CALPINE CORPORATION

1215 K Street
Suite 2210
Sacramento, CA 95814
916.491.3366

August 2, 2013

By Electronic Submission: http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=cap-trade-draft-ws&comm_period=1

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

Re: Comments on CARB Discussion Draft of Proposed Amendments to the Cap-and-Trade Regulation and July 18, 2013 CARB Public Workshop

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") Discussion Draft of 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, "Draft Amendments") and the July 18, 2013 CARB public workshop regarding the Draft 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") reduction program. The results of the three Cap-and-Trade auctions conducted to date demonstrate that the market for GHG emissions allowances is strengthening. We have actively participated in development of the Regulation, most recently at the July 18, 2013 workshop, and have offered our input throughout on how CARB could strengthen the program and resolve lingering uncertainties.

Collectively, the Draft Amendments discussed below threaten to (1) muddle an already complex program, (2) inject a significant degree of uncertainty for market participants, and (3) impose intrusive requirements without any apparent benefit for market transparency or security. Given the risks that a number of the Draft Amendments pose to the Cap-and-Trade Program, Calpine provides the following comments:

A. Legacy Contracts: Although Calpine appreciates that CARB has taken up the issue faced by generators subject to legacy contracts that provide no mechanism for recovery of GHG compliance costs, the Draft Amendments do not go far enough. Providing an allocation to legacy contract generators for only 2013 and 2014 emissions, when their contracts may run for several more years, is an incomplete solution that neither relieves

the financial burden the program will impose on them, nor incents their counterparties to return to the bargaining table. Calpine urges CARB to revisit the proposals it presented this past spring and provide relief to legacy contract generators for the life of the relevant legacy contract.

B. Auction Purchase Limit: Despite the clear direction of the Board to ensure that the auction purchase limit does not deny the largest facilities the flexibility that the Regulation was designed to provide all covered entities, the Draft Amendments made no proposal to increase the current vintage auction purchase limit for non-utility covered entities. Calpine urges CARB to increase the current vintage auction purchase limit for non-utility covered entities from 15% to 25%.

C. Prohibitions on Trading: The Draft Amendments propose additional language relating to the permissibility of an entity holding allowances on behalf of another entity. Calpine urges CARB to clearly indicate that the prohibition on beneficial holdings does not apply to an electric distribution utility's procurement of allowances that it intends to transfer to the seller under a power purchase agreement to cover the compliance obligation associated with electricity delivered pursuant to the agreement.

D. Reporting of Transaction Agreements in CITSS: The Draft Amendments would require every CITSS transfer request to specify the type of agreement pursuant to which the transfer request is made and then provide information about the underlying agreement. This new requirement is unduly invasive and burdensome and in many cases will yield irrelevant data. Moreover, the classification scheme CARB has proposed is ill suited to many common types of contracts under which instruments will be transferred. Calpine urges CARB not to include this requirement in the forthcoming 45-day notice of proposed amendments to the Cap-and-Trade Regulation.

E. Corporate Association Disclosure: CARB staff proposes to amend the Regulation to require CITSS registrants to disclose all corporate associations, regardless of whether the associates are also registered in CITSS or serve as the link between entities which are. The proposed broadening of the disclosure requirement would require potentially voluminous reporting of irrelevant information. It would also dramatically heighten the risk of both misreporting and inadvertent disqualification from auction participation. The Regulation should remain as-is and only require the disclosure of corporate associates that are also registered in CITSS or that serve as the link between associated entities registered in CITSS.

F. Employee, Auction Advisor, and Contractor Disclosure: The Draft Amendments would require entities to disclose information relating to employees, advisors, and contractors that have access to information regarding an entity's compliance with the Cap-and-Trade Regulation. These proposed amendments, which are unprecedented in scope or scale, are unreasonably broad and, in certain circumstances, risk violating the attorney-client privilege. They also would require voluminous reporting with apparently little or no value to CARB's enforcement of the Regulation.

G. Changes in Auction Application Information: CARB staff proposes a draft amendment whereby an entity experiencing certain changes to information in its auction application 30 days prior to an auction, or an entity whose information will change 15 days after an auction, will be denied participation in the auction. This requirement is unworkable and unduly harsh. CARB should not propose this amendment as part of the forthcoming 45-day notice of proposed Cap-and-Trade amendments.

H. Compliance Instrument Surrender Order: The Draft Amendments would specify the order by which CARB would retire compliance instruments from each covered entity's compliance account. The Draft Amendments fail to clarify, however, the fate of over-surrendered offset credits, which may occur as a result of the mandatory retirement order. Over-surrendered offsets should be returned to the covered entity or credited against its future compliance obligation. Additionally, CARB should create functionality in CITSS for covered entities to specify the compliance instruments they wish to retire.

These comments are discussed in more detail below.

II. DISCUSSION

A. CARB Should Provide Relief to Legacy Contract Generators for the Entire Term of the Legacy Contract

The Draft Amendments propose a set of regulatory revisions that would define legacy contracts and provide temporary relief to legacy contract generators. Generally, legacy contracts are written contracts governing the sale of electricity and/or thermal energy from an electric generating facility at a price that does not allow for recovery of the GHG costs associated with compliance with the Cap-and-Trade Regulation and that were entered into prior to the enactment of Assembly Bill ("AB") 32, the law that authorized CARB to promulgate the Regulation.

CARB has identified 19 legacy contracts for which generators would potentially be provided relief under the Draft Amendments.[1] Of the 19 legacy contracts identified by CARB, Calpine itself is party to four contracts that were initially entered into long before the passage of AB 32—in most cases, over 25 years ago—and therefore do not contemplate the allocation of responsibility for paying for costs pursuant to the Cap-and-Trade Regulation associated with deliveries of electricity and/ or steam.[2] Each contract will expire at a different time subsequent

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

[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.

to the commencement of the first compliance period (in 2016, 2018 or 2019), with some subject to automatic extension rights on the same terms.

Where renegotiation of contracts was possible, Calpine has renegotiated its contracts to address the Cap-and-Trade compliance obligation, both with electric distribution utilities and purchasers of steam and electricity from combined heat and power ("CHP") facilities. Despite Calpine's good faith efforts to bring our counterparties to the negotiating table, we have not, to date, 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 CHP facilities; this remains the case, notwithstanding that some of our counterparties are receiving a free allocation of allowances for industrial assistance.

