

## Separate Source Determination Request

### Proposed Solomon Renewable Energy Company Biomass Cogeneration Facility

#### A. Background and Project Description

Solomon Renewable Energy Company, LLC (SREC) will own and operate a proposed 31 MW biomass cogeneration facility in Shelton, WA. The facility will be located on property leased from Simpson Lumber Company, LLC (SLC), in the same industrial complex that houses the SLC lumber mill and the Olympic Panel Products (OPP) plywood mill. The SREC boiler will be designed to burn biomass fuel, including sawmill by-products such as sawdust, bark and shavings, and forest slash from logging operations.

SREC is motivated by Washington State Initiative 937 and subsequent renewable energy legislation that encourages “green” power production using biomass-powered facilities. Locating the facility adjacent to two existing wood products mills makes good business sense, but as discussed below, SREC will not have to depend on those mills for fuel. The Shelton area is a prime location for access to biomass fuel.

The following descriptions provide background information for each facility.

SREC. Solomon Renewable Energy Company, LLC is a Washington limited liability company. The SREC cogeneration plant will be comprised of a stoker wood-fired boiler, a steam turbine generator, an evaporative cooling tower, a condenser, and a fuel storage building. The boiler will be rated at 437 million British thermal units per hour (MMBtu/hr) and designed to produce up to 250,000 lb/hr of full load steam to supply a steam turbine generator with a nominal gross electrical output rating of 31 MW. The unit will be capable, through heat recovery, of selling lower pressure steam from two extraction ports. The boiler is intended to run as continuously as possible, but maintenance will require occasional shutdowns. During shutdown periods, the adjacent mills will have to provide their own steam to continue operations. As part of its cogeneration function, SREC is entering into steam agreements with the owners of the two adjacent mills to provide each with process steam and into wood fiber supply agreements with the mills for biomass fuel from the companies. The primary function of the facility will be to produce power that qualifies as biomass renewable energy under state law, for sale to the power grid. A site plan showing the location and layout of the SREC facility is provided in **Attachment 1**.

SLC. Simpson Lumber Company, LLC, a Delaware limited liability company, owns and operates a sawmill and planing facility that produces green and dried dimensional lumber. An existing steam generating plant produces steam to heat lumber dry kilns and buildings at the sawmill. Additionally, SLC provides high-pressure steam to the adjacent Olympic Panel Products plywood mill pursuant to a steam agreement between the two companies. The SLC plant uses lower pressure, 100 psi steam. SLC will retain the ability to use its existing hog fuel boiler in the event SREC does not provide SLC with process steam.

OPP. Olympic Panel Products operates a plywood manufacturing facility adjacent to SLC. It produces higher-end specialty plywood, including use of overlays, for use in concrete forms, road signs, and other specialty applications. OPP requires high pressure (300 psi) steam for its veneer dryers. This steam is currently produced by SLC's existing boiler. SREC plans to provide 300 psi steam to OPP, while the existing SLC boiler would remain available as an alternative source of steam.

## **B. Definition of "Source"**

This request addresses two different regulatory definitions of "source." First, under state and local new source review rules, "source" means all of the emissions units ... located on one or more contiguous or adjacent properties, and under the control of the same person or persons under common control, whose activities are ancillary to the production of a single product or functionally related groups of products. WAC 173-400-030(76); ORCAA Reg. 1.4. Second, under NESHAP rules, "affected source" means the collection of equipment, activities, or both within a single contiguous area and under common control ... . 40 CFR § 63.2, adopted by reference in WAC 173-400-075(6)(a), and applicable under ORCAA Reg. 6.1.4(a)(1). The relevant criterion shared by these two definitions is "common control." This request, therefore, asks Ecology and ORCAA to make a case-specific determination that SREC will not be under "common control" with SLC or OPP, to confirm that it is a separate source for air regulation applicability purposes.

## **C. Common Control Analysis**

EPA regulations do not define "control," so a case-by-case evaluation is to be guided by the SEC definition of control. 45 Fed. Reg. 59874, 59874 (Sept. 11, 1980). Under SEC rules:

Control is the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person (or organization or association) whether through the ownership of voting shares, contract, or otherwise.

17 C.F.R. § 240.12b-2. In applying this definition in determinations over the past 30 years, EPA has looked to see if (1) control is established through ownership by the same parent corporation or subsidiary of the parent corporation, (2) direct control is established

through contract, or (3) indirect control is established through a support or dependency relationship such that one would not exist but for the other, or a contract-for-service relationship in which one sells all of its product to the other. *See, e.g.*, Letter from Richard Long, EPA Region 8, to Margie Perkins, Colo. Dept. of Public Health & Env't, Oct. 1, 1999, p. 2.

