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By *Electronic Submission*: <http://www.arb.ca.gov/lispub/comm/bclist.php>

Hon. Mary D. Nichols, Chairman
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments on Proposed Amendments to the Cap-and-Trade Regulation

Dear Madam Chairman:

Calpine Corporation (hereinafter, “Calpine”) appreciates the opportunity to provide these written comments on the California Air Resources Board’s (“CARB” or the “Board”) Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (Cal. Code Reg. tit. 17, §§ 95800 *et seq.*, “Cap-and-Trade Regulation” or “Regulation”) (collectively, “Proposed Amendments”).

I. INTRODUCTION AND SUMMARY

Calpine has been a longtime supporter of CARB’s efforts to develop and implement an economy-wide greenhouse gas (“GHG”) mitigation program. We have actively participated in the development of the Cap-and-Trade Regulation, offering our input throughout the regulatory process on how CARB could best create a robust and workable program.

We are grateful that CARB staff has continued to work with stakeholders to improve the program and resolve concerns regarding its implementation, including two primary concerns for Calpine:

- The problem faced by legacy contract generators; and
- The auction purchase limit.

Calpine deeply appreciates that CARB staff has taken important steps in the Proposed Amendments to resolve these concerns. We therefore urge the Board to adopt the Proposed Amendments, with direction to staff to initiate a 15-day rulemaking regarding several minor technical amendments described below.

- A. Legacy Contracts: Calpine strongly supports and appreciates CARB’s proposed resolution of the legacy contract issue. Where a counterparty to a legacy contract is itself

scheduled to receive an allocation for industrial assistance, but will not face an increase in its steam or electricity costs due to the legacy contract, the emissions attributable to generation of steam and/or power pursuant to that contract should be deducted from the counterparty's allocation and provided to the generator instead. The Proposed Amendments satisfy fundamental fairness in this respect by providing relief to the generator for the entire life of the legacy contract and withholding from the counterparty the windfall it would otherwise receive as a result of its unwillingness to renegotiate the contract terms. We likewise support CARB's revised proposal, which would extend the transitional assistance for legacy contracts with counterparties who are not receiving an allocation of industrial assistance through the second compliance period. Calpine urges the Board to adopt the Proposed Amendments' provisions concerning legacy contracts and direct staff to undertake a 15-day rulemaking consistent with staff's revised proposal.

- B. Auction Purchase Limit: Calpine strongly supports and appreciates CARB's proposed revisions regarding the auction purchase limit. The Proposed Amendments would increase the covered entity auction purchase limit to 20 percent (%) through 2014 and 25% thereafter. This would provide the largest covered entities assurance that they can obtain all they need to fulfill their compliance obligation and afford them some of the same flexibility afforded to other covered entities with respect to their procurement decisions. Calpine therefore urges the Board to adopt the proposed revisions to the auction purchase limit and direct staff to finalize these revisions at the earliest opportunity, so they will apply to all auctions occurring in 2014.
- C. Prohibition on Holding "On Behalf Of" Another Entity: The Proposed Amendments include additional criteria intended to clarify that forward contracts are not subject to the prohibition of an entity holding allowances on behalf of another entity. However, these criteria may outlaw many common arrangements for delivery of allowances between parties to power sales contracts. Rather than treat power sales contracts as a subset of forward contracts, Calpine urges CARB to adopt an express exception, clarifying that the prohibition does not apply to procurement of allowances by the buyer under a power or steam sales contract, for later transfer to the seller to cover the compliance obligation associated with deliveries of electricity and steam.
- D. Changes in Auction Application Information: The Proposed Amendments would allow CARB to deny participation in the auction to any entity if certain information in its auction application or accounts application should change within the 30 days before or 15 days after an auction. The proposal is unworkable with respect to changes occurring after the auction because it is unclear how CARB could enforce it without impairing the integrity of the certified auction results. Even if a change should occur before the auction, the proposal sweeps too broadly and could bar participation due to changes only affecting distantly related companies having nothing to do with the Cap-and-Trade program or inconsequential personnel changes. CARB should rethink this proposal and at the very least limit it to changes occurring within the 30 days prior to an auction that

pertain to the entity itself or its direct corporate associations and may affect computation of the purchase limit or holding limit.

