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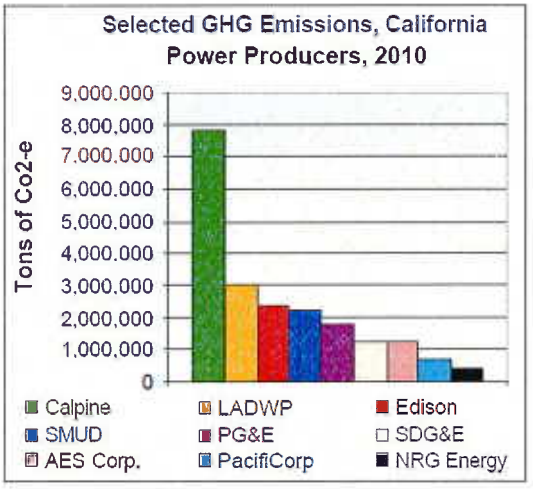
By Electronic Submission
(http://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtrade2012&comm_period=A; http://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtradelinkage12&comm_period=A)

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

Re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Madame Chairman:

Since 2001, Calpine Corporation ("Calpine") has invested over $6 billion in California to become the state's largest independent power producer, the state's largest provider of renewable energy, and owner of the state's largest and most efficient fleet of combined heat and power ("CHP") and cogeneration facilities. Because of the size of our fleet, the Cap-and-Trade Program Regulation (Cal. Code Reg., tit. 17, §§ 95800 *et seq.*) ("Regulation") will uniquely affect Calpine. Although we will receive no free allocation of allowances, Calpine has by far the largest compliance obligation of any power roducer y in California, as illustrated by the chart below.[1]



Fossil-fuel sources below 25,000 metric tons of CO_2-equivalent each year, and geothermal and biomass emissions, were excluded from the data.
Source: CARB 2010 emissions reporting data.

[1] *California Energy Markets*, Energy NewsData Corp., Mar. 2, 2012, No. 1170, at 8.

It is through this lens that Calpine offers comments on the California Air Resources Board's ("CARB" or the "Board") Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms ("Clean-Up Amendments")[2] and 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 Jurisdictions ("Linkage Amendments").[3] Calpine's detailed written comments on both the Clean-Up Amendments and Linkage Amendments are enclosed as Attachment A.

Again, because of Calpine's sheer size and the fact that it is not receiving any free allowances, the Regulation places unique stresses on Calpine. As CARB is well aware, Calpine has been and remains a supporter of carbon regulation and a well-designed cap-and-trade regulation. However, the proposed amendments are flawed and unfortunately would only make the current Regulation worse. Calpine recommends the following changes to the Clean-Up Amendments (as detailed in Attachment A):

- Beneficial Holding Relationships: CARB should revise, not delete, the beneficial holdings provisions so that allowances held by a utility on a generator's behalf count against the holding limit of neither the utility nor the generator. *At a bare minimum, the Board should not adopt proposed section 95921(f)(1), which would prohibit more conduct than beneficial holdings alone.*
- Holding Limits: CARB should *not* apply the holding limit during the first compliance period (2013-2014) to any covered entity or direct corporate association whose annual compliance obligation exceeds the holding limit.
- Auction Purchase Limits: The proposed current vintage auction purchase limit of 40% for electrical distribution utilities should likewise apply to all covered entities whose compliance obligations are greater than the allowance holding limit.
- Resource Shuffling: The Board should narrow the resource shuffling definition and provide detailed guidance to covered entities regarding the scope of the resource shuffling prohibition.
- Know-Your-Customer Requirements: CARB should revise the "Know-Your Customer" requirements to make them less intrusive.
- "Days" versus "Business Days": References to "days" in the Clean-Up Amendments (and the Regulation) should be revised to "business days."

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[2] CARB, Proposed Regulation Order - Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms, *available at*: http://www.arb.ca.gov/regact/2012/capandtrade12/appendixa2.pdf.