**1. There is no control through ownership: the SREC plant will be owned by a separate company and will not share the same parent as SLC or OPP.**

EPA guidance and determinations on common control generally first ask whether control through common ownership exists. Using the SEC definition, the question is whether the owners of one company have the power to direct or cause the direction of the management and policies of the other through the ownership of voting shares. EPA interprets this to mean that a person with as much as 50% voting interest in an entity should be considered to control it. Letter from Douglas Skie, EPA Region 7, to Jeffrey Chaffee, Montana Dept. of Health and Env'tl Sciences, March 22, 1990, p. 2; letter from Jewell Harper, EPA Region 4, to Ron Methier, Georgia Dept. of Nat'l Resources, July 20, 1995, p. 1 (citing a March 16, 1979 memo from John Seitz). In particular, EPA states that the "determination must focus on who has the power to manage the pollutant-emitting activities of the facilities at issue, including the power to make or veto decisions to implement major emission-control measures or to influence production levels or compliance with environmental regulations." Letter from Robert Miller, EPA Region 5, to William Baumann, Wisconsin Dept. of Nat'l Resources, Aug. 25, 1999, p.2; *see also*, memo from J. Seitz, EPA OAQPS, August 2, 1996, p. 10.

In this case, there will be no common shareholder or member with a 50 percent or greater voting interest in SREC and either SLC or OPP. As a result, there will be no common owner with the ability to exercise control over SREC and SLC or SREC and OPP. This fact distinguishes the SREC plans from determinations in which EPA found common ownership through voting interest. See J. Harper, EPA Region 4, July 20, 1995 letter (United Technologies and Precision Components plants were under common control because UT had 50% voting power over Precision through another company, which UT had 100% control over); letter from D. Neely, EPA Region 4, to E. Reksten, Chattanooga-Hamilton Air Pollution Control Bureau, Aug. 8, 2001 (DuPont and DUSA facilities were under common control because DuPont had 50% joint ownership in DUSA); letter from D. Skie, Letter from Douglas Skie, EPA Region 6, to C. Rhodes, Colorado Air Pollution Control Div'n, Aug. 22, 1991 (two cogeneration turbine projects were under common control because CTI Partners, the 100% owner of one project, was also 50% owner in the other).

In addition, neither SLC nor OPP will otherwise have the power to manage the pollutant-emitting activities at SREC, and vice-versa. Under the Solomon Renewable Energy Company, LLC Operating Agreement, which serves as SREC's charter, the business and affairs of SREC will be managed by an Operational Manager and an Administrative Manager. Initially, both posts will be held by a single individual. Under

Sections 2.1.1 and 2.1.2 of the Agreement, the Operational Manager has the sole power to manage the plant, including construction, operation, production, emission control measures, and environmental compliance. Copies of relevant agreement provisions are provided in **Attachment 2**. SREC is wholly-owned by a limited liability company, which was formed by nine investors whose ownership interests range between approximately 9 to approximately 14 percent per investor. While each of these nine investors is a direct or indirect shareholder of SLC's ultimate parent company (of which they collectively own a majority share), the initial Operational and Administrative Manager is the sole “active” investor with any operational or administrative control over SREC; the eight other “passive” investors have no voting or other power to direct the management or policies of SREC. The person serving as the initial Operational and Administrative Manager for SREC is not a director, officer or otherwise a control person of SLC, its parent or ultimate parent, or OPP. Moreover, the Operating Agreement (in Amendment 1) requires that any person deemed to be a control person of SLC, its parent, or ultimate parent, is disqualified from serving as SREC’s Operational or Administrative Manager.

Operating Agreement Section 2.1.1 gives the Operational Manager sole authority to manage plant construction and operation, and SREC’s day-to-day routine operations. Under Section 2.1.2, the Administrative Manager’s duties consist of managing all aspects of SREC's business that are not delegated to the Operational Manager. The Operating Agreement allows, but does not require, the same person to serve as both the Administrative Manager and the Operational Manager. Under the Agreement, neither SREC’s parent nor any of the passive investors in the parent company has the authority to remove or replace either of these managers. The Administrative Manager has the sole authority to appoint the Operational Manager, to remove the Operational Manager for cause, and to appoint any successor Operational Manager. In the event the Operational Manager position is vacant, the Administrative Manager is authorized to also act as Operational Manager. Under Sections 2.1.1 and 2.1.2, the Administrative Manager is the only person with the authority to appoint a successor Administrative Manager. As a result, only the Administrative Manager has control over appointment and removal decisions regarding the Operational Manager. The passive investors, acting alone, cannot amend the Operating Agreement. SREC's Operating Agreement, therefore, ensures that neither SREC’s parent company nor its passive investors may exercise any control over operational or emission-control measures at the plant, or any other business of SREC.

SREC’s Operating Agreement provides that the SREC parent company (the initial member of SREC) may transfer some or all of its ownership interests in SREC. In the event that more than a majority of the ownership interests are transferred or issued to one or more third parties who did not, directly or indirectly, own or control any interests in SREC before such transaction or transactions (a “change of control”), then the management structure of SREC would change. The Operating Agreement provides that the new majority owners would have the right to change the number of managers and to appoint managers. Additionally, following a change of control, an amendment to the Operating Agreement would no longer require the consent of the Administrative Manager. In the event of such a change of control, the power to control the operations of

SREC would then be shared among the SREC managers and the new majority owners, and the provisions of Sections 2.1.1 and 2.1.2 would no longer apply. See Operating Agreement Sections 2.1.3 and 2.1.4. Accordingly, both before and after a change of control, the owners of SREC's current parent company would not have the ability to control SREC's operations.