As Calpine has repeatedly stated,[3] providing relief to CHP generators subject to legacy contracts incents the operation of efficient CHP resources and is consonant with the AB 32 Scoping Plan.[4]

---

[3] *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-day_modifications_to_proposed_ca_cap_on_ghg_emissions.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra 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 Kassandra 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 Kassandra 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 Kassandra 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 Kassandra 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

Along with other stakeholders, Calpine has worked with CARB to develop a solution to this problem. We closely reviewed each of three options CARB proposed at a workshop this past spring.[5] We compared how the various formulae either would or would not promote efficient generation and further the program's goals and ultimately endorsed the first option ("Option 1")[6] We also proposed a calculation methodology that includes a true-up mechanism to assure that the legacy contract generator received just what it needed, and no more than that, to meet the compliance obligation for the duration of the contract.

While Calpine appreciates that CARB has taken up the issue of legacy contracts, we were surprised and disappointed to see that the Draft Amendments would only provide limited relief for the first compliance period. There is no justification for providing an allowance allocation to legacy contract generators for only 2013 and 2014 emissions. In the July 18, 2013 workshop, CARB staff indicated that it believed that an allocation to legacy contract generators for 2013 and 2014 emissions alone is sufficient because it provides more time for contract renegotiation. However, at this point—nearly seven years after the passage of AB 32 and seven months into the first Cap-and-Trade compliance period—*time* is not the missing element to propel the renegotiation of legacy contracts.

What is lacking is any *incentive* on the part of legacy contract counterparties to renegotiate legacy contracts prior to their termination when such renegotiation would increase the overall operating costs. The Draft Amendments would, in fact, subtract the legacy contract allocation amount from the number of allowances directly allocated to industrial sector legacy contract counterparties that are otherwise eligible to receive a free allowance allocation.[7] But, by only proposing to provide a legacy contract allocation for two years, the incentive this adjustment might otherwise provide for counterparties to renegotiate is muted significantly: Only in the case of legacy contracts set to expire by the end of the first compliance period or soon thereafter would there be any appreciable incentive for a counterparty to renegotiate; otherwise, the counterparty is likely to simply "wait it out" through 2013 and 2014 (when it would receive fewer allowances as a result of the adjustment for the legacy contract generator allocation) and instead begin receiving full allocations again starting in 2015. Further, if a contract is set to expire in the near future, the likelihood of renegotiation may be greatly diminished in any event due to the transaction costs and time it would take to consummate such an amendment. As a

---

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-VGEBKlZlA2EEL1Bi.pdf ("May 2013 Comments").

[4] CARB, Climate Change Scoping Plan: A Framework for Change, 44 (2008) (recommending measure no. E-2, "Increase Combined Heat and Power Use by 30,000 GWh").

[5] CARB, Presentation, Staff Workshop, Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, "But For" CHP, and Legacy Contracts, at 21 (May 1, 2013), *available at*: http://www.arb.ca.gov/cc/capandtrade/meetings/050113/final.pdf ("May Workshop Presentation").

[6] *See* May 2013 Comments, *supra* note 3, at 2.

[7] Draft Amendments § 95891(f).

consequence, the practical impact of the Draft Amendments is that renegotiation is unlikely to occur under any scenario.

Where the counterparty is scheduled to receive an allocation for industrial assistance, the Draft Amendments would result in a windfall: The counterparty will receive free allowances—now, in some cases, in significantly increased numbers during the second and third compliance periods due to the proposed adjustments in industry assistance factors—but will experience little to no increase in its steam or electricity costs due to the legacy contract. The rationale for providing such an allocation is to prevent leakage that might occur due to the increase energy intensive/trade exposed industries are expected to experience in energy prices as a result of the program. Where the expected increase cannot occur, however, due to a legacy contract, the rationale for awarding that allocation no longer exists.

If CARB's rationale for only providing an allocation to legacy contract generators for two years is in response to the letter sent to CARB by the California Public Utilities Commission ("CPUC") President Michael Peevey[8], Calpine believes the solution is not to punish those who truly have no avenue for relief and have tried in good faith to renegotiate their contracts. Rather, CARB should refer any remaining investor-owned utility ("IOU") contracts that have not been resolved by the qualifying facility ("QF") settlement[9] or through bilateral negotiation to the CPUC for resolution. The fact remains that IOUs were awarded allocations based upon their load and, just as the CPUC has ordered the IOUs to use the revenue from the sale of those allowances for the benefit of ratepayers, so, too, could it order the IOUs to resolve any GHG obligations under legacy contracts.

Calpine's proposed revisions to the Draft Amendments to address the legacy contract allocation issue are described below. These revisions are intended to provide a complete solution and draw upon the framework for "Option 1" described by CARB in its May Workshop Presentation.

1. The Legacy Contract Generator Allocation Methodology

The only way to incent counterparties to renegotiate legacy contracts—and equitably resolve this issue—is to provide an allocation to legacy contract generators until their legacy contracts expire. Additionally, the allocation to legacy contract generators should include a true-up to ensure that legacy contract generators receive the correct amount of allowances for each year of legacy contract emissions (and no more than needed). Accordingly, Calpine proposes the

[8] *See* Letter from Michael R. Peevey, President, CPUC, to Mary D. Nichols, Chairman, CARB (June 5, 2013) (stating that "[i]f ARB decides that legacy facility operators should receive some administrative relief from cap and trade compliance costs, then I see no reason for ARB to treat facilities differently on the basis of whether the counterparty is an IOU or another type of entity").

[9] *See* CPUC, Qualifying Facilities and Combined Heat and Power Program Settlement, Decision 10-12-035 (Dec. 16, 2010) (the "QF Settlement").

following revisions to the Draft Amendments, tracking the allocation methodology outlined by CARB as part of its previously proposed "Option 1"[10]:

§ 95894. Allocation to Legacy Contract Generators for Transition Assistance.

…

(b) Determination of Eligibility. Upon receipt of the information required by paragraph (a) of this section, the Executive Officer shall determine whether the party submitting such information has demonstrated that it is eligible to receive a direct allocation of allowances pursuant to this section and shall notify that party by September 30, 2014 if it is eligible to receive an allocation ~~for the following compliance year~~of 2015 vintage allowances pursuant to section 95894(d)(1) and by September 30 of each subsequent year if it is eligible to receive an allocation of allowances of that same vintage pursuant to section 95894(d)(2).

