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VIA Post and Email http://www.arb.ca.gov/lispub/comm/bclist.php

Re: Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols.

To Whom it May Concern:

Constellation Energy

Constellation Energy appreciates the opportunity to comment on California's Proposed Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols. Constellation Energy (www.constellation.com) is a leading supplier of energy products and services to wholesale and retail electric and natural gas customers. A FORTUNE 500 company headquartered in Baltimore, Constellation Energy had revenues of $15.6 billion in 2009. Constellation Energy owns a diversified fleet of generating units located in the United States and Canada, totaling approximately 9,000 megawatts of generating capacity. The company delivers electricity and natural gas through the Baltimore Gas and Electric Company (BGE), its regulated utility in central Maryland.

In California, Constellation has interest in the Rio Bravo Poso, Rio Bravo Jasmin and ACE Cogeneration Company coal fueled power plants which will fall under the proposed cap and trade program. Additionally, Constellation has interest in the Rio Bravo Fresno, Rio Bravo Rocklin and Pacific-Ultrapower Chinese Station biomass fueled power plants that currently submit verified GHG Emission Inventories; however, they are exempt from the cap and trade program as proposed. Constellation Energy is also modifying the Poso and Jasmin power plant permits to burn biomass.

General Comments

Although a strong supporter of moving forward on a progressive national greenhouse gas reduction program, Constellation Energy has concerns with programs implemented at the state or regional level. Nevertheless, Constellation Energy is pleased to see California moving ahead to create a cap and trade program for carbon rather than rival approaches. However, even beyond our general concerns, the proposed California program will have an uneven impact on the facilities we own within the State.

Specific Comments

Public Participation - Constellation Energy suggests that additional time be allocated to consider and address public comment. Given the far-reaching impact of the rule, it is important that the contributions of all stakeholders be fully considered. The comment period ends at noon on the 15th, and the CARB will vote on the proposed regulations during the 16th – 17th meeting. Given the potential for thousands of comments, CARB will be hard put to review, let alone seriously consider comments in such a timeframe. On a similar note, Constellation Energy is skeptical that issues related to Independent Power Producers (IPPs) can be resolved within a 1-2 day period.

Fairness of allocations and pass-though costs for IPPs should be thoroughly developed in a public participatory process. The proposed rule provides for free allocations to the electric utilities but there is no corresponding free allocation to the merchant or contracted power plants. These facilities will be placed at an extreme economic disadvantage because the independent power producers (IPPs) and qualified facilities (QFs) cannot pass through environmental control costs to the consumers. This is a part of the contract with the utility and is also part of the law that formed the basis of the IPPs and QFs. Constellation Energy believes that the allocation scheme for all generating facilities should be rethought to help smooth the imposition of a carbon price to ensure the success of the program. The fact that the regulation is not complete in this regard has been recognized in staff reports:

> "In arriving at its recommendations, the EAAC closely considered the existing legal rules that relate to possible allowance distribution methods and uses of allowance value. However, in forming its recommendations, the EAAC decided to consider broadly what seemed best for the state, recognizing the possibility that in some cases the most desirable allocation design might not fit within existing rules." - Staff Report: Initial Statement of Reasons (ISOR), Annex L.

Furthermore, the staff assumes full and "guaranteed" pass-through of costs in their analysis of the allocation of allowances:

> "Windfall profits may be avoided through program design. Requiring covered entities ***with cost pass-through ability*** to purchase allowances at auction ensures that such entities do not capture windfalls. Alternatively, freely allocating allowances in a manner that gives industries a sufficient incentive not to pass the cost through to consumers can also help to avoid windfalls. Staff has addressed windfalls in the proposed regulation by relying on allowance auctioning when possible and requiring, to the extent feasible, free allocation to industrial facilities be based on emission efficiency benchmarks with updating output measurements. Auctioning allowances will prevent windfalls to those sectors otherwise able to pass the cost through to consumers, and the updating output-based free allocation to leakage-exposed industries should dull the incentive for those industries to raise product prices." [emphasis added] - Staff Report: Initial Statement of Reasons (ISOR) Annex J Allowance Allocation

The staff analysis above assumes, as shown in the subsequent Table J-1 of Annex J that: "***All in-state consumption is priced evenly and utility rate-making guarantees full cost pass-through,"*** [emphasis added]. It is clear that the architects of the regulation intend there to be full pass-through of any carbon costs. What is not explicit in the language of the regulation to date, and what needs to be added, is inclusion of all electricity generators, i.e. the IPPs. This is clearly the intent as shown in the quote from Annex J below:

> "The point of regulation for electrical generating facilities in the cap-and-trade system is the electricity deliverers. Therefore, operators of power plants will need to surrender allowances to match against any greenhouse gas emissions they generate. Imposing the carbon cost in the cost of generating electricity will ensure that bids into Californian electricity markets will reflect the marginal abatement costs of greenhouse gases and generate an incentive to dispatch the cleanest facilities first. ***Because these generators will be able to fully pass any carbon cost through into the wholesale power market, no free allocation will be given to these entities***." - Staff Report: Initial Statement of Reasons (ISOR) Annex J Allowance Allocation

Although in-state or out-of-state consumption prices are relatively "even," the cost to generate the power varies greatly and is dependent on many factors, such as technology, heat rate, fuel, contractual terms, permit conditions, etc., which can place IPPs at a competitive disadvantage. Implementation of the California GHG cap and trade program is liable to put IPPs at a further disadvantage in the market place. It should be noted that many IPP power plants are very efficient and very clean, yet if free allocations are not available, they may not be able to operate and would not be dispatched to bring this power to the grid.

