

October 22, 2013

**Comments of the Independent Energy Producers Association on
The Proposed Amendments to the Cap-and-Trade Program
Released September 4, 2013
&
The Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade
Released October 16, 2013**

The Independent Energy Producers Association (IEP) submits these comments on the California Air Resources Board's *Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Staff Report: Initial Statement of Reasons*, released September 4, 2013 and on the *Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade*, released October 16, 2013. IEP's comments focus primarily on CARB's proposal regarding "Legacy Contracts."

I. Legacy Contracts. Board Resolution 12-33 requires the CARB to provide "transition assistance to covered entities that have a compliance obligation cost that cannot be reasonably recovered due to a legacy contract."¹ Initially, in the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanisms Staff Report: Initial Statement of Reasons and Proposed Regulation Order ("Proposed Amendments"), CARB staff proposed the following bifurcated approach to address legacy contracts:

- 1. Provide Allowances to the Legacy Contract Generator for the Duration of the Contract By Adjusting Their Industrial Counterparty's Allocation:** For legacy contracts with industrial counterparties that are receiving a free allocation, CARB proposes to adjust the industrial counterparty's allocation and provide those allowances to the legacy contract generator.² Importantly, this approach would allocate allowances to the legacy contract generator for the entire length of the contract with the industrial counterparty.³
- 2. Provide Transition Assistance For the Remaining Legacy Contract Generators For The First Compliance Period.** For legacy contract generators where the counterparty is not an industrial entity receiving a free allocation (i.e. counterparties including IOUs, POUs, marketers, and industrial entities not receiving a free

¹ California Air Resources Board Resolution 12-33.

² Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Staff Report: Initial Statement of Reasons, Page 17

³ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 17

allocation) CARB proposed to provide transition assistance for the first compliance period (i.e. 2013 and 2014).⁴

Most recently, CARB released a *Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade* (“Revised Staff Proposal”) which extends the “transition assistance for legacy contracts that are not with an industrial counterparty through the second compliance period (i.e. through 2017) instead of ending after 2014.”⁵

First, IEP fully supports CARB’s proposal to provide relief to legacy contract generators with industrial counterparties that are receiving a free allocation. This approach is designed to provide allowances to the legacy contract generator for the entire duration of the contract.

Second, IEP supports the *Revised Staff Proposal For Legacy Contract Treatment in Cap-and-Trade* to provide transition assistance through 2017, rather than through 2014.

- a. IEP Supports CARB’s Revised Staff Proposal to Provide Transition Assistance Through 2017.** Unlike obligated entities that have a reasonable means for passing through the costs of their GHG compliance obligation, generators operating under Legacy Contracts, by definition, do not have a reasonable means of cost recovery for their AB 32 compliance obligation.

Legacy Contracts are defined as:

“a written contract or tolling agreement, originally executed prior to September 1, 2006, governing the sale of electricity and/or Legacy Contract Qualified Thermal Output at a price, determined by either a fixed price or price formula, *that does not provide for recovery of the costs associated with compliance with this regulation...*”⁶

CARB’s Revised Staff proposal to provide transition assistance to legacy contract generators through 2017 is a substantial improvement to addressing the compliance costs that cannot be reasonably recovered due to a pre-AB 32 legacy contract. **IEP recommends that the CARB Board approve the *Revised Staff Proposal for Legacy Contract Treatment in the Cap and Trade*. In addition, IEP agrees that it is appropriate to develop language to address the Revised Staff Proposal in a 15-day comment period following the October Board Meeting.**

- b. Extending the Transition Assistance Through 2017 is Appropriate Because Little Incentive Remains for Renegotiation.** In the Proposed Amendments, CARB indicates that its preferred approach for addressing legacy contracts is to let renegotiation between counterparties occur.⁷ While IEP agrees that the proposal to subtract allowances from the

⁴ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 18, 52.

⁵ Revised Staff Proposal for Legacy Contract Treatment in the Cap-and-Trade, released October 16, 2013.

⁶ Appendix E: Proposed Regulation Order, Section 95802(a)(195), emphasis added.

⁷ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 17

industrial counterparties receiving a free allocation and provide those allowances to the legacy contract generators *may* create an incentive for renegotiation among *these* counterparties; IEP is not convinced that limiting the transition assistance to the 2013-2014 time period for the remaining subset of legacy contract generators, as originally proposed, creates any new incentive to renegotiate; nor does it provide appropriate transition assistance for these generators in accordance with Board Resolution 12-33. Where the counterparty is 1) an IOU; 2) a POU; 3) a marketer; or 4) an industrial entity not receiving an allocation, no incentive exists to renegotiate.