…

(d) The Executive Officer shall calculate the number of California GHG Allowances directly allocated due to the emissions under a legacy contract from a Cogeneration system using the following formulas:

(1) The following formula applies for allocating 2015 vintage allowances to Legacy Contract Generators for 2013 and 2014 Legacy Contract Emissions ~~For 2012 reported and verified legacy contract emissions~~ from a cogeneration system:

...

(2) The following formula applies for allocating allowances to Legacy Contract Generators for 2015 and each subsequent year's Legacy Contract Emissions:

$$A_t = ((Q_{lc\text{-}2} * B_s + E_{lc\text{-}2} * B_e) * C_t) + ((Q_{lc,\ trueup} * B_s + E_{lc,\ trueup} * B_e) * C_{t\text{-}2})$$

Where:

"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";

"t-2" is the year two years prior to year "t";

"t-4" is the year four years prior to year "t";

[10] All of Calpine's proposed revisions to the Draft Amendments are indicated in underlined text for insertions and in ~~strikethrough~~ text for deletions.

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

"E_{lc-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 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;

"$Q_{lc,\ trueup}$" adjusts for any Qualified Thermal Output in MMBtu sold pursuant to a Legacy Contract in year "t-2" not accurately accounted for in prior allocations. The Executive Officer will calculate this term using the difference between (1) the amount of steam sold pursuant to a legacy contract reported in data year "t-2" and (2) the amount of steam sold pursuant to a legacy contract reported in data year "t-4";

"$E_{lc,\ trueup}$" adjusts for any electricity, in MWh, sold pursuant to a Legacy Contract in year "t-2" not accurately accounted for in prior allocations. The Executive Officer will calculate this term using the difference between (1) the amount of electricity sold pursuant to a legacy contract reported in data year "t-2" and (2) the amount of electricity sold pursuant to a legacy contract reported in data year "t-4";

"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.

…

(f) Contract Expiration or Amendment. Once a legacy contract expires or the legacy contract generator closes operations, the legacy contract generator will no longer be eligible for a free allocation. If the legacy contract expires before ~~2015~~the end of 2020, the allocation will be prorated for the time in which the contract was eligible.

Calpine's proposal would retain CARB's proposed section 95894(d)(1) formula for calculating the allocation for 2013 and 2014 emissions. Calpine's proposal would simply add another formula for calculating the allocation for legacy contract emissions in 2015 and thereafter.

2. Legacy Contract Counterparty Allocation Adjustment

Calpine would likewise propose amendments to the legacy contract counterparty allocation adjustment formula by adding a new formula to address adjustments for emissions occurring in budget years 2015 and beyond, as shown below:

§ 95891. Allocation for Industry Assistance.

…

(f) Adjustment to Allowance Allocation of a Legacy Contract Counterparty. The Executive Officer shall subtract the allocation adjustment from the number of California GHG Allowances directly allocated to the Legacy Contract Counterparty pursuant to 95891(b) through 95891(d)~~:~~.

(1) For budget year 2015, the allocation adjustment formula is as follows:

$$Adj_{2015} = \sum_{t=2013}^{~~2014~~2015} GHG_{LC} * c_t$$

Where:

"Adj_{2015}" is the allocation adjustment for budget year 2015. This number shall be subtracted from the number of California GHG allowances directly allocated to a legacy contract counterparty for budget year 2015~~.~~;

"GHG_{LC}" are the Legacy Contract Emissions calculated pursuant to data reported to MRR under the legacy contract for 2012 emissions; and

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

(2) For each budget year after 2015, the allocation adjustment formula is as follows:

$$Adj_t = GHG_{LC} * C_t$$

"Adj_t" is the allocation adjustment for budget year "t". This number shall be subtracted from the number of California GHG allowances directly allocated to the Legacy Contract Counterparty for budget year "t";

"t-2" is the year two years prior to year "t";

"GHG_{LC}" are the Legacy Contract Emissions calculated pursuant to data reported pursuant to the MRR under the legacy contract for emissions in data year "t-2";

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

(~~1~~3) In the case that the allocation adjustment is greater than the number of California GHG Allowances directly allocated to a Legacy Contract Counterparty pursuant to sections 95891(b) through 95891(d), the allocation adjustment shall be equal to the number of California GHG Allowances directly allocated to the legacy contract counterparty.

Calpine's proposed revisions to the Draft Amendments would achieve the fairest result and appropriately incent legacy contract counterparties to renegotiate legacy contracts. Should such renegotiation fail to occur, the legacy contract counterparty's allocation would be adjusted accordingly. Calpine urges CARB to incorporate the above suggested revisions into its Draft Amendments before the release of the 45-day Cap-and-Trade amendment package.

B. CARB Should Increase The Auction Purchase Limit from 15% to 25% for Non-Utility Covered Entities

In September 2012, the CARB Board directed staff to "take appropriate action, including proposing potential regulatory 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."[11] Despite this clear directive from the Board (and nearly a year later), CARB has yet to propose regulatory amendments that would provide the largest covered entities the flexibility they need to comply with the Cap-and-Trade Regulation.

As Calpine has stated previously,[12] Calpine's direct compliance obligation will be greater than any of the IOUs in the period covered by the auction purchase limit. Further, given CARB's willingness to amend the Regulation to provide a 40% auction purchase limit to the IOUs, CARB should provide additional flexibility to other large covered entities. Recognizing that CARB might not want to provide the same 40% auction purchase limit for non-utility covered entities, Calpine proposes that the current vintage auction purchase limit for non-IOU covered entities should be increased to 25% from the current 15%. Calpine's proposed revision, which should be included in the 45-day proposed amendments to the Regulation, is as follows:

§ 95911. Format for Auction of California GHG Allowances.

…

(d) Auction Purchase Limit.

…

(4) For the auction of current vintage allowances conducted pursuant to section 95910(c)(1):

(A) The purchase limit for covered entities and opt-in covered entities will be ~~15~~ 25 percent of the allowances offered for auction;

[11] CARB, Board Resolution 12-33, at 3 (Sep. 20, 2012), *available at*: http://www.arb.ca.gov/cc/capandtrade/res12-33.pdf.

[12] June 2012 Comments, at 13.

Section 95914(d) ("Application of the Corporate Association to the Auction Purchase Limit") should likewise be amended to reflect Calpine's proposed revision.[13]

These straightforward regulatory amendments would ensure that California's largest covered entities will be able to purchase sufficient allowances at auction and, thereby, will not be subject to price gouging by potential manipulators on the secondary market.