[3] CARB, Proposed Regulation Order - 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, *available at*: http://www.arb.ca.gov/regact/2012/capandtrade12/appendixa2.pdf.

- The August 2012 "Practice" Auction: CARB should clarify the parameters of the August 2012 "practice" auction in order for it to serve as a model for the first real auction of allowances in November 2012.

Calpine has raised a number of these issues in previous comments and provided workable solutions to outstanding regulatory deficiencies. Particularly regarding the beneficial holdings, holding limit, and auction purchase limit issues, CARB has failed to explain how the Regulation (or, the proposed amendments) is superior to Calpine's proposed solutions or why Calpine's proposed changes would impair the environmental and economic success of the Regulation. Calpine would note that AB 32 creates a continuing duty for CARB to (1) achieve maximum cost-effective reductions in GHG emissions[4] and (2) rely upon the best available economic and scientific information in adopting the Regulation.[5] CARB Staff, in proposing the Clean-Up Amendments, has ignored the clear directive of the state Legislature: the proposal would *raise* the cost of GHG emissions reductions (thus, not maximizing cost-effective emissions reductions) and Staff does *not* rely upon the best available information in formulating the amendments.[6] Both Staff and the Board, however, still have this opportunity to correct course and produce a sensible Regulation prior to the commencement of the first compliance period.

Should the Board decide to proceed with linkage at this time, Calpine recommends the following change to the Linkage Amendments (as detailed in Attachment A):

- Measured Relief for Generators: Quebec's Regulation appropriately provides a free allowance allocation to generators subject to fixed-price electricity contracts, as well as for cogenerators selling steam to third-parties. In contrast, CARB's Regulation provides *no* relief to generators subject to long-term contracts. CARB should adopt Quebec's approach to mitigate the Regulation's severe impact on generators. Alternatively, for entities receiving an allocation for industrial assistance who will experience no increase in their energy costs due to a pre-AB 32 contract, CARB should shift the allowance allocation from these entities to their contracted generators.

Calpine has raised the issue of the Regulation's treatment of generators subject to long-term contracts in previous comments and provided workable solutions to this problem. While CARB has recognized that it would be unfair to provide a direct allocation to steam hosts that will experience no increase in their energy costs due to a fixed-price contract with a CHP generator that provides no mechanism for recovery of GHG costs,[7] CARB has sidestepped this issue by arguing that generators and steam hosts should renegotiate their contracts to address GHG cost

[4] *See* Health and Safety Code § 38562(c).

[5] *See id.* § 38562(e).

[6] *See, e.g.*, Attachment A, section II.B.1. CARB Staff inappropriately relied upon only one report by a consultant to the Western Climate Initiative ("WCI") Markets Committee in defending the Regulation's holding limits. However, this report concludes that holding limits should *not* apply to entities with compliance obligations, and that holding limits in other market contexts *exempt* entities engaged in the market for *bona fide* hedging purposes.

[7] California's Cap-and-Trade Program: Final Statement of Reasons ("FSOR"), 655.

responsibility. However, a number of Calpine's contracts with steam hosts will not expire for years and steam hosts have no incentive to renegotiate these contracts before the contract term expires. CARB's failure either to provide a direct allocation to the CHP generator or, alternatively, to deny the free allowance allocation to the steam hosts in these circumstances is plainly unfair.

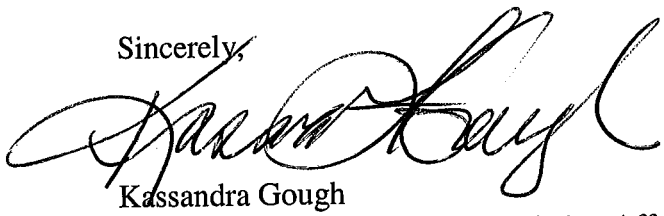
Finally, Calpine is aware that CARB intends for the Regulation to (1) serve as a model for other jurisdictions to adopt Cap-and-Trade systems[8] and (2) spur other U.S. states and Canadian provinces to join the Western Climate Initiative ("WCI") and link to California's Cap-and-Trade Program. It has been Calpine's hope and desire that these goals would be realized sooner rather than later. Therefore, Calpine strongly urges that the Regulation be amended to address these outstanding issues prior to the first auction of allowances in November 2012; failure to adopt such amendments diminishes the prospects that other jurisdictions will consider the Regulation a sound model for carbon regulation and may deter potential WCI partners from linking with California's Cap-and-Trade Program.