There is no reason for any of the counterparties listed above to renegotiate with the legacy contract generators and begin paying for the GHG compliance costs that they currently receive for free. Meanwhile legacy contract holders are facing the real world implications of unrecoverable costs associated with their generation assets which lead to downgraded credit ratings, inability to finance debt, etc. As a result, it is very important that CARB's proposal to provide transition assistance through 2017 is adopted by the Board. Extending the sunset date for transition assistance from 2014 to 2017 helps tremendously generators subject to a legacy contract that by definition cannot recover the costs associated with greenhouse gas compliance.

- c. Resolving Legacy Contracts Does Not Create Perverse Incentives.** Some have suggested that providing transition assistance to the remaining legacy contract generators for the duration of their existing legacy contracts would create a perverse incentive in that “those who renegotiated could have received less favorable treatment than those who did not renegotiate.”⁸

As a practical matter, all generators with pre-AB 32 contracts without GHG cost recovery in a position to renegotiate their contracts did indeed renegotiate. These contracts should be presumed to be fairly balanced (otherwise they would not have been renegotiated) and no longer under CARB's purview for resolution.

For all other legacy contracts, CARB requires “an attestation under penalty of perjury under the laws of the state of California that... the legacy contract generator made a good faith effort, but was unable to renegotiate the legacy contract with the counterparty to address recovery of the costs of compliance with this regulation.”⁹ Hence, all legacy contract generators must show an attempt to renegotiate with their contract counterparties to qualify for transition assistance.

Given these requirements, it is clear that the legacy contracts that remain do not have alternative options available. They are relying on CARB to provide a comprehensive solution. CARB's proposal to aid legacy contracts that are still stranded, by extending the transition assistance through 2017, is helpful.

- d. It Is Important for CARB to Make Decisions Now Regarding How Allowances Will Be Allocated to Legacy Contract Generators in the Future.** IEP appreciates CARB's Revised Staff Proposal which takes action now to provide transition assistance to legacy

⁸ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 18.

⁹ Appendix E: Proposed Regulation Order, Section 95894(a)(3), page 158.

contract generators through 2017. In the Proposed Amendments, CARB proposes to allocate 2015 vintage allowances to legacy contract generators for transition assistance for 2013 and 2014 in part because there are no more 2013 or 2014 vintage allowances available to allocate for this purpose. Thus, it will be important for CARB to make decisions now regarding how allowances will be divvied up in the out years to be sure that sufficient allowances will be available to provide transition assistance through 2017.

IEP supports CARB staff's proposal to open up a subsequent 15-day comment period following the October Board hearing to refine language consistent with providing transition assistance through 2017. It is appropriate for CARB to address legacy contracts that extend beyond 2015 now rather than waiting until 2017 when the compliance instruments are due.

- e. **2015 Vintage Allowances Allocated to Legacy Contract Generators for 2013 and 2014 Should be Eligible for Use Prior to 2015.** CARB's Proposed Amendments seem to allow 2015 vintage allowances, allocated to legacy contract generators for 2013 and 2014 to be eligible for use prior to 2015.¹⁰ Specifically, staff proposes to allow "facilities to use up to the amount of true-up allowances provided for compliance obligation two years prior to the vintage of the allowances provided by the true-up."¹¹ However, there are some inconsistencies in the actual language in the Proposed Regulation Order that need to be corrected in order to ensure that entities that are eligible to use 2015 vintage allowances in this manner, are included.

Specifically, Section 95856(h)(3) indicates:

"An entity that is not eligible to receive true up allowances pursuant to section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), or 95894(d)(1), cannot use the current calendar year's vintage allowances or allowances allocated just before the current surrender deadline to meet the timely surrender of compliance instrument requirements in section 95856."¹²

In Section 95856(h)(3) above, it seems that CARB may have unintentionally excluded sections 95894(c)(1), 95894(c)(2), and 95894(d)(2) from the list. The entities described in 95894(c)(1), 95894(c)(2), and 95894(d)(2) are entities that qualify for a true-up and thus should be eligible to use 2015 vintage allowances prior to 2015 for compliance.

IEP recommends adding these three Sections to the list as described in Section 95856(h)(3). Corresponding changes should also be made in Section 95856(h)(1)(D) and 95856(h)(2)(D). All of these changes are necessary to clarify that entities receiving "true-up" allowances can fulfill their compliance obligation with allowances "allocated immediately

¹⁰ See Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 15, 16 & 142. Also See Appendix E: Proposed Regulation Order Section 95894(c) and Section 95894 (d).

¹¹ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 15.