As discussed below, there will be contract for service agreements among the three companies, but they will be negotiated, arms-lengths contract that will not give any one company authority to make or veto decisions to implement major emission-control measures at another, or to influence production levels or compliance with environmental regulations.

EPA suggests evaluating the following questions to assist in determining if control through ownership exists. Answers for the proposed SREC cogeneration project are provided.

**Q.** *Will the entities share the same parent corporation or subsidiary of a parent corporation?*

**A.** No. Each of the three companies is a subsidiary of different, separate parent corporations. There is no common parent corporation or subsidiary of the parent corporation between SREC and either SLC or OPP. SREC's parent corporation owns only SREC; it is not owned or controlled by any other corporation, and has no corporate relationship with SLC's or OPP's parent companies.

**Q.** *Will the facilities share common workforces, plant managers, security forces, corporate executive officers, or board of directors?*

**A.** There will be no sharing of personnel. First, SREC will have its own, separate Board of Directors. There is no bright line as to how many common board members create common control. EPA found no common control between a cogeneration plant and a pulp mill even though one of five board members for the cogeneration plant was from the pulp mill (letter from David Conroy, EPA Region I, to Jane Gilbert, Maine DEP, April 26, 1991, p. 1), but did find control where, among other reasons, two of six DUSA directors were DuPont employees and a third, who was also the CEO of DUSA, was a former DuPont employee on loan to DUSA (D. Neely, EPA Region 4, Aug. 8, 2001 letter). In the SREC case, there will be no common board members among the three companies.

Second, there will be no common executive officers and managers. SREC's managers will not also be SLC or OPP employees. Third, SREC's own employees will be responsible for operating the cogeneration boiler, and these people will not also be employees of SLC or OPP. As discussed further below, SREC is contracting with SLC to provide accounting and payroll services, but the contract for service relationship reflects an arms-length transaction between two financially separate companies.

- Q.** *Will managers or other workers frequently shuttle back and forth to be involved actively in both facilities?*
- A.** No. SLC employees will continue to run the sawmill and planing mill, OPP employees will continue to operate the plywood mill, and SREC employees will operate the cogeneration boiler. SLC or OPP employees will not have any reason to be at the SREC plant. The only possible “shuttling” of workers would result from the possibility of SLC leasing its existing boiler to SREC, which is discussed in detail below. If this occurs, it would not somehow create common ownership. This is simply a screening question suggested by EPA to determine if there is common control through ownership. The information provided above shows that there will be no common control through ownership.
- Q.** *Do the facilities share common payroll activities, employee benefits, health plans, retirement funds, insurance coverage, or other administrative functions?*
- A.** SREC plans to contract with SLC to have SLC administrative staff handle accounts payable, accounts receivable and payroll services for SREC, but this is a matter of business convenience rather than an indicator of ownership. This will not make SLC administrative staff SREC employees; SLC will be paid for their services. The paychecks for SREC employees will be paid by SREC.

**2. There is no control relationship through contract.**

EPA also considers whether direct control is established by a contractual arrangement giving one entity decision-making authority over the operation of a second entity. Letter from Henry Thomas for John Seitz, EPA Office of Air Quality Planning and Standards, to John Homback, Kentucky Div’n for Air Quality, March 29, 2001, p. 2. That will not be the case as between SREC and either SLC or OPP. (Note that the issue of indirect control through a contract for service relationship is discussed in Section C.3 below.)

EPA’s screening questions for evaluating whether common control is established through contract focus on whether a contract gives one entity the ability to affect pollution control or production at another. Reflecting this focus, EPA found common control through contract in a situation where a power supply contract gave one entity the authority to exert direct control over start-ups, shut-downs, and electricity generation levels at another. R. Long, EPA Region 8, letter to Margie Perkins, CO DPHE, Oct. 1, 1999, p. 3 (finding that the Public Service Co. of Colorado and Front Range Energy facilities constituted a single source because the power supply contract gave PSC “the sole right” to determine operations at Front Range).

SREC’s cogeneration relationship with SLC and OPP will involve contracts between the entities, including a pre-construction services agreement, a property lease with a utility services agreement, wood fiber and steam agreements, and an administrative services agreement. But unlike the agreement in the PSC/Front Range case, these are arms-length business arrangements that do not give one entity decision-making authority over, or the ability or right to control, one of the others. Each of the

three companies will have the responsibility to install, operate, and maintain its own equipment, including required air emission controls, and to meet its own air emissions compliance obligations.

EPA questions to ask in determining whether there is control through contract include:

- Q.** *What are the contractual arrangements for providing goods and services? What does the contract specify with regard to pollution control responsibilities?*
- A.** The various contracts for service are described below in section C.3.b.2 on page 14; copies of referenced provisions are provided in **Attachment 2**. As discussed below, none of the agreement terms give one party control over the other, and none of the terms shift pollution control responsibilities. Each party retains full liability for the pollution control responsibilities of its respective plant. For instance, Lease Condition 6 states that SREC “shall at its sole cost and expense comply with and perform all obligations with respect to ... all applicable local, state, tribal and federal laws, ordinances and regulations, and other governmental rules, orders and determinations ... including ... environmental compliance ... .”
- Q.** *Do the facilities share equipment, other property, or pollution control equipment? Can the managing entity of one facility make decisions that affect pollution control at the other facility?*
- A.** No. Each company has the responsibility to operate and maintain its own equipment and to meet its own air emissions compliance obligations. The fuel conveyor and steam lines will be owned and maintained by SREC (see Lease Condition 12.1), and neither SLC nor OPP will have the ability to dictate how SREC operates them. The equipment will be run consistent with the lease, wood fiber, and steam supply agreements. Similarly, none of the companies will be able to make decisions that affect pollution control at either of the other plants.
- Q.** *Who accepts the responsibility for compliance with air quality control requirements? What about responsibility for violations of the requirements?*
- A.** Each of the three companies will accept responsibility for air quality control compliance and violations, and each will be subject to its own permit.

