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VIA ELECTRIC SUBMISSION

February 14, 2014

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

Subject: Comments on CARB's January 31, 2014 Informal Discussion Draft Regarding California Cap-and-Trade Regulation

Dear Madam Chairman:

We appreciate the opportunity to provide these comments regarding the California Air Resources Board ("CARB") January 31, 2014 informal discussion draft regarding its potential amendments (the "Draft Amendments")[1] to the California Cap-and-Trade Regulation (the "Regulation").[2]

I. Introduction

CARB staff has worked closely with numerous stakeholders to address the legacy contracts issue,[3] which threatened the continued viability of highly efficient electricity producing and combined heat and power ("CHP") facilities in California. We greatly appreciate CARB staff's decision in the Draft Amendments to provide relief to legacy contract generators through the Regulation's second compliance period (i.e., 2017). However, the Draft Amendments arbitrarily discriminate between legacy contract generators whose counterparties receive allocations for industry assistance and those who do not.

As described below, there is no rationale for providing different levels of relief to legacy contract generators based on the type of counterparty. We therefore encourage CARB staff to propose regulatory amendments for the Board's consideration which treat similarly situated entities equally (i.e., which allow all legacy contracts to use the same data year and "true up" mechanism for calculating emission allowances). There is no basis in fact or law for the different treatment now being proposed.

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[1] CARB Discussion Draft – January 31, 2014; Potential Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms, *available at*: http://www.arb.ca.gov/cc/capandtrade/capandtrade.htm.

[2] Tit. 17, Cal. Code Reg. §§ 95800 *et seq.*, referred to herein as the "Regulation".

[3] "Legacy contracts" are those contracts that do not allow for a pass-through of the cost to purchase greenhouse gas ("GHG") emission allowances to meet generators' compliance obligation under the Regulation. *See* Draft Amendments, § 95802(a)(197).

II. Treatment Of Legacy Contract Generators Should Be Fair And Consistent With Relief Provided To Generators With Counterparties Receiving Industry Assistance

CARB staff should provide the same transition assistance to *all* legacy contract generators as it proposes under the Draft Amendments to provide to legacy contract generators whose counterparties are receiving allowance allocations for industry assistance.[4] In particular, in calculating the initial allowance allocations made to this particular subset of legacy contract generators, CARB staff is proposing to use 2013 data[5] and will provide a subsequent "true-up"[6] to account for any shortfall of allowances not accurately provided for in prior allocations. In furtherance of the traditional notions of fairness and equity, CARB staff should utilize 2013 data to calculate the GHG allowance allocation and provide a subsequent "true-up" to legacy contracts generators whose counterparties are *not* receiving allowance allocations for industry assistance. As described below, such an approach is critical to providing complete relief to all legacy contract generators.

A. The Most Current Data Available Should Be Utilized To Calculate GHG Emission Allowances

To help ensure that allowance allocations accurately reflect current operating output and to avoid any shortfall to generators, CARB should use the most current data available (i.e., 2013) for facility emissions (for stand alone electricity generating facilities) and the amount of electricity and steam sold (for CHP facilities) under a legacy contract. Under the Draft Amendments, unlike the relief provided to generators whose counterparties receive allowance allocations for industry assistance, the allocation for legacy contract generators whose counterparties do *not* receive allowance allocations for industry assistance will be based on 2012—not 2013 data.[7]

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[4] *See* Draft Amendments, § 95802(a)(181) (An "Industrial Sector Legacy Contract Counterparty" or "Legacy Contract Counterparty" means "an entity that has been identified under industrial allocation pursuant to Table 8-1 to receive allowance allocation, and has a contract to purchase Legacy Contract Qualified Thermal Output and/or electricity from a Legacy Contract Generator.").

[5] *See* Definition of "EEm_{lc}" in Draft Amendments, § 95894(c)(1) (emphasis added) (For stand-alone electricity generating facilities, GHG emission allowances are calculated using emissions "associated with electricity sold under the legacy contract ***in 2013***."); *see also* definition of "Q_{lc}" in § 95894(c)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "thermal output . . . sold under a legacy contract ***in data year 2013.***"); *see also* definition of "E_{lc}" in § 95894(c)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "electricity . . . sold under a legacy contract ***in data year 2013.***")

[6] *See* Draft Amendments, § 95894(c)(1) (Providing a subsequent "true-up" to stand-alone electricity generating facilities "[f]or years after 2015."); *see also* § 95894(c)(2) (Providing a subsequent "true-up" to CHP facilities "[f]or years after 2015.").