C. CARB Should Clarify That Utilities' Allowance Procurement To Fulfill a Contractual Obligation Under a Power Purchase Agreement Is Permissible

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 Calpine stated when section 95921(f)(1) was proposed[14], the provision—which was intended to prohibit beneficial holding relationships—prohibits conduct separate from and in addition to beneficial holdings. Under the beneficial holding relationship provisions, after the principal in the relationship (i.e., the contracted generator) confirmed that the agent (i.e., the electrical distribution utility) was authorized to act on its behalf, the allowances held by the agent would count against the holding limit of the principal. On the other hand, section 95921(f)(1) could be interpreted to prohibit an entity from ever acquiring allowances on behalf of another entity regardless of whether the allowances count against the holding limit of the entity acquiring the allowances, creating an untenable double-bind for utilities and their contracted generators.

The Draft 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."[15]

Presumably, the second sentence of the above proposed revision is intended to exempt utilities' power purchase agreements that authorize the utility, as purchaser, to provide compliance instruments to its counterparty to cover the GHG emissions resulting from the electricity delivered pursuant to that agreement. However, if that is the case, the proposed language is inadequate because such agreements often do not specify either a date for delivery or a specified quantity of allowances, but instead provide only that the utility will transfer the number of compliance instruments needed to meet a compliance obligation in advance of a surrender deadline. Further, the requirement that such agreements include "no terms applying to

[13] Regulation § 95914(d)(3)(A) should read "The total purchase limit for the association is ~~15~~25 percent, unless some of the included covered entities are electrical distribution utilities, in which case the purchase limit is 40 percent."

[14] June 2012 Comments, at 7.

[15] Draft Amendments § 95921(f)(1)(B).

allowances residing in another entity's account" is so vague as to potentially exclude many common utility-generator agreements. Indeed, if a contract requires a utility to notify its counterparty that it has acquired a certain number of allowances for later transfer to the counterparty and provides penalties if the utility fails to deliver them when due, one might argue that the contract contains "terms applying to allowances residing in another entity's account."

Calpine proposes that CARB adapt language concerning the delivery obligation between utilities and generators that it is proposing elsewhere in the Draft Amendments (i.e., in section 95921(b)(6) [16]) to clearly indicate in section 95921(f)(1) that the prohibition on entities acquiring and holding allowances on behalf of another entity does not apply to any agreement between an electric distribution utility and a seller of electricity pursuant to a power purchase agreement whereby the utility provides compliance instruments to cover emissions attributable to delivered electricity. To the extent that the second sentence of proposed section 95921(f)(1)(B) is intended to apply to other agreements (e.g., forwards and futures), Calpine does not propose to strike the draft language. Accordingly, Calpine proposes the following revision to section 95921(f)(1) of the Draft Amendments:

§ 95921. Conduct of Trade.

…

(f) General Prohibitions on Trading.

(1) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity ~~I~~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 <u>any agreement between an electric distribution utility and a seller of electricity pursuant to which the electric distribution utility provides compliance instruments to its counterparty to account for the Emissions attributable to the electricity delivered pursuant to the agreement and</u> 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.

[16] Section 95921(b)(6) of the Draft Amendments states that "[i]f the transaction agreements do not contain a price for compliance instruments, entities may enter a price of zero into the transfer request if the transfer request is submitted to fulfill", *inter alia*, agreements between an electric distribution utility and an electric generation facility under a tolling agreement or other long-term power purchase agreement that does not specify a price or cost basis for the sale of compliance instruments. *Id.* § 95921(b)(6)(E). We offer revisions to this provision of the Draft Amendments *infra* at note 23.

Calpine's proposed revision would provide the necessary certainty to utilities and their counterparties, so that utilities can lawfully procure compliance instruments for later transfer pursuant to their tolling agreements or other long-term power purchase agreements.

D. CARB Should Not Require Every CITSS Transfer Request to Identify The Underlying Transaction Agreement

The Draft Amendments would require every CITSS transfer request to identify the type of transaction agreement for which the transfer request is being submitted.[17] The Draft Amendments propose three categories of transaction agreements: (1) "Over-the-Counter"[18] agreements for which delivery will occur no more than three days from the date the agreement is entered into, (2) "Over-the-Counter" agreements for which delivery will occur more than three days from the date the agreement is entered into or that involve multiple transfers of allowances over time or the bundled sale of allowances with other products; and, (3) "Exchange-Based"[19] agreements (e.g., spots and futures). Depending on the type of underlying transaction agreement, the transfer request would also need to identify additional agreement-specific information.[20]

The stated justification for this requirement is that, by requiring the disclosure of the underlying transaction agreement to a transfer request, purported transferors will be prevented from wrongfully initiating a transfer request just so they can determine, based upon whether the request is immediately rejected or not because it would result in an exceedance of the holding limit, what the purported recipient's position is with respect to compliance instruments.[21] Even if there is a risk that covered entities will abuse the transfer request process in this manner, the Draft Amendments present a roundabout way to protect CITSS registrants from such abuse. There are innumerable less intrusive and burdensome ways that CARB could seek to prevent such abuse, which would not involve application of an unduly complicated and yet overly simplistic classification scheme for all contracts pertaining to the transfer of compliance instruments.

---

[17] *Id.* § 95921(b)(2) (stating that "[t]he transfer request must identify the type of transaction agreement for which the transfer request is being submitted…").

[18] *Id.* § 95802(a)(YYY) ("Over-the-Counter" means the trading of carbon compliance instruments, contracts, or other instruments not listed on any exchange).

[19] *Id.* § 95802(a)(XX) ("Exchange" means a central marketplace with established rules and regulations where buyers and sellers meet to conduct trades).

[20] *Id.* §§ 95921(b)(3)-(5).

[21] *See*, CARB, Workshop re: Proposed Changes To The California Greenhouse Gas Cap-And-Trade Regulations, at slide 47 (July 18, 2013) (hereinafter, "July 18, 2013 Workshop Presentation"), *available at*: http://www.arb.ca.gov/cc/capandtrade/meetings/071813/workshoppresentation.pdf (the oral comment of CARB staff during the presentation elaborated on this point).