**3. There will be no support/dependency or contract for service relationship to such a degree that a common control relationship exists.**

A support facility relationship is presumed when more than 50% of one facility’s output or services are dedicated to the other. Even where this 50% test is not met, financial, functional, contractual, or other legal factors may be evidence of a support facility relationship. These include: (1) the degree to which the supporting activity receives materials or services from the primary activity; (2) the degree to which the primary activity exerts control over the support activity’s operations; (3) contractual arrangements between the facilities; and (4) the reasons for the presence of the support

activity on the same site as the primary activity (e.g., whether the support activity would exist at that site but for the primary activity). Letter from Robert Miller, EPA Region 5, to William Baumann, Wisconsin Dept of Nat'l Resources, Aug. 25, 1999, p. 2. Common control can be based on indirect control where goods or services provided by a collocated, contract for service entity are integral to or contribute to the output provided by a separately owned or operated activity with which it operates or supports. Memo from J. Seitz, EPA OAQPS, August 2, 1996, p. 10.

Cogeneration, also known as combined heat and power, entails producing two forms of energy from the same process. This often takes the form of producing steam heat for use in a manufacturing process and steam energy to generate electrical power. It's the nature of a steam generating cogeneration facility, therefore, to provide steam to one or more adjacent business through a physical connection, which necessarily entails contracts setting steam terms. This type of relationship does not, however, necessarily create a support/dependency or contract for service relationship to such a degree that a common control relationship exists.

There are several examples where agencies in Washington found separate sources despite steam being piped from one facility to another, including the Commencement Bay sawmill in Tacoma (separate source from the adjacent pulp mill), SPI kilns (separate source from the SPI Aberdeen boiler), and the PSD permit prepared for the NESCO cogeneration facility adjacent to Hampton Lumber's Darrington mill. Similarly, in a case-by-case determination, EPA agreed with the state of Maine that a new cogeneration project designed to replace steam previously generated by oil-fired boilers at the adjacent International Paper Co. pulp mill was a separate source from the IP mill. Letter from David Conroy, EPA Region I, to Jane Gilbert, Maine DEP, April 26, 1991. In accordance with EPA guidance and determinations, as long as SREC retains the ability to operate independently and enters into contract for service relationships that do not limit its function to serving the adjacent mills, it will not have a common control relationship with either SLC or OPP. That is the case here.

**a. There is no support/dependency relationship that creates common control**

First, there is no support facility relationship based on the 50 percent output test. The primary function of the SREC facility will be to generate biomass power for sale on the grid, and none of its electrical output will be sent to either SLC or OPP. In terms of forgone power generation, the 50 percent test would also be met. If SREC did not send any steam to the mills, it could produce roughly 31MW. Based on "calculated expected performance" drawings provided by the turbine manufacturer (Siemens), sending 300 psi steam to OPP reduces output by approximately 5MW, and sending 100 psi steam to SLC reduces output by another roughly 5MW (SLC requires more steam, but at lower pressure). The Siemens drawings, which are provided in **Attachment 3**, show a "Pgen" of 31115kW with no steam extracted from the turbine and a "Pgen" of 20667 kW with steam extracted for use by SLC and OPP. From this perspective, roughly two-thirds of



SREC's total steam energy will go toward power production and one-sixth of the energy will go to each of two other entities.

This roughly 16% allocation to each steam off-taker will be implemented through the steam sales agreements with SLC and OPP, which will contain clear caps on the amount of steam SREC will provide to each. Section 2.1(a) of the Steam Purchase and Sale Agreement between SREC and SLC requires SREC to provide the "Steam Quantity" to SLC. Section 1.1 of the agreement defines "Steam Quantity" as "Steam in an amount up to 100% of the Steam requirements of the Shelton Mill, but not in any event exceeding 100 Klbs./hr." SREC's steam agreement with OPP will similarly cap the amount of steam SREC is obligated to provide.

Second, there is also no support facility relationship due to financial, functional, or other factors. EPA guidance describes a "primary" activity and "supporting" activity, with the evaluation designed to determine whether the supporting activity is so tied to the primary activity that it must be considered part of that source. Using these criteria, SLC and OPP would presumably be the "primary" activities, because they are pre-existing production facilities, and SREC would be the "support" activity because it will provide steam to SLC and OPP, which they need to make their products. In this case, however, these labels don't fit. While SREC will provide steam to the mills, the plant will exist to generate green power for sale to the grid. Further, while SREC will agree to provide specific amounts of steam to the mills, the agreement terms will not give either mill the ability to control steam production at the SREC plant. Simply put, SREC will not be a "support facility" as defined by EPA guidance and determinations.