[7] *See* Definition of "EEm_{lc}" in Draft Amendments, § 95894(d)(1) (emphasis added) (For stand-alone electricity generating facilities, GHG emission allowances are calculated using emissions "associated with electricity sold under the legacy contract ***in 2012***."); *see also* definition of "Q_{lc}" in § 95894(d)(2) (emphasis added) (For CHP facilities, GHG

There is no principled reason for the disparate treatment of legacy contract generators, and CARB staff has not provided any rationale for using a different data year in this regard. As CARB staff is aware, facility output varies based market demand, production capacity, the specific terms of the legacy contract, and facility downtime and maintenance. In particular, utilizing data from the 2012 recessionary period would result in an under-allocation of allowances to such legacy contract generators. Further, the expected shortfall from using 2012 data will be more pronounced for efficient facilities that experience increased demand as the annual GHG emissions cap declines to incentivize the dispatch of more efficient facilities. By using the most current data, there is less risk that legacy contract generators would incur the likely substantial costs to purchase allowances to make up for any shortage. Indeed, as described in CARB staff's proposal for legacy contract treatment, legacy contract generators "have no reasonable means to pass GHG compliance costs to the contract counterparty."[8] Thus, the cost to make up for any shortfall in CARB's allowance allocation will arbitrarily and unfairly strand legacy contract generators with unrecoverable costs. In such a circumstance, the financial gains to end users—such as profiting energy marketers—would not be diminished whatsoever, whereas generators would suffer significant economic losses without any corresponding benefit in furtherance of the Regulation or the State's GHG emissions reduction goals under AB 32.[9]

In light of these significant issues, for *all* legacy contract generators CARB staff should use 2013 data for legacy contact generators' reported GHG emissions or amount of electricity and steam sold pursuant to a legacy contract (as the case may be) to help ensure that allowance allocations accurately reflect current operating output and to avoid any inequitable shortfall to generators. The Boards' directive to CARB staff was clear: "[D]evelop a methodology that provides transition assistance to legacy contract generators that have a compliance cost that cannot be reasonably covered due to a legacy contract."[10] Contrary to such directive, CARB staff's proposed use of 2012 data in the Draft Amendments will result in significant unrecoverable costs—falling well short of the transition assistance necessary to avoid financial harm to such generators.

B. A True-Up Is Necessary For Accurate Allocations To Legacy Contract Generators

A "true-up" is necessary to protect against any over or under allocation of emission allowances. As noted above, the Regulation is designed to promote the increased utilization of energy efficient facilities over time. Thus, a shortfall in the allowance allocation will result if there is an increase in output from efficient legacy contract generators compared to prior years. Such a deficit, of course, will be more pronounced over time as the declining GHG emission cap under the Regulation incentivizes increased dispatch from such efficient facilities. Conversely, the development of renewable energy projects in the furtherance of the State's

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emission allowances are calculated based on "thermal output . . . sold under a legacy contract ***in data year 2012.***"); *see also* definition of "E_{lc}" in § 95894(d)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "electricity . . . sold under a legacy contract ***in data year 2012.***")

[8] CARB Staff, "Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade" (October 16, 2013) (the "Legacy Contract Proposal"), available at: http://www.arb.ca.gov/cc/capandtrade/legacy-contract-proposal.pdf.

[9] Health & Safety Code, §§ 38500 *et seq.* (The Global Warming Solutions Act of 2006).

[10] Board Resolution 12-33, at 3 (September 20, 2012).

renewable portfolio standard ("RPS") goals may result in less deployment of energy from conventional power sources. As recognized in the Executive Order S-14-08, "to meet the greenhouse gas reduction goal of 1990 levels by 2020 and 80 percent below 1990 emissions levels by 2050, [] the success and expansion of renewable energy sources [is] a key priority for California's economic and environmental future."[11] Absent a true-up correction, the successful deployment of renewable energy could possibly result in legacy contract generators receiving more allowances than necessary to satisfy their compliance obligation. Thus, to ensure that the appropriate number for emission allowances are provided to legacy contract generators (thereby avoiding any shortfall or windfall), CARB staff should include a "true-up" in the equations in sections 95894(d)(1) and (d)(2) of the Draft Amendments for allocating allowances to legacy contract generators whose counterparties are not receiving allocations for industry assistance. As noted above, providing such a true-up is consistent with the allocation calculation methodology in sections 95894(c) of the Draft Amendments for counterparties receiving allowance allocations for industry assistance.