Again, in the discussion of wholesale electricity rates in the staff analysis in Annex J, it is clear that staff assume the electricity generators will have the ability to fully pass through "***any"*** carbon cost to the consumer, which will not be the case for the IPPs and Qualifying Facilities.

Constellation Energy requests that a formal public participation process be initiated to assess the issue of pre-existing power purchase agreements with IPPs. The issue of pass-through of carbon costs must be resolved. Constellation Energy has ownership interest in three coal plants and three biomass generation facilities, and has permit applications for co-burning coal and biomass at two of their existing coal facilities. Constellation Energy notes that staff is aware that some power purchase contracts existing within California, "…do not allow full pass-through of carbon costs."

> "Thus, the electricity generators will be natural purchasers of allowances in the system, and they are expected to be highly active in acquiring allowances at auction and in the secondary market. Among the electricity generators are waste-to-energy facilities that would have a compliance obligation for the fossil carbon component of their waste stream. These facilities would be treated in the same manner as other generators.
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> ***Some generators (including waste-to-energy facilities) have reported that some existing contracts do not include provisions that would allow full pass-through of carbon costs.*** These contracts pre-date the mid-2000s and many may be addressed through the recently announced combined heat and power (CHP) settlement at the California Public Utilities Commission. Staff will continue to evaluate this issue to determine whether some specific contracts may require special treatment." [emphasis added] - Staff Report: Initial Statement of Reasons (ISOR) Annex J Allowance Allocation

Constellation Energy urges that staff recommendation for the potential of avoided emissions from energy-from-waste facilities and biomass (if determined to be a waste by EPA definition change) be assessed using criteria appropriate for offset projects in a formal process with opportunity for public consultation. These energy-from-waste and biomass facilities reduce emissions from uncapped sectors. Constellation Energy notes with approval that staff is of the opinion that energy-from-waste and biomass facilities should be given credit for avoided emissions that would otherwise result from alternative waste management practices, such as landfilling and open burning:

> "The combustion of organic waste at these waste-to-energy facilities may avoid emissions that otherwise would result from alternative waste management practices, such as landfilling. The potential for avoided emissions could be assessed using criteria appropriate for offset projects, which reduce emissions from uncapped sectors."

> "Staff is continuing to examine options and obtain feedback. With input from stakeholders, staff's analysis is examining additional factors that could be considered beyond historical emissions and sales, including, among other things, the dates of contract expirations, the rate of achievement of renewable and other low-emitting resources, incentives for early reductions in commitments for high-emitting resources, and other program design features. Staff will continue to work with stakeholders and will review comments received during the comment period on this proposal. ***Staff may bring a more detailed proposal to the Board based on this ongoing effort, and will circulate any such proposal for review in a subsequent 15-day comment period***." [emphasis added]- Staff Report: Initial Statement of Reasons (ISOR) Annex J.

Availability of Fuel Supply – Biomass-derived fuels. The CO_{2e} emissions from biomass plants will not be subject to the compliance obligation if certain verifiable criteria are met. The proposed regulation section §95131(i) states that if the fuel is not certified by an accredited certifier of biomass-derived fuels, the verification team shall examine the fuel contracts to determine if the fuel being provided under a contract dated after January 1, 2010 is only for the amount of fuel that is associated with an increase in the biomass-based fuel producer's capacity (95131(i)(2)(A)2.). This seems to state that a biomass purchaser cannot purchase additional fuel from a supplier unless the supplier has increased their fuel output. It would be allowed to purchase additional fuel from a supplier if a previous purchaser is no longer purchasing biomass fuel from that supplier.

Under "Excluded Emissions" in CARB's proposal, a host of emissions would be subject to reporting thresholds, but would not be subject to a covered entity's compliance obligations. Several coal plants are contemplating the change to biomass fuel, which means biomass fuel will be at a premium and difficult to obtain, causing "green" electricity prices to go up and possible offline periods when biomass plants can't get fuel.

CARB still must to define the qualifications of an "accredited certifier of biomass-derived fuels."

Miscellaneous

The Proposed Allowance Reserve Price Is Too High. Reserve prices similar to those used in the Northeast's Regional Greenhouse Gas Reduction Initiative (RGGI) should be applied, especially as linkage between the two would benefit both programs. The proposed $45 "price containment" reserve price for allowances appears to be to high. This target is substantially above the current domestic and international markets. The RGGI market is currently trading at 1.85/ton CO_{2e}. Given this magnitude of discrepancy, it is extremely difficult to budget power generation finances.

Constellation Energy is in favor of the "border adjustments" on power purchased from out of state generators as mentioned in the Staff Report, Initial Statement of Reasons (ISOR), Annex L, as an equitable means of preventing "leakage" in the power sector. CARB's economic analysis used several different models that generated a large range in allowance costs, from $15 to $160 per ton, depending on the year and the effectiveness of the program. At $45 per ton $CO2_e$, coal plants with existing PPAs are likely to become uneconomic. In addition to allowances, CARB is requiring facilities to pay an annual GHG Program Fee, and some facilities over 100 MW will also have to perform an Energy Efficiency Evaluation. Constellation Energy is concerned that California plants will become uneconomic in competition with plants in other states prior to regulation under a federal program. Constellation Energy is concerned that CARB is underestimating the potential for leakage with respect to the IPPs.

The offset limit should be increased. Allowing only 8% of compliance requirements to be met by offsets seems too low to provide flexibility for compliance. Constellation Energy requests that the opportunity for compliance using qualified offsets be increased substantially.

Constellation Energy appreciates the opportunity to contribute to the development of robust and practical air pollution regulations, and will be happy to work with the California Air Resources Board (CARB), or to answer any questions CARB may have.

Sincerely,

Paul J. Allen