



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

OFFICE OF
AIR AND RADIATION

Mr. David S. Langer
Beveridge & Diamond, P.C.
15th Floor
477 Madison Avenue
New York, NY 10022-5802

Subject: Applicability Determination for KIAC Partners
Cogeneration Project

Dear Mr. Langer:

This letter is U.S. EPA's official response to Raymond Luxton's February 12, 1998 letter requesting an applicability determination under the Acid Rain Program for the KIAC Partners Cogeneration Project ("the KIAC Project" or "the Project"). Based on the information submitted to EPA and the discussion below, EPA has determined that the KIAC Project meets the requirements for a qualifying facility exemption in 40 CFR 72.6(b)(5) and, therefore, is not subject to the requirements of the Acid Rain Program.

Description of Project

According to Mr. Luxton's letter, the KIAC Project comprises a 107 MW natural gas-fired combined-cycle cogeneration plant, principally consisting of two identical combustion turbines and one steam turbine that is fed by two heat recovery steam generators. The Project is located in the Central Terminal Area of John F. Kennedy International Airport ("the Airport") and is operated by KIAC Partners, a New York general partnership between CEA KIA, Inc. and subsidiaries of Gas Energy Inc. The Federal Energy Regulatory Commission certified the Project as a qualifying facility on September 28, 1992.

On November 14, 1990, KIAC Partners and the Port Authority of New York and New Jersey (the "Port Authority") entered into the Letter of Intent that obligated the Port Authority to purchase from the KIAC Project all its requirements for

electricity at the Airport (up to the net rated capacity, required to be at least approximately 76 MW). The total output capacity of the facility was planned to be approximately 97 MW.¹ The Letter of Intent also obligated the Port Authority to purchase from the KIAC Project all its requirements for hot water (up to 225 mmBtu/hr) and chilled water (up to 22,000 tons) at the Airport.

The Letter of Intent set the price of electricity at an amount based on "105 percent of the then-current" New York Power Authority's tariff rates at the Airport. The aggregate dollar amount of the 5 percent surcharge over the tariff rates was limited by, among other things, fixed amounts set forth in the letter of intent.

The hot water and chilled water are produced using electricity and waste steam from the facility. The Letter of Intent set the hot water price at a base price of \$13.50/mmBtu. A portion of this amount was to be adjusted to reflect fuel market escalation and the All-Urban Consumer Price Index as reported by the U.S. Government. The chilled water price was a base price of \$58.60/mmBtu with adjustments for electricity price escalation and the All-Urban Consumer Price Index.

On April 28, 1993, the same parties entered into the Energy Purchase Agreement, under which KIAC Partners agreed to sell and deliver to the Port Authority the electric energy requirements of the Airport (up to the electrical capacity of 76.3 MW) and thermal energy-heating and thermal energy-cooling requirements² of the Airport (up to 225 mmBtu/hr and 22,000 tons respectively). The price of the electricity was 105 percent of the New York Power Authority tariff. The aggregate amount of the 5 percent surcharge over the tariff was limited by, among other things, fixed amounts set forth in the agreement. The thermal energy-heating(hot water)had a base price of \$17.0161. A portion of

¹ The total planned net output capacity exceeded the full net rated capacity in order to meet the New York Power Pool's reserve requirement. KIAC Partners had also made agreements with Consolidated Edison Company of New York, the New York Power Authority, Long Island Lighting Company, and Northeast Utilities for the sale or delivery of electricity produced by the KIAC Project.

² The Energy Purchase Agreement required thermal energy-heating to be provided in the form of hot water and thermal energy-cooling in the form of chilled water.

this amount was to be adjusted to reflect the actual burner tip cost of fuel and the U.S. Government-reported Employment Cost Index. The thermal energy-cooling (chilled water) had a base price of \$71.676 adjusted to reflect electricity price and the Employment Cost Index.

Relevant Applicability Provisions

Forty CFR 72.6(b)(5) states that the requirements of the Acid Rain Program do not apply to a qualifying facility that:

(i) Has, as of November 15, 1990, one or more qualifying power purchase commitments to sell at least 15 percent of its total planned net output capacity; and

(ii) Consists of one or more units designated by the owner or operator with total installed net output capacity not exceeding 130 percent of the total planned net output capacity.

A "power purchase commitment" under 40 CFR 72.2 means, among other things, (1) an obligation of a utility to purchase electric power (actual electrical output or generator output capacity) from a facility pursuant to a letter of intent committing to purchase power from the source at a previously offered or lower price and (2) a power sales agreement applicable to the source is executed no later than November 15, 1993.

A "qualifying power purchase commitment" under 40 CFR 72.2 means a power purchase commitment in effect as of November 15, 1990 without regard to changes to that commitment so long as:

(1) The identity of the electric output purchase or the identity of the steam purchaser and location of the facility, remain unchanged as of the date the facility commences 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.

Analysis

The KIAC Project meets the requirements of 40 CFR 72.6(b)(5). First, the Project meets the qualifying facility requirement because of its certification as a qualifying facility by the Federal Energy Regulatory Commission on September 28,

1992. Second, the Project had a power purchase commitment before November 15, 1990. KIAC Partners entered into a letter of intent with the Port Authority on November 14, 1990, obligating the Port Authority to purchase all its electricity requirements from the Project. The Letter of Intent set specified prices for the purchase of electricity, hot water, and chilled water. Further, before November 15, 1993, the parties executed a power sales agreement (i.e., the Energy Purchase Agreement) applicable to the Project.