The implied justification for the CITSS disclosure requirement is market transparency. However, at least in the case of exchange-traded contracts, the market information that CARB seeks is best obtained from the exchange itself. Combined with the market information obtained from the quarterly auctions of allowances, this information is sufficient to provide a price signal to market participants. Indeed, Calpine is aware of no analogue in any similar GHG compliance program where the regulator requires an entity to provide so much information concerning the actual form or contents of an agreement used by an entity to procure compliance instruments. Accordingly, there is little to gain in terms of market transparency by forcing every CITSS transfer request to identify the form of underlying agreement.

For example, for "Exchange-Based" Agreements, there is no apparent value in requiring reporting of the "[d]ate of close of trading for the contract" or the "[p]rice at close of trading"[22] because such information is irrelevant to whether the transaction satisfies the criteria for CARB's approval of it under the Cap-and-Trade Regulation. Moreover, it may be practically impossible for covered entities to provide the required price information for Exchange-Based futures agreements, where several buy and sell transactions are often settled against one another at different prices, before an allowance is finally delivered and an actual transfer occurs in CITSS. Thus, the price reported at the close of trading for the contract may not in any way be reflective of the actual cost to an entity resulting from its multiple buy and sell transactions. Additionally, covered entities are not regularly in the habit of recording information on the price at the close of trading or of any particular price in association with any individual allowance. Therefore, Calpine submits that information on pricing in the secondary and derivatives markets would be better obtained from the data published by those markets than through the addition of a burdensome reporting requirement for each CITSS transfer request.

For "Over-the-Counter" agreements for which delivery will occur more than three days from the date the agreement is entered into, it is unclear what interest CARB has in collecting information on the other types of products that may be purchased along with the compliance instruments in a "bundled" contract. CARB provides no explanation for how this information is pertinent to its role in monitoring the functioning of the GHG allowance market. Calpine believes that covered entities should not be required to provide such information for every CITSS transfer request.

Further, CARB should at least clarify the information requirements relating to proposed transfers between an electric distribution utility and an electric generation facility or power marketer under a tolling agreement or other long-term power purchase agreement that does not specify a price or cost basis for the sale of compliance instruments.[23] Transfer requests pursuant to these

[22] Draft Amendments §§ 95921(b)(5)(D), (E).

[23] Section § 95921(b)(6) of the Draft Amendments states that "[i]f the transaction agreements do not contain a price for compliance instruments, entities may enter a price of zero into the transfer request if the transfer request is submitted to fulfill", *inter alia*, agreements between an electric distribution utility and an electric generation facility under a tolling agreement or other long-term power purchase agreement that does not specify a price or cost basis for the sale of compliance instruments. *Id.* § 95921(b)(6)(E).

contracts should not also be subject to section 95921(b)(2) of the Draft Amendments. CARB's suggestion in the July 18, 2013 workshop that such agreements would constitute an "Over-the-Counter" agreement for which delivery will occur more than three days from the date of agreement is puzzling. CARB's expectation that such contracts would even specify a frequency for transfer[24] bears little resemblance to many actual contracts addressing the Cap-and-Trade compliance obligation. Further, the catch-all requirement to provide a description of "the pricing method"[25] is at odds with the "zero price" reporting provision that occurs in following paragraphs of the Draft Amendments.[26]

In sum, the classification scheme CARB has prescribed is ill suited to many contracts governing transfer of compliance instruments, in particular power purchase agreements with utilities. Attempting to fit all such contracts into a "check-box" framework is fraught with the risk of error and misreporting. Further, the requirement to disclose information about the underlying agreement would amount to an incredible administrative burden for market participants, many of whom may engage in multiple transactions on a daily or even more frequent basis. Placing such a burden on market participants to determine which box to check, when none may seem particularly relevant to the particular transaction at hand, is only likely to result in inaccurate reporting and information of little to no value for CARB.

Calpine supports coherent market oversight of the Cap-and-Trade Program. However, CARB has failed to adequately justify how the information it is requesting for every transaction would further any legitimate interest in market oversight. In light of the sheer complexity the proposed disclosure requirements would add to an already complex regulatory scheme, the proposed transaction disclosure requirements do not support the smooth functioning of the Cap-and-Trade market, but may do just the opposite. Accordingly, Calpine would urge CARB to rethink its approach and the utility of the requested information, before adding undue layers of complexity to the CITSS transfer process.

E. The Proposed Expansion of the Requirement to Disclose Corporate Associations Is Unduly Broad

---

We would note that the proposed language concerning zero price transfers errs in two respects: First, a long-term power purchase agreement may not be with the "generation facility" itself or an entity operating the facility, but an intermediary or power marketer who is acting on behalf of the generator (i.e., generation providing entity). Second, such agreements do not necessarily amount to the "sale" of compliance instruments. Accordingly, we offer the proposed revisions to Section 95921(b)(6)(E):

> The proposed transfer is from an electric distribution utility to an entity ~~operating a generation facility~~ selling electricity under a tolling agreement or other long-term power purchase agreement that does not specify a price or cost basis for the ~~sale~~delivery of the compliance instruments alone.

[24] *Id.* § 95921(b)(4)(C).

[25] *Id.* § 95921(b)(4)(G).

[26] *See supra* at note 23.

The Draft Amendments would drastically broaden the requirements that pertain to disclosing corporate associations. The current Regulation requires all entities registering with CARB to identify "all other entities *registered* pursuant to this article with whom the entity has a corporate association, direct corporate association, or indirect corporate association pursuant to section 95833, and a brief description of the association."[27] CARB proposes to amend the CITSS registration requirement such that any entity applying for a CITSS account must identify not just registered corporate associates, but "*all* other entities [] pursuant to this article with whom the entity has a corporate association…"[28] Further, the Draft Amendments would specify that an entity has a corporate association with another entity, "regardless of whether the second entity is subject to the requirements of this article", if either one of the entities otherwise satisfies the criteria for determining corporate associations (e.g., one of the entities holds more than 20 percent of any class of listed shares of the other entity).[29] In sum, whereas the disclosure obligation under the current Regulation is limited to those entities which are also registered[30] and unregistered entities serving as the link between registered entities,[31] the Draft Amendments would demand disclosure of all associations, irrespective of whether they pertain to another entity registered in CITSS.

The Draft Amendments would amount to a significant new burden for CITSS registrants without any apparent countervailing benefit for CARB. By requiring the disclosure of *all* corporate associates, CITSS applicants will need to prepare extensive corporate organization analyses, even if the corporate associations that are disclosed to CARB have absolutely no bearing on the Cap-and-Trade Program. For entities with multiple corporate associates and complex ownership structures, this requirement would be extremely onerous. Moreover, the obligation to update this information in a timely fashion[32] and the consequences upon an entity's auction participation should any of this information change prior to an auction strongly suggests that the requirement is only likely to lead to errors in reporting and disqualification from auction participation,[33] even

[27] Cap-and-Trade Regulation § 95830(c)(1)(H) (emphasis added).