The main elements in EPA determinations evaluating whether a support or dependency relationship exists include the ability of the facilities to operate independently, physical connections, and reasons for locating a new facility near the existing facility.

1. Ability to operate independently

EPA determinations finding common control through a support or dependency relationship have focused on whether the relationship is such that one facility would not exist "but for" the other. In the Gallatin Steel determination, EPA found that the Heckett slag processing facility would not exist but for the adjacent Gallatin steel mini-mill, concluding that they were commonly controlled because all of Gallatin's slag went to Heckett and the only slag processed by Heckett came from Gallatin – there was no other reason for the slag processing facility to exist. H. Thomas, EPA OAQPS, letter to J. Homback, Kentucky DAQ, March 29, 2001, p. 2. Similarly, in the United Salt determination, EPA found that the NE Hub brine processing facility was a support facility because United Salt's mine "would not have a viable operation at this location but for the existence of NE Hub." Letter from Judith Katz, EPA Region 3, to James Salvaggio, PA Dept of Env'tl Protection, undated, p. 3.

In both determinations, EPA found common control because one facility existed solely to serve the other, such that it was not possible to operate the two independently if necessary. The relationship between SREC and the two adjacent mills is totally different. There are no intermediate products made by one and finished by another, nor any waste material, such as slag or brine, that requires adjacent processing. SLC and OPP will transfer wood fiber to SREC, but selling biomass fuel does not create the kind of support or dependency relationship described in EPA determinations. The fuel is a valuable commodity that SLC or OPP could sell on the market, or use in the existing SLC boiler as is currently the case.

Unlike the support facilities described in EPA determinations finding common control, SREC on the one hand, and SLC and OPP on the other, would have viable operations at the Shelton location if the other were to shut down. The SREC plant will be capable of operating independently. It will be equipped with a steam condenser and so will be able to operate solely as a power producer. If the steam hosts were not taking steam, the plant would be able to use 100 percent of the steam flow to generate power using the condenser. And, if SLC or OPP were unable or unwilling to provide contracted fuel, the plant would be able to purchase fuel from the open market. The plant's location in Shelton puts it in an area where biomass fuel is readily available.

Further, under the Industrial Lease Agreement between SLC and SREC, SLC is completing a boundary line adjustment "that will create the Premises [the property leased to SREC] as one or more legal lots separate from the remainder of the Real Property [the larger property owned by SLC]." Lease Recital C and Condition 2. Lease Condition 5.2 requires the Premises to be assessed as one or more separate tax parcels, and Condition 5.3 requires SREC to pay all taxes assessed against the Premises. The separate nature of the SREC facility will also be reflected in the fact that SREC will have its own separate employee and delivery gate and its own separate fuel truck gate, serving its own fuel storage house. SLC will retain its existing fuel house.

The lease parcel location within the SLC complex (shown in Attachment 1) is influenced by the federal New Markets Tax Credit program, which offers a credit for making qualified equity investments in designated low-income areas called "Community Development Entities" (CDEs). In the Shelton area, the southern edge of a CDE boundary is Goldsborough Creek, which bisects SLC's property. The creek apparently provided a convenient geographical boundary for what is otherwise an arbitrary federal boundary. Although SREC considered a location within the SLC complex that would have avoided the unique shape of the SREC parcel, it was just south of the creek, outside the CDE boundary. The tax credit opportunity provided sufficient incentive to locate the main components of the plant on the north side, within the CDE. As the site plan shows, the SREC boiler, turbine, and fuel house will be west of the existing SLC boiler and north of the creek. The SREC fuel truck entrance, as well as the employee and delivery entrance and parking lot, will be south of Goldsborough Creek.

The location will not affect SLC's and OPP's ability to operate independently of the SREC plant, because the existing SLC boiler, which produces steam for both plants,

will not be removed. All relevant agreements ensure that the existing SLC boiler is available to produce steam for the mills in the event the SREC plant cannot or does not.

i. Potential for SREC to lease SLC boiler

SLC is considering leasing its existing wood-fired boiler to SREC, subject to a condition giving SLC the right to cancel the lease at any time with just 24-hours notice. Doing so would provide business benefits for both parties, without affecting the ability of SLC and OPP to operate independently of SREC. It would relieve SLC of the cost of keeping the boiler ready to run while providing SREC with the flexibility to make business decisions based on periods when the market price for power is high enough to offset the costs of running the SLC boiler. Given the option to operate the SLC boiler, SREC would have the flexibility to meet its steam obligations to SLC and OPP while operating its own plant at maximum power production capacity during times of peak power demand.

If the parties enter into such an agreement, they are committed to accepting terms that would ensure that the boiler lease would not adversely affect the mills' ability to rely on the SLC boiler for steam should they need it. The main such provision would be a 24-hour cancellation clause. The lease would also require SREC to maintain the boiler in serviceable condition (and provide the necessary access to do so) such that it could be used by SLC if necessary without excessive delay. And it would require SREC to operate the boiler in compliance with all applicable requirements, but would also make it clear that as the boiler owner, SLC retains full liability for compliance. To that end, the lease would contain mutual notice obligations in the event one party identifies any issue with potential compliance-related implications.