- E. Limited Exemption from Holding Limit: The Proposed Amendments include new language that would revise the limited exemption from the holding limit. However, assuming the Proposed Amendments are intended to become effective prior to October 1, 2014, then covered entities will have *no* limited exemption whatsoever, until October 1, 2014. This could result in unintended violations of the holding limit among covered entities and should be fixed by CARB prior to finalizing the Proposed Amendments.
- F. Elimination of Annual Compliance Surrender Obligation. The Proposed Amendments would impose a mandatory retirement order for compliance instruments and, to avoid the circumstance where entities might be deemed to over-surrender offsets, would eliminate retirement of compliance instruments to fulfill the annual compliance obligation. By not retiring allowances at the annual compliance obligation, the Proposed Amendments would result in covered entities carrying large liabilities on their balance sheets, even after the 30% annual compliance obligation was deemed to be satisfied. This could cause confusion to the public, who may closely monitor companies' corporate filings to confirm that they have satisfied the compliance obligation. While Calpine appreciates CARB's efforts to avoid over-retirement of offset credits, the best way to avoid this is for CARB to allow entities to specify the retirement order for compliance instruments in their compliance account.

These comments are discussed in greater detail below.

II. DISCUSSION

A. **CARB's Proposed Resolution of The Legacy Contract Issue Is Consistent With Both Fundamental Fairness And The Overall Program Goals And Should Therefore Be Adopted**

Calpine strongly supports CARB's approach to resolving the long-standing issue of how best to provide measured relief to generators subject to legacy contracts entered into prior to the enactment of Assembly Bill ("AB") 32 that do not allow for recovery of GHG compliance costs for electricity and/or thermal energy delivered pursuant to the contract.

Calpine has consistently advocated for a fair resolution of the legacy contract issue¹ and has, whenever possible, renegotiated pre-AB 32 contracts to address GHG costs. Despite Calpine's

¹ See Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed Regulation to Implement the California Cap-and-Trade Program, at 3-10 (Dec. 9, 2010), *available at*: http://www.arb.ca.gov/lists/capandtrade10/253-carb_letter_re_cap-and-trade_20101209.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed 15-Day Modifications to the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, at 10-12 (Aug. 11, 2011), *available at*: http://www.arb.ca.gov/lists/capandtrade10/1450-8-11-2011_calpine_comments_re_proposed_15-

good faith efforts to bring our counterparties to the negotiating table, we have not been able to renegotiate four remaining legacy contracts to allow for the pass-through of compliance costs associated with deliveries of electricity and/ or steam from our combined heat and power (“CHP”) facilities.²

The Proposed Amendments strike the right balance in resolving this issue: Where a legacy contract counterparty will receive an allocation for industrial assistance, but will not experience

[day modifications to proposed ca cap on ghg emissions.pdf](#); Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Second Proposed 15-Day Amendments to the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, at 7-9 (Sep. 27, 2011), available at: http://www.arb.ca.gov/lists/capandtrade10/1658-9-27-2011_calpine_comments_re_proposed_15-day_modifications_to_proposed_ca_cap_on_ghg_emissions.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Public Workshop to Discuss Linking the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation to Western Climate Initiative Jurisdictions, at 9-11 (Feb. 17, 2012), available at: http://www.arb.ca.gov/lists/feb-3-link-wci-ws/7-2-17-2012_calpine_comments_re_cap_and_trade_workshop.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Draft of Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions, at 12-14 (Apr. 13, 2012), available at: http://www.arb.ca.gov/lists/april-9-draft-reg-ws/14-4-13-2012_calpine_comments_re_draft_amendments_to_ca_cap_on_ghg_emissions-linked_jurisdictions.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms, at 19-20 (June 21, 2012), available at: http://www.arb.ca.gov/lists/capandtrade2012/9-6-21-2012_calpine_comments_re_cap-and-trade.pdf (hereinafter, “June 2012 Comments”); Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments issued by Linked Jurisdiction, at 3-4 (Jan. 23, 2013), available at: http://www.arb.ca.gov/lists/capandtradelinkage12/25-1-23-2013_calpine_comments-linked_jurisdictions.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Barbara McBride, re: Comments on CARB Staff Workshop regarding Proposed Adjustments to the Cap-and-Trade Program’s Treatment of Universities, “But For” CHP , and Legacy Contracts, at 1-11 (May 21, 2013), available at: <http://www.arb.ca.gov/lists/com-attach/13-may1-unilegbutfor-ws-VGEBKIZIA2EEL1Bi.pdf>; Letter to Hon. Mary D. Nichols, Chairman, from Cassandra Gough, re: Comments on CARB Discussion Draft of Proposed Amendments to the Cap-and-Trade Regulation and July 18, 2013 CARB Public Workshop, at 3-10 (Aug. 2, 2013), available at: <http://www.arb.ca.gov/lists/com-attach/67-cap-trade-draft-ws-VmQCNFBgWDhWfQQ0.pdf> (“August 2013 Comments”).