[28] Draft Amendments § 95830(c)(1)(H) (emphasis added).

[29] *Id.* § 95833(a)(1).

[30] Cap-and-Trade Regulation § 95830(c)(1)(H).

[31] *Id.* § 95833(d) (requiring disclosure of specific information for any "corporate, direct or indirect association with another registered entity or *an unregistered entity involved in* determinations made pursuant to 95833(a)(3), (4) or (5)") (emphasis added). The requirement to disclose unregistered entities "involved in determinations" under the enumerated paragraphs, while imprecisely worded, can be interpreted to mandate disclosure of, *inter alia*, an unregistered common parent linking two registered entities. It cannot, however, be interpreted to mandate disclosure of unregistered entities which do not serve as the connection between two registered entities under one of the enumerated paragraphs.

[32] *Id*. § 95833(e)(1) (requiring disclosure of any change in information disclosed on corporate associations within 30 days of the change).

[33] *See infra* at section II.G.

if the newly associated or disassociated entities have no involvement with the Cap-and-Trade Program.[34]

At the same time, it is unclear why CARB needs the information that it would acquire through this proposed amendment or what it will even do with the information, once it is acquired. Requiring the disclosure of every corporate association, no matter how unrelated to the Cap-and-Trade Program, would demand a significant amount of time and energy on the part of CITSS registrants without any benefit for CARB or the Cap-and-Trade market. Accordingly, Calpine urges CARB to retain the language in the Regulation that only requires the disclosure of those corporate associates which are also registered in CITSS or serve as the link between entities so registered.

F. The Proposed Employee, Advisor, and Contractor Disclosure Requirements Are Invasive and Unnecessary

The Draft Amendments would unreasonably expand the disclosure requirements with respect to employees, advisors, and contractors who have access to any information relating to Cap-and-Trade compliance. Calpine's concerns with these disclosure requirements are detailed below.

1. Employee Disclosure

Under the Draft Amendments, any entity applying for a CITSS account and any entity already registered in CITSS would need to identify the "[n]ames and contact information for all persons employed by the entity that will either have access to any information regarding compliance instruments, transactions, or holdings; or be involved in decisions regarding transactions or holding of compliance instruments; or both. An entity already registered in the tracking system must provide the notarized letter from their employer no later than January 31, 2015."[35]

It is unclear why CARB would need the identity of every person employed by a CITSS registrant who has access to "*any* information regarding compliance instruments, transactions, *or* holdings." (Emphasis added). This capacious language could conceivably include accountants, facility personnel, administrative personnel and attorneys who might have access to such information but do not make any executive decisions regarding the disposition of compliance instruments or any other aspect of Cap-and-Trade compliance. For large market participants,

[34] Consider, for example, what the expanded disclosure obligation would require with respect to a minority shareholder of a registered entity. Assuming that shareholder constitutes an "indirect corporate association" of the registered entity (e.g., a subsidiary of a bank which has invested in a registered entity/facility and controls more than 20% of that entity), the registered entity is now charged with understanding changes in corporate structure that might occur to another unregistered entity which controls its minority shareholder (e.g., the bank), even though it may not have access to information on such changes or reason to know of them. If such a change were to occur in the 30 days prior to an auction, as a result of the broader disclosure obligation, the registered entity would be deemed ineligible from the auction. *See* Draft Amendments § 95921(d)(5) (discussed *infra* at section II.G.).

[35] Draft Amendments § 95830(c)(1)(I).

this could include a significant number of individuals and, therefore, would amount to a burdensome requirement without any clear policy rationale that would justify the associated burden.

While the presentation given by CARB at the July 18, 2013 workshop only suggests such disclosure would be required with respect to employees who are themselves voluntarily associated entities ("VAEs"),[36] that is not what is provided by the Draft Amendments.[37] Rather, CARB requires reporting of *any* individual who may has access to information regarding compliance instruments, transactions or holdings; it will then presumably use these voluminous lists to run a "cross-check" against individuals seeking to register as VAEs, so as to enforce the proposed prohibition on employees with such information registering as VAEs.[38]

But the Draft Amendments would already require any individual seeking to register VAE who is also an employee of a covered entity to provide a notarized letter from her or his employee, stating that the employer is aware of its employee's plans and that the employer has conflict of interest policies and procedures in place to prevent the employee from misusing information obtained during the course of employment.[39] Given this obligation, it is unclear why CARB also needs to impose such an incredibly broad disclosure obligation on all registered entities with respect to all of their employees who may have access to any information regarding compliance instruments, transactions or holdings, even if such individuals are not involved in decisions regarding such transactions or holdings. Satisfying this requirement, as proposed, is very likely to result in entities in certain sectors disclosing nearly every employee, at risk of facing an enforcement action for underreporting if, for example, they should fail to disclose the identities of information technology personnel who maintain databases containing compliance instruments data. Further, the obligation to update this information within 10 days of any change[40] means that, to timely comply with the updating obligation, registrants will need to establish sophisticated systems to assure that any new employee who has access to such data or information is disclosed to CARB within 10 days.

In this respect, the Draft Amendments again reflect an apparent belief among CARB staff that more disclosure is better than less, even when the required response is likely to be so voluminous that it burdens the entity responsible for its submission and provides no apparent benefit to CARB. Calpine would urge CARB to rethink its approach in these respects and at the very least provide an explanation for how it intends to manage the voluminous information it expects to receive and what market abuses it intends to police through its receipt.

---

[36] *See* July 18, 2013 Workshop Presentation at slide 34 (only discussing the expanded employee disclosure obligation in the context of VAEs).

[37] Draft Amendments, § 95830(c)(1)(I).

[38] *Id*. § 95814(a)(6).

[39] *Id*. § 95814(a)(3).

[40] Cap-and-Trade Regulation § 95830(f)(1).

2. Auction Advisor Disclosure

The Regulation currently requires any auction participant that has retained the services of an advisor regarding auction bidding strategy to (A) ensure against the advisor transferring information to other auction participants or coordinating the bidding strategy among participants; (B) inform the advisor of the prohibition of sharing information with other auction participants and ensure the advisor has read and acknowledged the prohibition under penalty of perjury; and, (C) inform CARB of the advisor's retention.[41] These requirements are intended as a prophylactic measure to ensure that auction advisors do not share sensitive information with other market participants or otherwise serve as intermediaries for market collusion.