The boiler lease concept is not a necessary part of the contractual arrangement between SREC and SLC. It is simply a business-related option, described here in order to confirm that, if pursued, it would not adversely affect a separate source determination. If it would, the parties would not do it.

2. Physical connections

There will be three production-related physical connections between SREC and the mills: two steam pipes, one to provide 300 psi steam to OPP and one to provide 100 psi steam to SLC, and a fuel conveyor from the SLC fuel house to the SREC fuel house. In EPA determinations, direct physical connections have been considered evidence of interdependence between facilities, but their existence alone is not determinative. In most cases, EPA has relied on physical connections to conclude that sources separated by distance still qualify as being contiguous or adjacent. Here, the plants are in fact adjacent, so those determinations are not directly relevant. But in these determinations EPA has also cited physical connections, such as a pipeline or channel, as possible evidence of functional operational interdependency. *See, e.g.*, Letter from Richard Long, EPA Region 8, to Lynn Menlove, Utah Div'n of Air Quality, May 21, 1998, p. 3.

Here, however, the steam pipe and fuel conveyor connections are not evidence of a functional interdependence to such a degree that a common control relationship exists. First, as described above, steam pipes are inherent in a cogeneration configuration – there must be a way to convey process steam to the off-takers. EPA and Washington agencies have made separate source determinations in many steam pipe scenarios, including the Commencement Bay sawmill in Tacoma, the SPI kilns in Aberdeen, the NESCO cogeneration facility in Darrington, and the Pine State cogeneration plant in Maine. Further, the steam pipes are not evidence of functional interdependence because SREC is not the only source of steam available to SLC and OPP.

Second, the conveyor connecting the SREC and SLC fuel houses will allow for a convenient and efficient business relationship, but it is not a necessity. SREC could truck the fuel the short distance from SLC, but that would result in higher costs, higher emissions, and an increase in the number of trucks operating in the Shelton area. Furthermore, use of the conveyor is subject to lease provisions that address operation and maintenance issues. In both cases, the steam pipe and fuel conveyor connections support arms-length business relationships, but the facilities are capable of operating without using them.

### 3. Reason for location

Locating its cogeneration plant adjacent to two wood products mills provides SREC with several business advantages. Locating near steam off-takers that are also sources of high quality biomass fuel offers the opportunity to negotiate mutually beneficial fuel and steam agreements. SREC hopes this will provide an advantage vis-à-vis other companies seeking to build biomass power generation facilities in the area. In particular, locating close to known fuel sources can significantly reduce fuel transportation costs. And it's preferable from a community impact perspective because the plant is located at a site already subject to industrial uses and trucking of fuel on public roadways can be reduced.

#### **b. None of the contracts for service create a common control relationship**

There are a number of contracts where one entity provides a service to another, including a pre-construction services agreement, a property lease and utility services agreement, a wood fiber supply agreement, a steam purchase and sale agreement, and an administrative services agreement. These agreements do not, however, create a common control relationship.

#### 1. Comparison to EPA determinations

EPA determinations dealing with contract for service relationships evaluate whether the contracts give one entity indirect control over another or reveal that an indirect control relationship otherwise exists. In two determinations where EPA found common control based on contract for service relationships, the contracts showed that

one facility existed only to serve the other. In the PSC/Front Range determination noted above, EPA found that the contract for service relationship was evidence of common control because the contract, a single-purchaser power supply agreement, required Front Range to provide all of its generating capacity to PSC. EPA concluded that Front Range had “no other function” than to supply power to PSC. As a result, EPA found that the “essential function” and source of air emissions of the Front Range plant was under PSC’s control. R. Long, EPA Region 8, letter to Margie Perkins, CO DPHE, Oct. 1, 1999.

In a second contract for service determination, EPA found that a Project Agreement and Brine Agreement established an indirect control relationship between NE Hub (a mining operation that had to dispose of brine pumped from underground) and United Salt (a salt plant designed to recover salt from brine, located 3 miles from the NE Hub mine). Under the Project Agreement, NE Hub would incur all costs associated with permitting and constructing United Salt. When the Project Agreement ended and the Brine Agreement started, NE Hub would turn land over to United Salt for a price related to NE Hub’s construction costs and the long-term Brine Agreement would be in place. Letter from Judith Katz, EPA Region 3, to James Salvaggio, PA Dept of Env’tl Protection, undated. In other words, not only was the United Salt project not viable without NE Hub, United Salt also took no risk starting its business. NE Hub funded permitting and construction, then was reimbursed in an apparent cashless land transaction (where the price was based more on NE Hub’s construction costs than fair market value), after which a long-term brine sales agreement (guaranteed business) would be in effect.

Unlike the contracts in the PSC and United Salt determinations, the SREC contracts do not grant, nor reveal, indirect control. In the PSC case, the essential function of the Front Range facility was to produce power for PSC, under PSC’s indirect control. Here, the essential functions of each plant will remain under each company’s own control. SREC’s primary function and the anticipated source of the majority of its income – selling green power on the grid – neither depends on nor supports SLC’s or OPP’s businesses. Nothing in any of the contracts between the companies changes this. Similarly, because the SLC boiler will remain available to produce steam, SLC and OPP will not be dependent on SREC to continue their primary functions of producing wood products. Unlike the PSC case, there will be no contract terms that allow one company to make a decision upon which the existence or nonexistence of another turns.