¹² Proposed Regulation Order, Section 95856(h)(3).

before the current surrender deadline.”¹³ It is critical that generators have these allowances available for their use in demonstrating compliance during the first compliance period.

Proposed Regulatory Language:

Section 95856. Timely Surrender of Compliance Instruments by a Covered Entity:

(h)(1)(d) The current calendar year’s vintage allowances and allowances allocated just before the annual surrender deadline up to the True-up allowance amount as determined in sections 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), **95894(c)(1), 95894(c)(2)**, ~~95894(d)(1)~~, **or 95894(d)(2)** if an entity was eligible to receive true up allowances pursuant to section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), **95894(c)(1), 95894(c)(2)**, ~~95894(d)(1)~~, **or 95894(d)(2)**.

(h)(2)(D) The current calendar year’s vintage allowances and allowances allocated just before the triennial surrender deadline up to the true-up allowance amount as determined in section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), **95894(c)(1), 95894(c)(2)**, ~~95894(d)(1)~~, **or 95894(d)(2)** if an entity was eligible to receive true up allowances pursuant to section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), **95894(c)(1), 95894(c)(2)**, ~~95894(d)(1)~~, **or 95894(d)(2)**.

(h)(1)(3) An entity that is not eligible to receive true up allowances pursuant to section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), **95894(c)(1), 95894(c)(2)**, ~~95894(d)(1)~~, **or 95894(d)(2)**, cannot use the current calendar year’s vintage allowances or allowances allocated just before the current surrender deadline to meet the timely surrender of compliance instrument requirements in section 95856.

- f. 2013 Emissions Data Should Determine the Allowance Allocation Granted to Legacy Contract Generators for the 2013 and 2014 Transitional Period.** CARB is proposing to use 2012 emissions data to calculate the allocation that will be granted to legacy contract generators for the 2013 and 2014 transitional period.¹⁴ Given that the actual allocation will not occur until October 15, 2014, CARB should use 2013 emissions data, which will be reported and verified prior to the 2014 allocation date, to determine the amount of the allocation.

Using 2013 emissions data will more accurately represent the emissions for 2013 and 2014 because the information will be closer in time to the actual allocation in 2014. This is consistent with how CARB is proposing to determine the allocation for legacy contracts with industrial counterparties receiving a free allocation, which as IEP understands it, will use

¹³ Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 142.

¹⁴ See Appendix E: Proposed Regulation Order, Sections 95894(d)(1) and 95894(d)(2).

2013 emissions data for determining the allocation granted in 2014.¹⁵ Accordingly, IEP recommends using 2013 emissions data for determining the allocation for the transition assistance granted for 2013 and 2014.

II. Other Comments Associated with the Proposed Changes to the Cap and Trade Regulation.

- a. **IEP Supports the Creation of a Limited Exemption Holding Account.** The Limited Exemption Holding Account will be a temporary holding area for entities that qualify for an allocation under Section 95870.¹⁶ The Limited Exemption Holding Account is designed to hold future vintage allowances that are directly allocated to entities, like legacy contract generators, where a violation of the holding limit might otherwise occur.¹⁷

IEP supports this proposal and agrees that the Limited Exemption Holding Account is needed to avoid potentially placing entities subject to a direct allocation in violation of the holding limit.

- b. **Allocations to Natural Gas Suppliers Should Be Appropriately Tracked and Monitored.** Natural gas suppliers may also own, operate, and develop electric generation assets in competition with independent power producers (IPPs). Accordingly, any freely allocated allowances to these utilities on behalf of their natural gas interests, must be tracked, monitored, and accounted for by an appropriate regulatory agency such as the CPUC. CARB must be mindful that these allowances (or their intrinsic value) could be reattributed in a manner that inappropriately creates competitive advantage, an outcome that to date CARB has steadfastly opposed.

Going forward, the regulatory agencies should not delegate to the utilities the responsibility for managing how those allowances or their value are distributed. Rather, CARB and the California Public Utilities Commission (CPUC) should require proper oversight, and ensure that these allowances are fully tracked and monitored in terms of their use while subject to appropriate regulatory oversight.

IEP appreciates the opportunity to comment on CARB's *Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanisms Staff Report: Initial Statement of Reasons* and on the *Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade*.

¹⁵ See Appendix E: Proposed Regulation Order, Sections 95894(c)(1) and 95894(c)(2).

¹⁶ See Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 108 and Appendix E: Proposed Regulation Order, Section 95831(a)(6).

¹⁷ See Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms. Staff Report: Initial Statement of Reasons, Page 108, 109 and Appendix E: Proposed Regulation Order, Section 95831(a)(6).

Respectfully Submitted,



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