² See Steam Purchase and Sale Contract between Olam West Coast, Inc. and Calpine Gilroy Cogen, L.P. (dated Jan. 20, 1986); Steam Purchase and Sale Contract between Rava Family Ltd. Partnership and Calpine King City Cogen, LLC (dated July 31, 1987); Cogeneration Project Development and Supply Agreement between Sunsweet Growers Inc. and Calpine Greenleaf, Inc. (dated April 15, 1988); Energy Purchase and Sale Agreement between USS-Posco Industries and Los Medanos Energy Center LLC (dated Dec. 21, 1998). All of Calpine’s legacy contracts, and amendments thereto, have previously been described in submittals to CARB.

an increase in its steam or electricity costs due to the existence of the legacy contract, the emissions attributable to generation of steam and/or power pursuant to that contract should be deducted from the counterparty's allocation and provided to the generator instead. As CARB states in the Initial Statement of Reasons ("ISOR") for the Proposed Amendments, "[b]y adjusting the industrial counterparty's allocation and providing that to the generator, this proposal corrects the otherwise missing incentive and also encourages parties to renegotiate. Since the adjustment is equitable across the length of the legacy contract, this proposed approach would allocate to the legacy contract generator for the entire contract length for those with industrial counterparties."³ We agree that the Proposed Amendments correct the incentives and are wholly consistent with principles of fundamental fairness and the underlying rationale for providing transitional assistance to industry in the first place: To the extent that an industrial entity is insulated from an increase in its energy costs due to a legacy contract, it should not be receiving an allocation intended to offset that increase.

Calpine greatly appreciates CARB's willingness to work with affected parties to develop a solution that best supports the overall program goals and does not act as a disincentive to continued operation of CHP facilities. We likewise support CARB's revised proposal, which would extend legacy contract allocations with counterparties who are not receiving industrial assistance until the end of the second compliance period.⁴ The revised proposal would provide welcome relief for two of Calpine's four legacy CHP contracts, which are not with counterparties receiving industrial assistance. We urge the Board to adopt staff's proposed resolution of this issue and direct staff to undertake a 15-day rulemaking with respect to the extension of legacy contract allocations through the second compliance period.

We offer one minor comment: In another section of the Proposed Amendments generally concerning the timing and mechanics for allocation (section 95870, "Disposition of Allowances"), it appears that an oversight was made and this section still contemplates that, in all cases, legacy contract allocations would only be provided for 2013 and 2014 and not for the duration of the contract, as is the case where the counterparty receives an allocation for industrial assistance. Consistent with the intention stated by CARB in the quotation from the ISOR above, this section should be amended to reflect that, where the legacy contract counterparty will receive an allocation for industrial assistance, the allocation to the generator will be provided by October 15 of each year, as follows:

§ 95870. Disposition of Allowances.

...

³ Staff Report: Initial Statement of Reasons, Proposed Amendments To The California Cap On Greenhouse Gas Emissions And Market-Based Compliance Mechanisms, at 17 (Sept. 4, 2013), *available at*: <http://www.arb.ca.gov/regact/2013/capandtrade13/capandtrade13isor.pdf> ("ISOR").

⁴ CARB, Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade (Oct. 16, 2013), *available at*: <http://www.arb.ca.gov/cc/capandtrade/legacy-contract-proposal.pdf>.

- (g) Allocation to Legacy Contract Generators. Allowances will be allocated to legacy contract generators ~~for 2013 and 2014~~ for transition assistance in accordance with section 95894. The Executive Officer will transfer allowance allocations into each eligible generator's limited exemption holding account by October 15, 2014 for eligible Legacy Contract Emissions for calendar years 2013 and 2014 pursuant to the methodology set forth in section 95894 and by October 15 of each subsequent year if the generator qualifies for an allocation pursuant to section 95894(c).

B. The Board Should Adopt The Proposed Revisions To The Auction Purchase Limit And They Should Be Finalized At The Earliest Opportunity

Calpine strongly supports the Proposed Amendments to the auction purchase limit. We greatly appreciate this important step CARB staff has taken in fulfillment of the Board's direction to assure that the largest covered entities are afforded the same flexibilities as other market participants under the Regulation.⁵ We urge the Board to adopt the Proposed Amendments' increase to the auction purchase limit as soon as possible so that the increase will apply to all auctions occurring in 2014.