The agreements here also do not create a situation like that in the United Salt determination. SREC’s owners, not SLC or OPP, are taking the business risk associated with building and operating the cogeneration plant. Under the Project Pre-Construction Services Agreement, SREC is paying Simpson to perform specific pre-construction services in order to get the benefit of Simpson staff experience in these areas. SREC will buy its own equipment and will manage and fund construction of the plant. The agreements are arms-length and mutually beneficial. None allow SLC or OPP to direct or control steam or power production at SREC, or allow SREC to direct or control production of lumber, plywood, or wood waste at SLC or OPP.

And as discussed above, in the event SLC or OPP were unable or unwilling to take the steam, SREC would be able to use it to generate power. And if SREC were unable or unwilling to take the wood fuel, SLC and OPP could sell it or use it in the existing SLC boiler. Similarly, SREC could hire its own administrative staff or contract with a third company to provide the services, but it would cost more to do so. If the price is right, entering into an administrative services agreement simply makes good business sense. Doing so would not convey any control over SREC by SLC, as all decision-making authority will remain with the SREC managers.

## 2. Description of relevant agreement provisions

Descriptions of the agreements between SREC and SLC are provided below. Copies of specific provisions referenced are provided in Attachment 2.

Project Pre-Construction Services Agreement. The fourth Recital in the Project Pre-Construction Services Agreement states, “WHEREAS, Solomon wishes to retain Simpson to obtain any permits required for construction and operation of the Project, all in the name and at the cost and expense of Solomon and for the purposes set forth in this Agreement.” Accordingly, Section 2.1 of the agreement, titled, “Responsibilities of Simpson Generally,” lists the following services for Simpson to perform “at the cost and expense of Solomon:” project permitting; s

urveys and soil tests;

environmental review;

assistance in marketing project output to prospective purchasers; assistance with interconnection and transmission issues; and assistance with design, engineering and other pre-construction activities. Under Article 3 of the agreement, SREC pays Simpson a monthly fee (plus reasonable expenses) for the services, and if successful, a fee for completion. Under Section 4.1, the agreement terminates on completion of the specified pre-construction services or at the end of 2011, whichever comes earlier. In addition, under Section 7.3, either party may terminate the agreement upon default by the other.

Industrial Lease Agreement. Lease Recital C describes the parties’ agreement to create the SREC “Premises” through a boundary line adjustment to create “one or more legal lots separate from the remainder of” SLC’s other Shelton complex property. The specifics are addressed in Condition 2. The tax provisions require the SREC premises to be assessed as a separate tax parcel (Condition 5.2) and require SREC to pay all taxes assessed against the premises it’s leasing (Condition 5.3). Condition 7 addresses utility services. It requires, as additional monthly rent, SREC to pay “for the actual cost of all utilities that are delivered to or used at” the SREC plant, including electricity, gas, water, sewer and other utilities that can be separately metered. For utilities or services that aren’t separately metered, SLC and SREC “in good faith shall attempt to agree on an equitable allocation of such costs ...” and will resort to dispute resolution procedures if they cannot. Finally, the financial independence of the SREC facility is further insured through the lease project financing provisions (Condition 14). If SREC obtains financing, the provision requires it to use an “Institutional Lender,” which is defined as a

very large, major institution – one that will take appropriate steps to guard its financial interest in the company. No lease condition gives SLC the ability to control SREC’s operations.

Wood Fiber Supply Agreement. The third Recital in the Wood Fiber Supply Agreement states, “WHEREAS, Buyer wishes to purchase Wood Fiber from Seller, and Seller is willing to sell Wood Fiber to Buyer, for use as fuel at the Biomass Plant, all on the terms and subject to the conditions set forth in this Agreement.” The agreement requires SLC to supply the “Contract Quantity” of bone dry tons (BDT) of fuel to SREC. This quantity is the aggregate of “tiers” of wood fiber. For instance, “Tier 1 Fuel” means a specific amount of BDTs, for which SREC pays a specified price. Under Section 8, if SLC has an unexcused failure to deliver the contracted quantity of wood fiber, SLC is required to pay SREC specified damages, based in part on the replacement price of the fuel. Section 5(a) requires SLC to provide wood fiber that meets agreed-upon specifications. And Section 5(b) gives SREC the right to inspect, at its own cost and upon reasonable notice, the wood fiber before delivery to confirm it meets specifications.

Steam Purchase and Sale Agreement. The Steam Purchase and Sale Agreement requires SLC to pay for, and SREC to provide, “Steam in an amount up to 100% of the Steam requirements of the Shelton Mill, but not in any event exceeding 100 Klbs./hr.” Sections 2.1(a) and 1.1. Section 2.1(b) requires SREC to deliver steam to SLC at a defined “Steam Delivery Point,” at which point title to and risk of steam loss transfers from SREC to SLC. Agreement Section 4.1 requires SREC to operate the biomass plant in accordance with “Power Plant Prudent Operating Practices” and to maintain it in good operating condition. And Section 4.2 requires SREC to maintain the steam line in good operating condition up to the point the line crosses the property line between SREC’s leasehold and SLC’s property. Section 5.1 entitles SREC to deliver excess steam to third party purchasers (so it’s obligation to SLC is not exclusive). Finally, it’s worth pointing out that SREC’s obligations under Power Purchase Agreements to provide power to third parties will independently direct steam production at the plant, further ensuring that the adjacent mills cannot exercise control over steam production at SREC.