III. Auction Advisor Disclosure Requirements Should Be Modified To Safeguard The Attorney-Client Privilege And Avoid Violation of Attorneys' Duty of Confidentiality

We support CARB's proposal to delete section 95923(b)(2) of the Draft Amendments in its entirety. As described in our October 14, 2013 comment letter, stakeholders had significant concerns that such provision would potentially require disclosure of information that violates the attorney-client privilege. While we greatly appreciate CARB staff's decision in this regard, we continue to believe that section 95914(c)(3)(D) of the Draft Amendments could require an attorney, who provided advisory services regarding the Regulation to a client, to disclose information that is protected by the attorney-client privilege and the separate duty of confidentiality.

Section 95914 of the Draft Amendments requires a Cap-and-Trade Consultant or Advisor[12] to provide CARB staff, in writing, at least 15 days before an allowance auction:

1. Names of the entities participating in the Cap-and-Trade Program that are being advised;

2. ***Description of advisory services being performed***; and

3. Assurance under penalty of perjury that advisor is not transferring to or otherwise sharing information with other auction participants.[13]

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[11] Executive Order S-14-08 (November 17, 2008).

[12] A "Cap-and-Trade Consultant or Advisor" is "a person or entity that is not an employee of an entity registered in the Cap-and-Trade Program, but is providing the types of services listed in section 95979(b)(2) of the Cap-and-Trade Regulation or section 95133(b)(2) of the Mandatory Reporting Regulation specifically for the entity registered in the Cap-and-Trade Program." Draft Amendments, § 95923(a). Section 95979(b)(2) of the Regulation expressly includes "***Any legal services***" under the types of services that such an advisor may provide. *Id.* at § 95979(b)(2)(R).

[13] Draft Amendments, § 95914(c)(3)(D) (emphasis added).

As described in our October 14, 2013 comments, the attorney-client privilege protects confidential communications between clients and lawyers. The right to assert the privilege belongs to the client.[14] However, "the *attorney* is professionally obligated to claim it on behalf of his client's behalf whenever the opportunity arises unless he has been instructed otherwise by the client."[15] The essential importance of such protection is further evidenced by courts' inability to compel any waiver of the attorney client privilege.[16] Given the significance of the privilege in the American legal system, an attorney who willfully violates the attorney-client privilege may face disqualification from practicing law and incur other sanctions.[17] As written, section 95914(c)(3)(D) would require the attorney, not the client-holder of the privilege, to disclose privileged communications to CARB.

In addition, attorneys are subject to a separate ethical duty of confidentiality, which is even broader than the attorney-client privilege. The duty of confidentiality extends to cover all of the information gained within the scope of the attorney-client professional relationship that the client has requested be kept secret, or the disclosure of which could be harmful or embarrassing to the client.[18] Significantly, a lawyer must "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."[19] While the attorney-client privilege applies in judicial and other proceedings in which an attorney may be called as a witness or otherwise be compelled to produce evidence concerning a client, the duty of confidentiality prevents an attorney from revealing a client's confidential information—even when not confronted with such compulsion.[20] Like the attorney-client privilege, the duty of confidentiality "contributes to the trust that is the hallmark of the client-lawyer relationship," ensuring full and frank communication between client and lawyer, and enabling the lawyer to provide effective counsel to the client.[21] The disclosure requirements contemplated by section 95914(c)(3)(D), however, would require an attorney to violate this duty.

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[14] *OXY Resources Cal. LLC,* 115 Cal. App. 4th at 901; Cal. Evid. Code § 954.

[15] *Glade v. Superior Court* (1978) 76 Cal. App. 3d 738, 743 (emphasis added).

[16] *Shannon v. Superior Court* (1990) 217 Cal. App. 3d 986, 995.

[17] *See, e.g.*, *Snider v. Superior Court* (2003)113 Cal. App. 4th 1187, 1212; *Gomez v. Vernon*, 255 F.3d 1118, 1133-34 (9th Cir. 2001); *see also* Cal. Bus. & Prof. Code § 6068(o)(3).

[18] *See* Cal. State Bar Formal Op. No. 2003-161.

[19] Cal. Bus. & Prof. Code § 6068(e)(1).

[20] *See* California Rules of Professional Conduct, Rule 3-100, Discussion [2] (Confidential Information of a Client); *Goldstein v. Lees* (1975) 46 Cal. App. 3d 614, 621 n.5.