Third, the Project continues to have a "qualifying power purchase commitment" because there has been no change in the identity of the electric output purchaser and location of the facility. Further, while some terms and conditions in the Letter of Intent have changed in the power purchase agreement, EPA finds that the changes would not have allowed the costs of compliance with the Acid Rain Program to be shifted to the purchaser (here, primarily the Port Authority).

EPA considered whether changes in the electricity price in the Energy Purchase Agreement (at 6-7), as compared to the electricity price in the Letter of Intent (at C-1 and C-2), would allow shifting of Acid Rain Program compliance costs to the purchaser. In both documents, electricity is priced at 105 percent of the cost of obtaining electricity from the New York Power Authority. The 5 percent surcharge is subject to an annual dollar cap that declines over time. Since the schedule of dollar caps is lower in the Energy Purchase Agreement (Schedule EPA-2-2-2) than in the Letter of Intent (Schedule C-2), EPA finds that the electricity price changes would not have allowed for pass-through of Acid Rain costs.

EPA also considered whether the increase in the prices for thermal energy-heating (hot water) and thermal energy-cooling (chilled water) in the Energy Purchase Agreement (at 19-21), as compared to the prices in the Letter of Intent (at C-3 and C-5), would allow shifting of Acid Rain costs. The KIAC Project produces and sells hot and chilled water, as well as electricity, and the revenues from all these sales are intended to cover Project costs plus a return on investment. According to a July 30, 1998 letter from Jack Leibler of the Port Authority, who was personally involved with the negotiation of both the Letter of Intent and the Energy Purchase Agreement, the increase in the prices resulted from a decision by the Port Authority, after entry into the Letter of Intent, to scale back the redevelopment plan for the Airport and a consequent reduction in the projected revenues from sales of electricity and hot or chilled water to Port Authority tenants or other parties. The prices stated in

the Letter of Intent were therefore no longer sufficient to support financing for the cogeneration project. The parties therefore agreed to increase the hot and chilled water prices to raise total projected revenue and provide KIAC an anticipated return on investment comparable to the return previously negotiated and reflected in the Letter of Intent. To supplement Mr. Leibler's statements, you submitted documentation on January 15, 1999 showing the changes in projections from 1991 and 1992 in the year 2000 peak electrical energy, thermal heating, and thermal cooling loads. This documentation shows decreases of about 5-20% in all projected year 2000 peak loads but does not include projections for year 2000 annual loads. EPA finds this documentation, while not compelling evidence, is consistent with Mr. Leibler's statements.

Moreover, both the Energy Purchase Agreement (at 26-27) and the Letter of Intent (at 16) require KIAC Partners to rebate to the Port Authority revenues equal to 50 percent of net pre-tax cash flow in each year after the first year that the KIAC Project earns a cumulative 15 percent after-tax return on investment. Thus, regardless of the increases in specific prices, both documents limit KIAC Partners' total return to within essentially the same cap. This further supports KIAC's assertion that the price increases simply preserved the level of total revenues and the Project rate of return anticipated in the Letter of Intent and thought to be necessary to finance the Project. These price increases were adopted in the Energy Purchase Agreement before the Port Authority obtained any long-term financing for the project.

Under these circumstances, EPA finds that the changes in prices for hot and chilled water did not increase the ability of KIAC Partners to incur new costs (e.g., Acid Rain costs) and pass them through to the Port Authority. The price increases preserved the level of anticipated revenues and rate of return for the Project, but did not account for Acid Rain costs. Incurring acid rain costs would have reduced the anticipated rate of return and presumably jeopardized the ability to finance the Project. EPA therefore determines that the terms and conditions of the power purchase commitment were not changed in such a way as to allow Acid Rain costs to be shifted to the purchaser, and hence, the Project still has a qualifying power purchase commitment.³

³ EPA notes that this reasoning applies because the price increases occurred between the letter of intent and the power sales agreement and before any long-term financing was obtained. This reasoning would not apply where price increases occur after

Fourth, the Project meets the requirement to have a power purchase commitment to sell at least 15 percent of its total planned net output capacity. The Letter of Intent required KIAC Partners to deliver and sell to the Port Authority electricity up to at least approximately 76 MW.⁴ This amount represents 78 percent (well above the 15 percent threshold) of the total planned net output capacity of 97 MW.

Finally, the Project meets the requirement that the installed net output capacity of the project be less than 130 percent of planned net output capacity. The Project's installed net output capacity of 107 MW is only 110 percent of the total planned net output capacity of 97 MW.

In sum, the KIAC Project is not an affected source under the Acid Rain Program based on the information submitted concerning the Project. However, for the KIAC Project to remain an unaffected source, it must continue to meet the requirements of 40 CFR 72.6(b)(5). If these requirements are not met, then the facility may become an affected source.

The determination made in this letter is based on the representations made in Mr. Luxton's letter and attachments of February 12, 1998 and your letter and attachments of January 1, 1998 and January 15, 1999, and telephone conversations with you and Mr. Luxton and are made in reliance on the accuracy and completeness of those representations. The determination is appealable under 40 CFR part 78. If you have further questions regarding the Acid Rain Program, please contact Donna Deneen at (202) 564-9089.

Sincerely,

/s/ (February 11, 1999)

Brian J. McLean, Director
Acid Rain Division

cc: Gerry DeGaetano, EPA Region 2

the execution of the power sales agreement and the obtaining of any long-term financing.

⁴ Even though the Port Authority was not contractually obligated to purchase all 76 MW produced by the KIAC Project, KIAC Partners was committed to selling 76 MW if the electrical energy was needed by the Port Authority.