Under the Regulation, the current vintage auction purchase limit for covered entities is 15% of the allowances offered for auction at each auction occurring in 2013 and 2014. The corresponding limit on purchases from the advance auctions conducted during the same period is 25%. There is no limit currently specified for auctions occurring after 2014. The Proposed Amendments would (1) increase the current vintage auction purchase limit applicable to covered entities to 20% through 2014 and (2) establish a new auction purchase limit applicable to covered entities and electrical distribution utilities for auctions conducted from January 1, 2015 through December 31, 2020 of 25% of the allowances offered for auction, for both the current vintage and advance auctions.⁶

As one of the largest covered entities in California, Calpine will have one of the largest compliance obligations during the first compliance period. In addition, Calpine recently commissioned two highly efficient combined-cycle power plants in the San Francisco Bay Area.⁷

⁵ See CARB, Board Resolution 12-33, at 3 (Sep. 20, 2012), available at: <http://www.arb.ca.gov/cc/capandtrade/res12-33.pdf> (directing staff to "take appropriate action, including proposing potential regulation amendments in 2013 as necessary, to ensure that the purchase limit will allow covered entities to acquire sufficient allowances at auction to comply with the Regulation, and do not deny the largest facilities the flexibility that [the] regulation was designed to provide all covered entities.").

⁶ Proposed Amendments §§ 95911(d)(4)(A), (5).

⁷ Russell City Energy Center, a 619-megawatt ("MW") combined-cycle generation facility located in Hayward, California, recently completed construction and began commercial operations on August 8, 2013. Los Esteros Critical Energy Facility, which was operated prior to 2012 as a 188-MW simple-cycle

In light of the size of Calpine and its compliance obligation during the first compliance period, we greatly appreciate the increase to 20% for auctions conducted during 2014. This increase will assure that Calpine should be able to procure all the allowances it needs during the quarterly auctions conducted in 2014. We therefore urge the Board to adopt the proposed changes to section 95911(d)(4) and encourage CARB to finalize them as soon as possible, so they will be effective for all auctions occurring in 2014. Should the amendments not be final prior to the 2014 auctions, we look forward to working with CARB staff to assure that the existing auction purchase limit does not act as a bar to procurement of Calpine's needs in the quarterly auctions.

We also believe that imposition of a 25% auction purchase limit for auctions conducted after 2014 should provide sufficient flexibility for all covered entities to obtain allowances needed to comply from the quarterly auctions. We assume that the 25% limit is intended to apply separately to allowances from the current vintage auction and the advance (future vintage) auction and would recommend that CARB clarify this upon finalizing the Proposed Amendments by making the following minor amendment to section 95911(d)(5):

§ 95911. Format for Auction of California GHG Allowances.

...

(d) Auction Purchase Limit.

- (5) The auction purchase limit for auctions conducted from January 1, 2015 through December 31, 2020 will be 25 percent of the allowances offered for auction in each Current Auction and Advance Auction for covered entities, opt-in entities, and electrical distribution utilities or group of covered entities, opt-in entities, and electrical distribution utilities with a direct corporate association pursuant to section 95833.

...

C. CARB Should Clarify That Allowance Procurement To Fulfill A Power or Steam Sales Contract Is Not Unlawful

Section 95921(f)(1) of the Cap-and-Trade Regulation currently prohibits an entity from acquiring and holding allowances in its own holding account on behalf of another entity. As we suggested when this section was initially proposed,⁸ this could be interpreted to prohibit an entity from ever acquiring allowances on behalf of another entity, including under common arrangements between utilities and power suppliers. CARB subsequently published guidance

power plant, recently completed its conversion into a 309-MW combined-cycle generating facility and began commercial operations as such on August 9, 2013.

⁸ June 2012 Comments, at 7.

that clarified that the prohibition was not intended to apply to such arrangements between utilities and their contractual counterparties. However, the Proposed Amendments would impose additional criteria that could be interpreted to proscribe just such arrangements. We would therefore urge CARB, upon finalizing the Proposed Amendments, to incorporate an express statement in the Regulation which clarifies that arrangements between parties to energy sales contracts concerning procurement and delivery of allowances are lawful, as described below.