[21] California Rules of Professional Conduct, Rule 3-100, Discussion [2] (Confidential Information of a Client).

Absent an express exclusion of attorneys from this provision, to avoid running afoul of such disclosure requirements, outside counsel may be forced to refrain from providing any advice to entities regarding the auction bidding process and potentially other related aspects of the Cap-and-Trade Program. As a result, section 95914(c)(3)(D) could have a "chilling effect" on attorneys' ability to advise clients in this regard, which would severely limit the ability of clients to receive complete legal and other advice in such matters. To avoid undermining the attorney-client relationship in this regard, we again encourage CARB staff to expressly exclude attorneys from the disclosure requirements in section 95914(c)(3)(D). While CARB staff included this provision "to provide ARB with greater oversight of advisors,"[22] we believe such modification to the Regulation will not undermine or adversely affect CARB staff's ability to maintain such regulatory oversight.

IV. Conclusion

CARB staff first identified the legacy contracts issue in October 2010[23] and has worked diligently with stakeholders since then to address this important matter. We recognize the enormity of CARB staff's and the Board's efforts over the past many months and years to resolve this issue. As described above, we fully support CARB's the Draft Amendments, which are expected to provide the necessary transition assistance to the majority of legacy contract generators.

However, we encourage CARB staff—consistent with the treatment of generators whose counterparty is receiving allowance allocations for industry assistance—to provide for: (1) the use of the 2013 data when calculating the generators' reported GHG emissions or amount of electricity and steam sold pursuant to a legacy contract (as the case may be); and (2) a subsequent true-up to account for any shortfall in prior allocations. There is simply no policy justification for treating legacy contact generators differently in this regard based on the nature of the counterparty. Any such discrimination would arbitrarily and unfairly penalize such legacy contract generators and would not provide any GHG emissions reduction benefit in furtherance of the Regulation or AB 32. Without such regulatory amendments, certain legacy contract generators will be unfairly punished, contrary to the Board's directive to CARB staff to provide complete transition assistance to *all* legacy contract generators.

Separately, we request that CARB staff expressly exclude attorneys from section 95914(c)(3)(D) of the Regulation to avoid any potential requirement for attorneys to violate the attorney-client privilege or breach their ethical duty of confidentiality to their clients. Absent such modifications, outside attorneys may be forced to refrain from providing any advice to clients in order to avoid the risk of sanctions or even disbarment.

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[22] *See* CARB Staff Report: Initial Statement of Reasons, Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms, at 189 (September 4, 2013), *available at* http://www.arb.ca.gov/regact/2013/capandtrade13/capandtrade13isor.pdf.

[23] CARB Staff Report: Initial Statement of Reasons, Proposed Regulation To Implement California Cap-and-Trade Program, II-32, n.22 (October 28, 2010), *available at* http://www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf; *see also* Appendix J to same, "Allowance Allocation," J-16, n.15.

Consistent with these comments, we respectfully request that CARB staff incorporate the proposed modifications to the Draft Amendments included as Exhibit A to this comment letter.

We look forward to working with CARB staff to facilitate these necessary changes to the Draft Amendments.

Respectfully submitted,

/s/ Peter H. Weiner

Peter H. Weiner

and

/s/ Michael S. Balster

Michael S. Balster

cc: Board Members of the California Air Resources Board
Virgil Welch, Special Counsel to the Chairman
Richard Corey, Executive Officer
Rajinder Sahota, Branch Chief, CARB Cap-and-Trade Program

CARB January 31, 2014 Informal Discussion Draft
Potential Amendments to California Cap-and-Trade Program

Exhibit A: Recommended Changes CARB Staff's Potential Amendments[24]

§ 95914. Auction Participation and Limitations

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(c) Non-disclosure of Bidding Information

* * * *

(3) If an entity participating in an auction has retained the services of a Cap-and-Trade Consultant or Advisor regarding auction bidding strategy, then:

* * * *

(D) The advisor must provide to the Executive Officer in writing at least 15 days prior to an auction, the following information:

1. Names of the entities participating in the Cap-and-Trade Program that are being advised;

2. Description of advisory services being performed <u>without compromising the attorney-client relationship or any duty of confidentiality afforded by rule, regulation, case law or statute under which the Cap-and-Trade Consultant or Advisor may be required to observe</u>; and

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§ 95894. Allocation to Legacy Contract Generators for Transition Assistance

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(d) For legacy contracts not covered in 95894(c), the following formulae shall apply:

(1) For stand alone generation facilities:

$$TrueUp_{2015} = (EEm_{lc} * c_{2013}) + (EEm_{lc} * c_{2014}) + (EEmlc * c_{2015})$$

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[24] Recommended insertions are shown in <u>underlined</u> text and deletions are shown in ~~strikethrough~~.