Administrative Services Agreement. The second Recital in the Administrative Services Agreement states, “WHEREAS, SREC desires to retain Services Provider to perform certain administrative functions with respect to the Biomass Plant, including accounts payable, accounts receivable, and payroll services.” The agreement allows for flexibility. Section 3.2 states, “[t]his Agreement may be terminated by either Party at any time with or without Cause, but if without Cause, only upon ninety (90) days’ prior written notice,” and if the agreement is terminated, Section 3.3 requires SLC to “reasonably cooperate with SREC to effect an orderly transition of the management of SREC and the Biomass Plant to any new services provider designated by SREC.” Under Section 7.1, SREC pays a monthly administrative fee to SLC for the services provided.

**c. Screening questions**

EPA suggests asking the following questions when determining whether there is a support/dependency or contract for service or relationship to such a degree that a common control relationship exists:

- Q.** *Was the location of the new facility chosen primarily because of its proximity to the existing facility to enable the operation of the two facilities to be integrated? In other words, if the two facilities were sited much further apart, would that significantly affect the degree to which they may be dependent on each other?*
- A.** The nature of cogeneration is to locate close to one or more steam off-takers. As described in detail above, the plants would be able to operate independently.
- Q.** *Do the facilities share intermediates, products, byproducts, or other manufacturing equipment? Can one source purchase raw materials from and sell products or byproducts to other customers?*
- A.** The facilities will not “share” products, byproducts or equipment, but they will contract to sell fuel and steam to each other. Unlike the support or dependency relationships described in EPA determinations, the primary functions of the SREC plant and the existing mills are not connected. SREC will exist primarily to make power to sell to the grid. The mills exist primarily to produce lumber and plywood. The fact that the location will allow SREC to also sell steam to and buy biomass fuel from the mills is a matter of convenience and good business. It does not make the plant dependent on the mills, nor make it a support facility for them.
- Q.** *Will materials be routinely transferred between the facilities? How often will this transfer take place and how much will be transferred? Will materials be transferred to other facilities? If so, how much?*
- A.** This screening question is intended to assist agencies in determining whether two plants are involved in components of a single production process, which is not the case here. The primary products of each plant – lumber from SLC, plywood from OPP, and power from SREC – will not be transferred between the plants at all. As discussed, biomass fuel and steam will be routinely transferred as part of the cogeneration process. In terms of revenue for wood products facilities, hog fuel sales typically account only for a small portion of the total revenue – typically always less than 10%, and usually less than 5%. This will be the case for SLC and OPP.
- Q.** *Will the production process itself be split in any way between the facilities, i.e., will one facility produce an intermediate product that requires further processing at the other facility, with associated air pollutant emissions?*
- A.** No.
- Q.** *What is the dependency of one facility on the other? If one shuts down, what are the limitations on the other to pursue outside business interests?*
- A.** While the plants will operate under fuel supply and steam agreements, SREC will not be dependent on the existing mills and the mills will not be dependent on SREC. If one or both of the mills were to shut down, SREC would be able to



purchase fuel elsewhere on the Olympic Peninsula, a region rich in biomass fuel (as the proposed Adage project shows). And not having to provide process steam to the adjacent mills would not adversely affect its ability to generate power in any way. Similarly, if SREC were to shut down, the mills would be able to use the existing SLC hog fuel boiler to produce steam, as is currently the practice.

**Q.** *Does one operation support the operation of the other? What are the financial arrangements between the two entities?*

**A.** As discussed in detail above, there is no support facility relationship.

**d. The facilities also won't share the same SIC code**

As noted above, for adjacent emissions units to be considered a single source for new source review purposes, their activities must be “ancillary to the production of a single product or functionally related groups of products” in addition to being under common control. WAC 173-400-030(76); ORCAA Reg. 1.4. Activities are considered ancillary to the production of a single product or functionally related group of products if they have the same two-digit SIC code. ORCAA Reg. 1.4. In this case, SREC would not have the same SIC code as SLC and OPP. Cogeneration plants are listed in SIC Group 49, while sawmill and plywood plants are listed in Group 24.

EPA determinations have, however, overlooked SIC code differences in certain cases. But the test applied is the same as that discussed above: whether there is a support facility relationship. Letter from JoAnn Heiman, EPA Region 7, to James Pray, Dec. 6, 2004, p. 3, citing 45 Fed. Reg. 52695 (Aug. 7, 1980) and other determinations (“a support facility may be considered to be a part of the same major group as the primary facility it supports even if the support facility would be classified in a separate group when operated independently”). As demonstrated above, there is no support facility relationship as between SREC and either SLC or OPP. This provides an additional basis for the conclusion that SREC is a separate source from SLC and OPP for new source review applicability purposes.