The Proposed Amendments would establish three additional restrictions on section 95921(f)(1), including, *inter alia*, “[a]n entity may not hold allowances pursuant to an agreement that gives a second entity control over the holding or planned disposition of allowances while the instruments reside in the first entity’s accounts, or control over the acquisition of allowances by the first entity. *These prohibitions do not apply to agreements that only specify a date to deliver a specified quantity of allowances and that include no terms applying to allowances residing in another entity’s account.*”⁹ CARB explains in the ISOR that the Proposed Amendments are “needed to clarify that the prohibition on ‘holding on behalf of’” does not apply to, *inter alia*, “forward contracts that do not contain terms applying to the compliance instruments in the first entity’s account.”¹⁰

In its official regulatory guidance document, CARB explained that the existing Regulation’s prohibition is not intended to apply to forward contracts, including several variations of contracts utilized in the electricity sector whereby one party agrees to periodically transfer allowances to its counterparty.¹¹ CARB said it “views these contracts as essentially no different than forward contracts and, accordingly, they will not be barred by the Regulation, so long as the contract does not (1) give the ultimate recipient control of compliance instruments while they are still in the account of the entity from which they will be received, and (2) does not recognize any ownership interest by the ultimate recipient in the compliance instruments while they are still in such entity’s account.”¹²

In light of the Guidance Document’s statement that contracts between utilities and electric generators are viewed as essentially the same as lawful forward contracts, we assume that the Proposed Amendments likewise intend to authorize procurement and delivery of allowances pursuant to such utility-generator contracts. However, rather than provide clarity, the additional criteria that would be added by the Proposed Amendments suggest that deliveries of allowances pursuant to the terms of many common power sales contracts are prohibited. By requiring that lawful contracts “only specify a date to deliver a specified quantity of allowances and [] include no terms applying to allowances residing in another entity’s account”¹³, the Proposed

⁹ Proposed Amendments § 95921(f)(1)(B) (emphasis added).

¹⁰ ISOR, 207.

¹¹ Regulatory Guidance Document (December 2012), available at: <http://www.arb.ca.gov/cc/capandtrade/guidance/chapter5.pdf> (“Guidance Document”), § 5.7.1, 40.

¹² *Id.*

¹³ Proposed Amendments § 95921(f)(1)(B).

Amendments could be interpreted to outlaw many standard form contracts used today by the investor owned utilities (“IOUs”) to address GHG allowance costs.

The terms of standard IOU contracts often do not include any date-certain for transfer of a specified quantity of allowances, but instead provide the formula for determining how many allowances will be transferred and the relative time of delivery. Unlike bilateral forward contracts or futures, the quantity of allowances to be delivered is rarely (if ever) specified in the contract and the date when delivery must occur may be as indefinite as a reasonable amount of time prior to a compliance obligation becoming due for emissions associated with delivered energy. This is not because such contracts are purposefully vague, but rather because the volume to be delivered cannot be projected with any accuracy and depends on how frequently the contracted unit is dispatched by the utility, which cannot be known in advance and is subject to the many unpredictable factors that influence both demand for electricity and dispatch of electric generating resources; e.g., weather, the quantity of hydropower available and availability of other generating resources. A typical contract might only provide for the generator to report its estimated GHG emissions on a regular monthly invoice, with delivery of the accrued emissions to occur at some later date, prior to the relevant compliance deadline. Thus, such contracts might not be viewed as “specify[ing] a date to deliver a specified quantity of allowances”¹⁴, as required by the Proposed Amendments.

In addition, these contracts often include many additional terms that, although not giving one entity control over allowances in its counterparty’s account, might nevertheless be viewed as “applying to allowances residing in another entity’s account.”¹⁵ For example, they often provide that, if a compliance instrument delivered to the seller should later be invalidated, the buyer will replace it. With some variation, the contract terms also often provide that, if the generator or any of its affiliates should later receive any sort of free allocation with respect to the power delivered under the contract, it is obliged to share some amount of that allocation with the utility. Additionally, such contracts may mandate that the party to whom allowances are delivered will use them to satisfy a compliance obligation. While these terms do not provide one party control over allowances in another’s account, they might nevertheless be viewed to run afoul of the Proposed Amendments, which mandate that lawful contracts “include *no* terms applying to allowances residing in another entity’s account.”¹⁶

Counterparties to power or steam sales contracts may have any number of reasons for agreeing to the periodic transfer of allowances, in lieu of settling with one another financially for the compliance obligation attributable to deliveries of power or steam. This may be based on the parties’ assessment of their relative ability to assume the risk of price fluctuations in the market for compliance instruments or their relative sophistication with respect to participation in the auction and/or the secondary markets. Regardless of the reason, the Proposed Amendments

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* (emphasis added).

should not foreclose the development of appropriate commercial vehicles for parties to assure that the compliance obligation is satisfied with respect to sales of electricity or steam.