However, the Draft Amendments would go well beyond these current measures and potentially require the disclosure of protected information. The Draft Amendments would add to the existing disclosure obligation the following:

> 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; and
> 3. Assurance under penalty of perjury that advisor is not transferring to or otherwise sharing information with other auction participants.[42]

The proposed revisions to the auction advisor disclosure provision are unnecessary and incredibly intrusive. Calpine is particularly concerned with the proposed requirement that the advisor provide a "[d]escription of advisory services being performed."

Giving CARB the benefit of the doubt and applying a "rule of reason" to interpretation of the scope of the existing disclosure obligation, one could reasonably conclude that CARB could not possibly intend to require disclosure of, for example, attorneys who advise on the pending litigation regarding the Cap-and-Trade Regulation and how it might affect pricing in the allowance market. But, after reviewing CARB's proposed overly broad disclosure requirements for all employees having any access to information on compliance instruments and all contractors who advise in any respect with respect to compliance with the Cap-and-Trade Regulation,[43] no such rule of reason can be presumed.

We are concerned that the ill-defined term "an advisor regarding auction bidding strategy" could be interpreted as capaciously as CARB's other proposed disclosure requirements and, accordingly, require disclosure of even an attorney who is providing advice protected by the

[41] *Id.* § 95914(c)(2).

[42] Draft Amendments §§ 95914(c)(3)(C), (D).

[43] *See infra* at section II.F.3.

attorney-client privilege. Moreover, if so interpreted, requiring the "advisor" to provide a "[d]escription of advisory services being performed" would unavoidably amount to a violation of the attorney-client privilege, which is protected by statutory law in California[44] and which the attorney is sworn to uphold by the rules of the State Bar, at risk of disciplinary action.[45]

For these reasons, we would urge CARB not to broaden the disclosure requirement and, at the very least, to clarify that the intended disclosure is not intended as an intrusion on the attorney-client privilege. More generally, we would urge CARB to exercise restraint in introducing additional disclosure obligations to an already complex Regulation.

3. Cap-and-Trade Contractor Disclosure

The Draft Amendments would also create a new section regarding the disclosure of so-called "Cap-and-Trade Contractors". A Cap-and-Trade Contractor would be any contractor who, *inter alia*, "[a]dvises or consults with the entity regarding compliance with the Cap-and-Trade Program, and receives information from another registered Cap-and-Trade participant."[46] Unless already disclosed pursuant to the proposed expanded version of the auction advisor provision described above, an entity employing Cap-and-Trade Contractors must provide "[a] brief description of the work performed by the Contractor, to include information sufficient to explain the entity's evaluation of the measures contained in section 95923(a) used to determine the Contractor relationship."[47]

Much like CARB's proposed revisions to the auction advisor disclosure requirement, the new Cap-and-Trade Contractor disclosure requirement is overly broad and invasive. A multiplicity of outside consultants—including attorneys—could potentially advise or consult with the entity regarding compliance with the Cap-and-Trade Program and, thereby, be considered Cap-and-Trade Contractors for which the entity must disclose their work. Further, to require disclosure, such consultants need not receive information from another registered entity pertaining to the Cap-and-Trade Program, but must merely receive *any* information from another registered participant, even if unrelated to Cap-and-Trade compliance or strategy.

Again, the Draft Amendments could be interpreted to compel registered entities to waive the attorney-client privilege and disclose, not only the identity of their counsel, but the nature of work performed. This amounts to an intrusion on the attorney-client privilege, which CARB

---

[44] *See* Evidence Code § 954 ("…the client, whether or not a party, has a privilege to refuse to disclose, and to prevent another from disclosing, a confidential communication between client and lawyer if the privilege is claimed by: (a) The holder of the privilege; (b) A person who is authorized to claim the privilege by the holder of the privilege; or (c) The person who was the lawyer at the time of the confidential communication, but such person may not claim the privilege if there is no holder of the privilege in existence or if he is otherwise instructed by a person authorized to permit disclosure.").

[45] *See* California Rules of Professional Conduct, Rule 3-100 (Confidential Information of a Client).

[46] Draft Amendments § 95923(a)(1)(B).

[47] *Id.* § 95923(b)(2).

should not countenance, let alone compel, under threat of penalty. Therefore, Calpine urges CARB not to propose new section 95923 in the forthcoming 45-day amendment package.[48]

G. CARB Should Rethink Its Proposal to Deny Auction Participation Based on a Change to the Auction Application Information

The Regulation currently requires every auction participant to complete an auction participation application at least 30 days prior to each auction, providing information relating to the participant's corporate identity; the existence of corporate associations; any investigation with respect to any alleged violation of any rule, regulation, or law associated with any commodity, securities, or financial market; and, the participant's holding account number.[49] The Draft Amendments would revise and expand the categories of information (listed in section 95912(d)(4)) that must be disclosed in each auction participation application.[50]

Significantly, the Draft Amendments would also add a new provision whereby "[a]n entity with any changes to the auction application information listed in subsection 95912(d)(4) 30 days prior to an auction, or an entity whose auction application information will change 15 days after an auction, will be denied participation in the auction."[51]

This proposal is problematic for several reasons. First, how could an entity whose auction application information *will* change 15 days after an auction be denied participation in the auction, when the auction falls *before* the relevant change occurs? CARB is apparently mandating clairvoyance on the part of auction participants, requiring participants to foresee a change in, for example, the status of a legal investigation, before that change actually occurs.

There are innumerable situations where an auction participant will not be able to divine a change in the status of information relating to one of the section 95912(d)(4) categories before the change occurs. For instance, an entity's ownership or capital structure could change suddenly and without any advance notice. Another example is if a regulatory agency were to commence an investigation for an alleged violation of a regulation associated with a securities market, which the entity would not necessarily be able to foresee before the investigation was commenced.

When a stakeholder at the July 18, 2013 workshop raised the issue of how an entity would comply with this new requirement in a scenario where the change occurs *after* the auction, CARB staff provided a response to the effect that an applicant would only be denied

[48] Likewise, Calpine requests that CARB not propose the new CITSS registration requirement in draft section 95830(c)(1)(J), which would require a CITSS applicant to provide "[i]nformation required under section 95923 for individuals serving as consultants and bid advisors for entities participating in the Cap-and-Trade Program." Draft Amendments § 95830(c)(1)(J).

