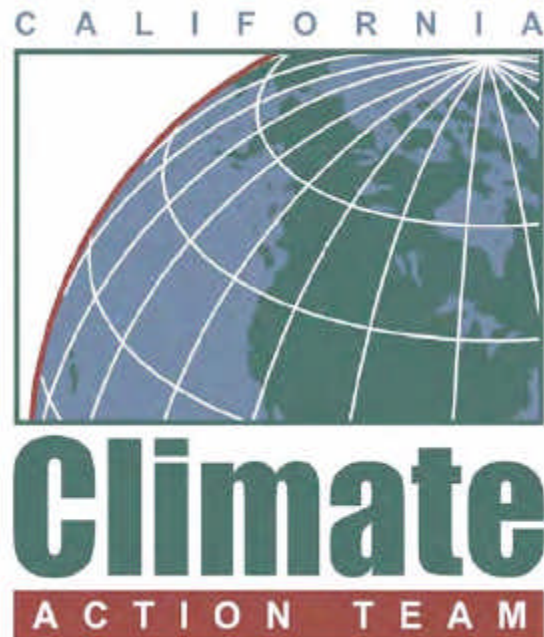


CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY

Climate Action Team Report to Governor Schwarzenegger and Legislature



March 2006

Investor-Owned Utility Combined Heat and Power Initiative

This strategy encourages the installation of on-site power production to meet both heat and electricity loads, known as combined heat and power projects (CHP). The PUC's existing Self-Generation Incentive Program allocates \$0.80 per watt to eligible CHP projects in the territories of the IOUs, up to a capacity size of 5 MW. Currently, all SGIP funds are reserved through 2007, although funding may become available if proposed projects do not materialize.

This strategy would seek to develop additional programs to further encourage the development of CHP. These additional programs are not yet underway, will require further consideration, and could likely require administrative, legislative, regulatory, and budget initiatives. To effectively implement this strategy, it is likely various policy instruments will be needed to attain the realistic market potential and subsequent CO₂ reductions.

These policy mechanisms may include regulatory incentives to encourage IOUs to promote customer and utility-owned CHP, changes to IOU rate design, market rules and regulations enabling easier access to wholesale markets, production tax credits for CHP, and other measures or incentives directed at key commercial and industrial activities in California. Statutory modifications are required in order to apply a similar strategy for CHP programs implemented by publicly-owned utilities.

**Excerpted from Report
(Pages 55-56)**

Municipal Utility Combined Heat and Power

This strategy constitutes cost-effective reductions from fossil fuel consumption in the commercial and industrial sector through application of on-site power production to meet both heat and electricity loads. To effectively implement this strategy, various policy instruments will likely be needed to attain the realistic market potential and subsequent climate change emission reductions.

These policy mechanisms may include regulatory incentives to encourage utilities to promote customer and utility-owned CHP, utility rate structures that are transparent and connected to market forces where externalities such as environmental impacts and transmission and distribution constraints are internalized, rules and regulations enabling easier access to wholesale markets, production tax credits for CHP, and other measures or incentives directed at key commercial and industrial activities in California.

Through existing efficiency commercialization programs at the CEC where relationships have been well established with the commercial and industrial sectors, a set of implementation activities will be developed that include:

- Utility tariffs to enable CHP owners to sell excess on-site electricity generation to the utility at prevailing wholesale prices. Existing analysis suggests this would be very effective in stimulating the near-term (next 5 years) market.
- Climate change emission reduction credits to reflect the net reduction of climate change emissions for the CHP systems compared to the avoided electricity and boiler fuel emissions.
- Transmission and distribution benefit payments that reflect the local and temporal benefits CHP provides utilities.
- Utility regulatory incentives to encourage utilities to promote installation of customer- and utility-owned CHP projects.