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May 21, 2013

California Air Resources Board
Cal/EPA Headquarters
1001 "I" Street
Sacramento, CA 95814

Re: Proposed Adjustments to Cap and Trade Program: May 1, 2013 Workshop

To: Air Resources Board

In accordance with the schedule established at the May 1, 2013 workshop, Shell Energy North America (US), L.P. ("Shell Energy") submits its comments on one of the workshop proposals advanced by the Staff of the State's Air Resources Board ("ARB"). Shell Energy's comments address the Staff's "Proposed Adjustments to the Cap-and-Trade Program's Treatment of . . . Legacy Contracts." The Staff's proposal is included in a Power Point presentation that was discussed at the May 1 workshop.

Shell Energy appreciates the opportunity to provide these brief comments on the Staff's proposed treatment of legacy contracts. In particular, Shell Energy addresses the Staff's proposed treatment of any pre-AB 32 (legacy) contract with an electricity generator, where the contract does not specify which contracting party bears responsibility for GHG compliance costs. The Staff proposes that for 2013 and 2014 legacy contract emissions, vintage year 2015 allowances will be distributed to the electricity generator. Beginning in 2015, the Staff proposes that if the contracting parties are unable to renegotiate the terms of the contract, the ARB will assign the compliance obligation. The Staff proposes that if the legacy contract is otherwise eligible (including an annual representation by the generator that the GHG costs cannot be "passed down"), the emissions should be "captured" (the compliance obligation would be shifted) to the "natural gas supplier."

The Staff proposal is not clear and has not been explained in sufficient detail. The Staff proposal has not been provided in writing and does not reference specific provisions of AB 32 (Health and Safety Code Sections 38500-38599) or existing ARB regulations for support. Although the Staff proposal seeks to impose the GHG compliance obligation on the "natural gas supplier," the

Staff proposal does not address the difference between a "natural gas supplier" (seller of the gas commodity) and the "supplier of natural gas" (which, within the meaning of Section 95811(c), is the local distribution company (LDC)). Without providing support, the Staff proposal appears to seek to shift GHG cost responsibility from the generator to the entity that "dispatches" the facility, without regard to the terms and conditions of the legacy contract.

Shell Energy does not support the Staff's proposal on this issue. First, the supplier of the natural gas commodity to the electric generating facility (supplier/marketer of natural gas) is not the "covered entity" under the ARB's regulations. The Staff's proposal, if adopted, would shift the GHG compliance obligation from the "first deliverer of electricity" (operator of an electricity generation facility) to the supplier of the natural gas commodity to that generation facility. Under current regulations (Title 17, Section 95811(b)), the "covered entity" is the "operator" of the generation facility. The Staff's proposal would dramatically alter the assignment of GHG cost responsibility under the regulations. Changing the definition of the "covered entity" for just a subset of contracts (legacy contracts) would be unreasonable and unduly discriminatory. The Staff's proposal would shift the compliance obligation to the natural gas commodity supplier under legacy contracts, but it would not shift the compliance obligation to the natural gas commodity supplier for post-AB 32 (non-legacy) contracts.

Second, the ARB does not have authority to judge the meaning of contract terms, interpret the obligations of contracting parties, or allocate cost responsibility between contracting parties. There is no legitimate basis for the ARB to change the definition of "covered entity" for one class of contracts (legacy contracts), but not for others. Furthermore, every legacy contract is different. Under different tolling arrangements, one entity may dispatch the entire facility, and another entity may dispatch only a portion of the facility. The contract price may or may not reflect the assumption of risk for GHG compliance costs. There may be terms and conditions that limit the circumstances under which an entity may dispatch a facility. In addition, in some cases, the natural gas commodity supplier may not have the dispatch rights under a legacy contract at all. If the ARB were to impose the compliance obligation on the gas commodity supplier in every legacy contract, that would not necessarily capture the entity that is dispatching the generation facility. This would result in differential treatment and arbitrary results.

Third, if the ARB were to declare that the natural gas commodity supplier should be the "covered entity" for purposes of legacy contracts, this would add a new "covered entity" that was not contemplated under the ARB's regulations. The gas commodity seller was not intended to be a "covered entity" under the regulations, unless the entity also provides distribution service (LDC) (Title 17, Section 95811(c)). Under the current regulations, "natural gas supplier" means the LDC or a publicly owned utility. If the ARB were to shift the compliance obligation to the "supplier of natural gas" (the LDC) for all generation facilities as of 2015, that would represent a significant change. If the ARB were to shift the compliance obligation to the <u>commodity</u> gas supplier, such a change would alter the fundamental structure of the program.

Fourth, the language under AB 32, including the "Definitions" (Health and Safety Code Section 38505(i)), refers repeatedly to a greenhouse gas emission "source." Whether or not the supplier "dispatches" the generation facility, the natural gas commodity supplier is not the "source" of GHG emissions. The ARB regulations reference Sections 38560 and 38562 of the Health and Safety Code as support for the cap and trade regulations. Both of these Code sections refer to a "source" of GHG emissions. In view of the statutory references to reducing emissions from the "source," it would be inconsistent with the statute to impose the compliance obligation on the natural gas commodity supplier.

The ARB does not have authority to modify the terms of a legacy contract. Allocation of the GHG compliance obligations between the parties is not a matter that the ARB should attempt to resolve. Any ARB determination would be a blunt instrument that likely would create economic dislocation and impose an undue burden on one or the other contracting party.

Finally, the Staff proposal contemplates that for those legacy contracts where the contracting parties are unable to renegotiate the contract terms (and where the GHG compliance costs cannot reasonably be passed through to the purchaser), vintage year 2015 allowances should be distributed to the electricity generator for 2013 and 2014 legacy contract emissions. If this approach is appropriate for the 2013-2014 period, the ARB should consider adopting this same approach (distribution of free allowances to the electricity generator) for 2015 and beyond as well.

Shell Energy appreciates the opportunity to provide written comments and looks forward to further discussions respecting this issue.

Respectfully submitted,

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cc: Claudia Orlando, ARB

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