If counterparties to power sales contracts are precluded from entering into reasonable commercial arrangements that spell out exactly how they will calculate the quantity of emissions attributable to dispatch of a generating unit, who will be responsible for procuring the compliance instruments to cover those emissions, and when and how they will effectuate delivery of those compliance instruments, the parties would face significant uncertainty with respect to satisfaction of the compliance obligation attributable to contracted generation. CARB should not force the parties to shoulder such uncertainty and administrative burden due to a lack of clarity in its Regulation.

Because the existing Regulation's prohibition has already raised interpretive questions, Calpine proposes that CARB revise the Proposed Amendments to make clear that the prohibition on entities acquiring and holding allowances on behalf of another entity does not apply to an agreement between a buyer and seller of electricity or steam, pursuant to which the buyer provides compliance instruments to cover emissions attributable to delivered power or steam. Accordingly, Calpine proposes the following revision to section 95921(f)(1) of the Proposed Amendments:

§ 95921. Conduct of Trade.

...

(f) General Prohibitions on Trading.

- (6) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity ~~including~~ the following restrictions:

...

- (B) An entity may not hold allowances pursuant to an agreement that gives a second entity control over the holding or planned disposition of allowances while the instruments reside in the first entity's accounts, or control over the acquisition of allowances by the first entity. These prohibitions do not apply to agreements for the purchase and sale of electricity and/or steam, pursuant to which the purchaser agrees to provide compliance instruments to the seller to account for the Emissions attributable to the electricity and/or steam delivered thereunder, and agreements that only specify a date to deliver a specified quantity of allowances and that include no terms applying to allowances residing in another entity's account.

D. The Proposal To Bar An Entity From The Auction Due To Changes In Its Auction Application Information Is Unworkable

Section 95912(d)(4) of the Regulation currently requires every auction participant to complete an auction participation application at least 30 days prior to each auction.¹⁷ The Proposed Amendments would expand the list of information that must be provided under section 95912(d)(4) and add a new provision whereby “[a]n entity with any changes to the auction application information listed in subsection 95912(d)(4)...within 30 days prior to an auction, or an entity whose auction application information...will change 15 days after an auction, may be denied participation in the auction.”¹⁸

Notably, CARB revised this provision slightly from what appeared in the July discussion draft, which stated that an entity whose auction application information changes “*will* be denied participation in the auction”.¹⁹ In contrast, the Proposed Amendments provide that an entity experiencing such changes “*may* be denied participation...”, suggesting that CARB intends to exercise discretion in deciding whether any particular change warrants disqualification from the auction. When a stakeholder at the July 18, 2013 CARB workshop regarding the discussion draft raised the issue of how an entity would comply with this new requirement in a scenario where the change in the application information occurs *after* the auction, CARB staff provided a response to the effect that an applicant would only be denied participation if the change in status were foreseeable, although neither the discussion draft, nor the Proposed Amendments, limits the changes that may trigger disqualification to only those that are foreseeable.²⁰ This response underscores the broad discretion that CARB will likely wield in enforcing this provision and, correspondingly, the great uncertainty registrants will face, as they wrestle with difficult questions of whether changes that might or might not occur within the 15 days following an auction (many of which they have no control over) will bar them from participation in the forthcoming auction.

It would be unworkable for CARB to bar entities from participation for changes that occur after an auction has already occurred. Excluding the disqualified participant’s bids after the auction has already been conducted and the results have already been certified by the auction administrator could result in changes in the reported settlement price and auction results. Such changes should not be countenanced, as they would seriously undermine the certainty associated with the certified auction results and the market signals they are intended to provide. In the event that a participant is not disqualified until after financial settlement has occurred, the change in settlement price could impact all parties to the auction, not just the participant who is disqualified, and the Regulation does not currently provide for such a post-settlement refund.

¹⁷ Cap-and-Trade Regulation § 95912(d)(4).

¹⁸ Proposed Amendments § 95912(d)(5).

¹⁹ CARB, Discussion Draft July 2013, *available at*: http://www.arb.ca.gov/cc/capandtrade/meetings/071813/ct_reg_2013_discussion_draft.pdf, § 95912(d)(5) (emphasis added).

²⁰ CARB, Workshop re: Proposed Changes To The California Greenhouse Gas Cap-And-Trade Regulations (July 18, 2013) (oral comment of CARB staff).