[49] Cap-and-Trade Regulation § 95912(d)(4).

[50] Draft Amendments § 95912(d)(4).

[51] *Id.* § 95912(d)(5).

participation in the auction if the change in status were foreseeable.[52] However, nothing in proposed section 95912(d)(5) provides that only foreseeable changes occurring after the auction will result in denial of participation. Even if there were a qualifier relating to the foreseeability of such changes in information, it is perfectly unclear who would determine whether the change was foreseeable and what standards would govern such a determination.

Finally, even if a change should occur within the 30 days prior to an auction to any of the information listed in subsection 95912(d)(4), Calpine believes it is unduly harsh to bar an entity from participation in the auction merely because some aspect of that information has changed. In fact, for entities with complex corporate structures and given the breadth of the proposed expansion of the disclosure obligation with respect to corporate associations, it may be nearly impossible to find a 30-day "blackout period" when no change in the identity of some indirect corporate association will occur.[53] Yet, under the Draft Amendments, such a change, no matter how small or inconsequential to one's status as an auction participant, would mandate disqualification from the forthcoming auction, even if the newly associated or disassociated entity had no relationship to or involvement in the Cap-and-Trade program.

Many large entities—due to the constraints of the auction purchase limit and holding limit—must participate in every quarterly auction of allowances to comply with the Cap-and-Trade Regulation. Punishing such entities by barring their participation in an auction for something that such entities cannot predict or control is unreasonable; excluding such entities from the auction may only result in market distortions. Accordingly, Calpine urges CARB to not propose section 95912(d)(5) as part of the forthcoming 45-day proposed amendments to the Regulation.

H. CARB Should Provide Covered Entities the Option to Specify Compliance Instrument Retirement Order & Not Otherwise Require the Forfeiture of Offset Credits

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 Draft Amendments would specify the order by which compliance instruments are retired, with offset credits being retired first. To meet the annual compliance obligation, CARB would retire offset credits first "without consideration of the quantitative usage limit set forth in section 95854."[54]

However, to satisfy the triennial compliance obligation, CARB would retire offset credits first "subject to the quantitative usage limit"[55] and "[i]f an entity used any offsets to meet its annual timely surrender pursuant to section 95856(d) and the cumulative offsets retired by the Executive

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

[53] *See* discussion *supra* at note 34.

[54] Draft Amendments § 95856(h)(1)(A).

[55] *Id.* § 95856(h)(2)(A).

Officer exceed the quantitative usage limit pursuant to section 95854 at the time of the triennial timely surrender pursuant to section 95856(f), the offsets already retired will remain in the Retirement Account and the entity must ensure they it has sufficient compliance instruments other than offsets to meet its triennial timely surrender pursuant to section 95856(e)."[56]

It is unclear what the Draft Amendments mean by "the offsets already retired will remain in the Retirement Account." CARB previously proposed pre-draft language whereby such over-surrendered offsets would be "excluded".[57] In response to this proposal, we argued that such over-surrendered offsets should not be extinguished, especially in the case where the covered entity had sufficient allowances of the appropriate vintage in its compliance account as of the surrender deadline for the triennial compliance obligation and could have fully met that compliance obligation without exceeding the quantitative usage limit, were it not for the mandatory retirement order imposed by CARB.[58]

To the extent that CARB's proposal is for over-surrendered offsets to "remain" in the Retirement Account and not be available in a subsequent compliance period to satisfy the compliance obligation of the entity from which they were taken, we renew our request to have such over-surrendered offsets returned to the entity's compliance account or remain in the retirement account, but be credited against future compliance obligations. The Regulation provides no authority for CARB to force the retirement of offsets in excess of the quantitative usage limitation, with no application of them to any compliance obligation and without otherwise returning their value to the entity in whose account they were located.

Additionally, Calpine supports 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 workshop.[59] If CARB were to keep the proposed retirement order as a backstop mechanism in the event that a covered entity does not specify the compliance instruments it would like to retire, Calpine nevertheless urges CARB to not extinguish over-surrendered offsets and instead return them to the entity's compliance account or credit them against future compliance obligations.

---

[56] *Id.* § 95856(h)(4).

[57] *See* CARB, Presentation re: Cap-and-Trade Workshop Compliance & Information Requirements, at 12 (June 25, 2013), *available at*: http://www.arb.ca.gov/cc/capandtrade/meetings/062513/arb-cr-mrr-present.pdf.

[58] Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Comments On The Public Workshop Regarding Cap-and-Trade Compliance & Information Requirements, at 8 (July 9, 2013), *available at*: http://www.arb.ca.gov/lists/com-attach/19-reportcostcontain-ws-BzVQZlJiUzMFLgk5.pdf.

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

III. CONCLUSION

CARB has done an admirable job in launching an unprecedented, economy-wide cap-and-trade program that is poised to serve as a model for other regional programs and play a role in California's satisfaction of any forthcoming federal obligations with respect to GHG reductions from the electric generating sector. However, in its implementation of a flexible compliance mechanism that relies upon market forces to achieve its goals, we would urge CARB not to saddle the compliance market with unduly burdensome administrative obligations. In particular, a number of the expanded disclosure obligations proposed by CARB would provide no apparent benefit in terms of increasing transparency or assuring the sound functioning of the carbon markets. We would therefore urge CARB to rethink its approach and the apparent assumption that heightened disclosure will produce better information. Additionally, we encourage CARB to resolve some of the most pressing issues it was directed to address by its Board to assure smooth functioning of the market by proposing a complete solution to the legacy contract problem and by reassessing the auction purchase limit.

* * * *

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/

Kassandra Gough
Director, Government and Legislative Affairs

cc: Richard Corey, Executive Officer
Edie Chang, Assistant Division Chief, Stationary Source Division
Steven S. Cliff, Ph.D., Chief, Climate Change Program Evaluation Branch
Sean Donovan, Staff, Cap-and-Trade Program Monitoring
Ray Olsson, Lead Staff, Office of Climate Change
Rajinder Sahota, Manager, Program Monitoring Section, Office of Climate Change
Holly Geneva Stout, Esq., Senior Staff Counsel, Office of Legal Affairs
Jakub Zielkiewicz, Staff, Cap-and-Trade Program Monitoring