] The analysis showed that the total gross revenue that CP&L would have received in 2008 under the 1984 agreement given actual and projected operations was $XX (assuming XX MWe available capacity). For purposes of comparing gross revenues under the two agreements, the analysis reflects simplifying assumptions, i.e., the Committed Capacity (XX MWe) and the amount of electricity sold for 2008 would be the same under both agreements and the fuel cost under the 1984 agreement would be the same as in 2005. Treating the Committed Capacity under the 1984 agreement as 136 MWe, as it was for February 2003-October 2005, would have

Because gross revenues, i.e., total payments by the purchaser, were significantly lower under the 2007 agreement than under the 1984 agreement, it is difficult to see how the provisions of the 2007 agreement could have provided the opportunity for increased pass-through of any costs to the purchaser. In these circumstances, U.S. EPA finds that the 2007 agreement did not change the terms and conditions of the 1984 agreement in a way that allowed Acid Rain Program compliance costs to be passed through to the electricity purchaser.

Conclusion

U.S. EPA therefore concludes that the CP&L facility continued to have a qualifying power purchase commitment and that CP&L Boiler #1 continued to be exempt from the Acid Rain Program under § 72.6(b)(5) through December 31, 2008. If CP&L Boiler #1 loses its exemption in the future, it will have to comply with all applicable requirements under the Acid Rain Program, including the requirement to apply for and receive an Acid Rain Permit (under Part 72), to monitor and report sulfur dioxide, nitrogen oxide, and carbon dioxide emissions and heat input (under Part 75) within the earlier of 90 unit operating days or 180 calendar days of the loss of the exemption under § 72.6(b)(5), and to hold allowances to cover sulfur dioxide emissions (under Parts 72 and 73) starting as of the monitoring and reporting deadline.

This determination relies, and is contingent, on the accuracy and completeness of the representations in CP&L's June 5, 2008 petition for an applicability determination and the supplemental information provided by CP&L on October 31, 2008 and June 30 and July 16, 2009 and is appealable under 40 CFR part 78. The applicable regulations require you to send copies of this letter to each owner or operator of CP&L Boiler #1 (§ 72.6(c)(1)). If you have further

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increased estimated gross revenues under the 1984 agreement by about 4%; increasing the amount of electricity sold and the price of fuel under the 1984 agreement to reflect the bearing of line loss by the purchaser and coal price increases since 2005 would also have increased estimated gross revenues under that agreement. Thus, the estimates of gross revenues under the 1984 agreement are conservative, i.e. on the low side. The total gross revenue received in 2008 under the 2007 agreement would have been $XX (assuming XX MW available capacity). See October 31, 2008 supplemental information, Attachment 1.

questions regarding the Acid Rain Program, please contact Robert Miller (at (202) 343-9077) of U.S. EPA's Clean Air Markets Division.

Sincerely,

Sam Napolitano, Director
Clean Air Markets Division

cc: Dave McNeal, EPA Region IV
Errin Pichard, Florida DEP