Even if a change should occur within the 30 days before an auction, it would be unworkable for CARB to bar participation based on many of the enumerated changes. This is particularly true given the breadth of the proposed expansion to the corporate association disclosure obligation²¹ and the new proposed obligations with respect to disclosure of “all persons employed by the entity in a capacity giving them access to information on compliance instrument transactions or holdings...”.²²

Under the Proposed Amendments, if a new indirect corporate association should come into existence within the 30 days preceding an auction, CARB could bar the entity from participation in the auction. This is even though the auction participant might not know about or control the existence of the new indirect corporate association and regardless of whether the new association has any relationship to, or involvement in, the Cap-and-Trade program. Given the complex corporate structures of some auction participants and the limitations on their ability to either control or receive notice of changes occurring with respect to entities with whom they may have only an attenuated relationship (i.e., indirect corporate associations), Calpine thinks it is unworkable for CARB to bar participation in such circumstances.

As another example, if a previously disclosed individual with access to information on compliance instrument holdings should be replaced during the 30 days prior to an auction (due to illness, termination, etc.), the simple act of hiring a new employee to replace that person could result in disqualification. Given the hundreds of individuals who may have access to such information in any company (including information technology personnel, systems analysts and accounting personnel) and the probability that any one of them might need to be replaced in any 30-day period, it seems likely that many auction participants could be susceptible to disqualification from some, if not most, auctions.

For the foregoing reasons, Calpine would urge CARB not to adopt section 95912(d)(5). If CARB proceeds to finalize this section, however, the only changes that should bar participation in the auction are those affecting direct corporate associations also registered within CITSS which occur prior to an auction, i.e., disqualification may only be triggered by changes in auction application information that could affect computation of the holding limit or auction purchase limit or concerning the status of certain regulatory investigations, as follows:

§ 95912. Auction Administration and Participant Application.

...

(d) Auction Participation Application Requirements.

...

²¹ See Proposed Amendments § 95830(c)(1)(H), § 95833(a)(1).

²² Proposed Amendments § 95830(c)(1)(I).

- (5) An entity with any changes to the auction application information listed in subsection 95912(d)(4) pertaining to the entity itself or any direct corporate association also registered pursuant to this article~~or account application information listed in section 95830~~ within 30 days prior to an auction, ~~or any entity whose auction application information or account application information listed in section 95830 will change within 15 days after an auction,~~ may be denied participation in the auction.

...

These proposed amendments would ensure two things:

- The integrity of certified auction results will not be threatened by the possibility that auction participants could be barred from participation due to changes occurring after an auction has already occurred and the results have been certified.
- Auction participants with complex corporate structures and many employees with access to procurement information will not be unfairly barred from participation due to changes occurring outside of their sphere of direct knowledge or control or inconsequential changes in personnel.

E. The Proposed Revisions To The Limited Exemption From The Holding Limit Should Be Revised So There Is No Gap Between When The Proposed Amendments Become Effective And The Limited Exemption First Applies

The Regulation currently provides a limited exemption from the holding limit, which is the number of allowances exempt from the holding limit calculation after they are transferred by a covered entity to its compliance account.²³ The Regulation states that “[o]n June 1, 2012 the limited exemption will equal the annual emissions most recent emissions data report that has received a positive or qualified positive emissions data verification statement” and “[b]eginning in 2013 on October 1 of each year the limited exemption will be increased by the amount of emissions contained in the most recent emissions data report that has received a positive or qualified positive emissions data verified statement during that year.”²⁴

The Proposed Amendments would eliminate these provisions and would instead begin calculating the limited exemption on October 1, 2014 (based on emissions in the 2012, 2013 and 2014 emissions data reports receiving a positive or qualified verification statement).²⁵ Thus, if the Proposed Amendments should become effective at any date prior to October 1, 2014, covered entities will have *no* limited exemption and could unintentionally violate the holding limit.

²³ Cap-and-Trade Regulation § 95920(d)(2)(A).

²⁴ *Id.* §§ 95920(d)(2)(B)-(C).

²⁵ *Id.* § 95920(d)(2)(B).

To maintain the limited exemption at the levels established by the current Regulation until the Proposed Amendments become effective, Calpine proposes that the Board revise the limited exemption provisions as follows:

§ 95920. Trading.

...

- (d) The holding limit will be calculated for allowances qualifying pursuant to section 95920(c)(1) as the sum of:

...

- (2) Limited Exemption from the Holding Limit.

...