Where:

"TrueUp2015" is the amount of true up allowances allocated from budget year 2015 and allowed to be used for budget years 2013 and 2014 and subsequent years, pursuant to sections 95856(h)(1)(D) and 95876(h)(2)(D), in vintage 2015 allowances based on calendar year ~~2012~~ 2013 Legacy Contract Emissions reported and verified pursuant to MRR;

"$EEm_{lc,}$" is the emissions reported, in MTCO2e, associated with electricity sold under the legacy contract in ~~2012~~ 2013; and

* * * * *

For years 2016 and 2017, the following equation applies:

$$A_t = (EEm_{lc,t-2} * C_t) + TrueUp_t$$

Where:

$$TrueUp_t = (EEm_{lc,t-2} * C_{t-2}) - A_{t-2,no\ trueup}$$

Where:

$TrueUp_t$ is the amount of true-up allowances allocated to account for the emissions reported for data year "t".

"$A_{t-2,no\ trueup}$" is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t-2" not including the true-up for that budget year.

(2) For legacy contract generators not covered in 95894(c) or 95894(d)(1):

$$TrueUp_{2015} = \big((Q_{lc} * B_s + E_{lc} * B_e) * c_{2013}\big) + ((Q_{lc} * B_s + E_{lc} * B_e) * c_{2014}) + ((Q_{lc} * B_s + E_{lc} * B_e) * c_{2015}\ )$$

Where:

"$TrueUp_{2015}$" is the amount of true-up allowances allocated from budget year 2015 and allowed to be used for budget years 2013 and 2014 and subsequent years pursuant to sections 95856(h)(1)(D) and 95856(h)(2)(D) in vintage 2015 allowances based on calendar year ~~2012~~ 2013 Legacy Contract Emissions reported and verified pursuant to MRR;

"Q_{lc}" is the Legacy Contract Qualified Thermal Output in MMBtu sold under a legacy contract in data year ~~2012~~2013, as reported to MRR;

"E_{lc}" is the electricity, in MWh, sold under the legacy contract in data year ~~2012~~2013;

* * * * *

For years 2016 and 2017, the following formula applies:

$$A_t = ((Q_{lc} * B_s + E_{lc} * B_e) * C_t) + TrueUp_t$$

Where:

$$TrueUp_t = ((Q_{lc,t-2} * B_s + E_{lc,t-2} * B_e) * C_{t-2}) - A_{t-2,no\ trueup}$$

"A_t" is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t". This value shall only be calculated if the entity meets the eligibility requirements, pursuant to section 94894(a) and 95894(b), and is covered under the Cap-and-Trade Program during the second compliance period.

And:

$TrueUp_t$ is the amount of true-up allowances allocated to account for the emissions reported for data year "t".

"$Q_{lc,\ t-2}$" is the Legacy Contract Qualified Thermal Output in MMBtu sold under a legacy contract in data year t-2, as reported under the MRR;

"$E_{lc,t-2}$" is the electricity, in MWh, sold under the legacy contract in data year t-2;

"B_e" is the emissions efficiency benchmark per unit of electricity sold or provided to off-site end users, 0.431 California GHG Allowances/MWh;

"B_s" is the emissions efficiency benchmark per unit of Legacy Contract Qualified Thermal Output, 0.06244 California GHG Allowances/MMBtu thermal;

"c_t" is the cap decline factor for budget year "t" as specified in table 9-2;

"c_{t-2}" is the is the cap decline factor for the budget year two years prior to year "t" as specified in Table 9-2;

"$A_{t-2,no\ trueup}$" is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t-2" not including the true-up for that budget year;

* * * *

(e) Data Sources. In determining the appropriate values for section 95894(c) and 95894(d), the Executive Officer may employ all available data reported to ARB under MRR for ~~2012~~ 2013 and all other relevant data, including invoices, demonstrating the amount of electricity and Qualified Thermal Output sold or provided for off-site use that does not include a carbon cost in the budget year for which it is seeking an allocation. If necessary, the Executive Officer will solicit additional data to establish a representative allocation. The operator of the Legacy Contract Generator must provide the additional data upon request by the Executive Officer.