- (B) On June 1, 2012 the limited exemption will equal the annual emissions subject to a compliance obligation pursuant to section 95851(a) reported by the most recent emissions data report that has received a positive or qualified positive emissions data verification statement. On October 1, 2013, the limited exemption will be increased by the annual emissions subject to a compliance obligation pursuant to section 95981(a) reported by the most recent emissions data report that has received a positive or qualified positive emissions data verification statement. On October 1, 2014, the limited exemption will be calculated as the sum of the annual emissions data reports received in 2012, 2013, and 2014 that have received a positive or qualified positive emissions data verification statement for emissions that generate a compliance obligation pursuant to section 95851(a).

F. CARB Should Provide Covered Entities The Option to Specify Compliance Instrument Retirement Order Instead of Eliminating The Annual Surrender Obligation

The Regulation does not currently indicate in what order compliance instruments will be retired from covered entities' compliance accounts into CARB's Retirement Account. The Proposed Amendments would mandate such a retirement order and, in so doing, create the possibility that entities that placed too many offset credits into their compliance accounts prior to an annual compliance obligation becoming due would lose the value of those offsets and need to come up with additional compliance instruments to meet the triennial obligation.

To avoid this result, the Proposed Amendments would postpone retirement of compliance instruments to meet the annual compliance obligation, until the triennial obligation is due (i.e.,

for one or two more years). Rather than retiring compliance instruments, CARB would determine whether a covered entity has fulfilled its annual compliance obligation “by evaluating the number and types of compliance instruments in the Compliance Account.”²⁶ CARB staff states that this proposal is primarily in response to “stakeholder concern about not estimating the [quantity] of offsets correctly to be placed into the compliance account and potentially over supplying offsets relative to the 8 per cent usage limit during the annual surrender event when instruments are retired.”²⁷

Calpine appreciates that CARB is attempting to resolve stakeholder concerns about how the mandatory retirement order risks over-surrender and forfeiture of valuable offset credits. However, the Proposed Amendments create the possibility for confusion between how companies must report liabilities for accounting purposes and public reports concerning compliance with the Regulation. Because CARB proposes to merely “evaluat[e] the number and types of compliance instruments in the Compliance Account”²⁸ without transferring such compliance instruments into CARB’s Retirement Account, compliance instruments relied upon to satisfy the annual compliance obligation will remain in each covered entity’s compliance account, until the triennial compliance obligation is due (up to two years later). As a result, even though the annual compliance obligation will be deemed fulfilled by CARB, the entity may be required, under generally accepted accounting principles (“GAAP”), to continue treating the 30% annual compliance obligation as an outstanding liability. This can only lead to confusion among members of the public, who may look to corporate reports for confirmation that an entity has satisfied its annual compliance obligation, only to see that the company is still accounting for a large outstanding liability for emissions already subject to that obligation.

Calpine believes that the underlying concern that stakeholders have expressed regarding over-surrendering offsets can be better resolved by providing functionality in CITSS for covered entities to specify which compliance instruments in their compliance accounts they would like to retire. CARB expressed a willingness to consider such an option at the July 18, 2013 stakeholder workshop.²⁹ Rather than postpone the retirement of compliance instruments at each annual compliance obligation for up to two more years, CARB should simply allow covered entities to specify which instruments in their respective compliance account they are seeking to retire. The mandatory retirement order would then function as a backstop mechanism in the event that a covered entity does not specify the compliance instruments it would like to retire, in which case Calpine would nevertheless urge CARB to return over-surrendered offsets to the entity’s compliance account or credit them against future compliance obligations.

²⁶ Proposed Amendments § 95856(g)(1).

²⁷ ISOR, at 137.

²⁸ Proposed Amendments § 95856(g)(1).

²⁹ CARB, Workshop re: Proposed Changes To The California Greenhouse Gas Cap-And-Trade Regulations (July 18, 2013) (oral comment of CARB staff).

III. CONCLUSION

Calpine is grateful for CARB's continued engagement with stakeholders to improve the Cap-and-Trade Regulation. We appreciate and support CARB's proposed revisions regarding legacy contracts and the auction purchase limit. Calpine urges the Board to adopt these revisions as presented in the Proposed Amendments and to direct staff to undertake a 15-day rulemaking with respect to its revised proposal with respect to legacy contracts. Calpine also urges the Board to consider the additional changes we have proposed and to provide staff with direction on changes that should be made to the Proposed Amendments, before they sent to the Office of Administrative Law for review and codification.

* * * *

Please feel free to contact me with any questions or concerns regarding these comments. Thank you for the opportunity to submit these comments.

Sincerely,

/S/

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Director, Government and Legislative Affairs

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