* * * *

Understanding that CARB Staff may be focused on implementation issues, we remain ready – as we have – to discuss our proposed improvements to the Regulation. Please feel free to contact me with any questions or concerns regarding the attached comments.

Thank you for the opportunity to submit the attached comments.

Sincerely,



Kassandra Gough
Director, Government and Legislative Affairs

cc: James Goldstene, Executive Officer
Edie Chang, Chief, Planning and Management Branch, Office of Climate Change

[8] *See, e.g.*, Q & A with Mary Nichols, Chairman of the California Air Resources Board (Mar. 7 2012), *available at*: http://environment.yale.edu/envirocenter/post/qa-with-mary-nichols-chairman-of-the-california-air-resources-board/ (Chairman Nichols stated that AB 32 was intended, in part, to build support for national carbon regulation and CARB would prefer to be operating under a national cap-and-trade program).

Steven S. Cliff, Ph.D., Chief, Climate Change Markets Branch, Office of Climate Change
Ray Olsson, Lead Staff, Office of Climate Change
Claudia Orlando, Air Pollution Specialist, Office of Climate Change
Rajinder Sahota, Manager, Market Monitoring, Office of Climate Change
Holly Geneva Stout, Esq., Senior Staff Counsel, Office of Legal Affairs

ATTACHMENT A – CALPINE COMMENTS ON PROPOSED AMENDMENTS TO THE CALIFORNIA CAP ON GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE MECHANISMS AND 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 JURISDICTIONS

I. SUMMARY – THE PROPOSED CLEAN-UP AND LINKAGE AMENDMENTS CONTAIN SEVERAL FLAWS THAT NEED TO BE RESOLVED PRIOR TO THE FIRST AUCTION OF ALLOWANCES

Calpine has consistently argued for pragmatic, cost-effective, and environmentally-sound changes to the Regulation. CARB has thus far not heeded these recommendations, and has failed to explain the basis for rejecting Calpine's proposed solutions. CARB still has this opportunity to make the proposed amendments, and the Regulation, better. We urge CARB, therefore, to reconsider the proposed Clean-Up and Linkage Amendments and make the following changes:

- CARB should revise, rather than delete, the beneficial holdings provisions so that allowances held by a utility on a generator's behalf count against the holding limit of neither the utility nor the generator, as long as they were promptly transferred to the generator's compliance account.
    - Alternatively, if the Board removes the beneficial holdings provisions from the Regulation entirely, the Clean-Up Amendments' petition procedure for expanding the limited exemption from the allowance holding limit should be amended, so that it also authorizes the Executive Officer to increase a utility's limited exemption by the number of allowances purchased and held on behalf of contracted generators.
    - Finally, if the Board does nothing else, it should *not* adopt proposed section 95921(f)(1), which would prohibit more conduct than beneficial holdings alone.
- Because serious questions remain about the impact that a one-size-fits-all holding limit will have on the largest covered entities, CARB should not apply the holding limit during the first compliance period (2013-2014) to any covered entity or direct corporate association whose annual compliance obligation exceeds the holding limit. Additionally, the Board should amend the proposed holding limit calculation for future vintage allowances purchased at advance auctions and the holding limit penalty provisions.
- The Clean-Up Amendments' proposed current vintage auction purchase limit of 40% for electrical distribution utilities (rather than the 15% auction purchase limit that applies to covered entities generally) should likewise be applied to *all* covered entities whose compliance obligations are greater than the allowance holding limit. Anything less would be anathema to fundamental fairness. The Board should also amend the advance auction purchase limit for future vintage allowances.

- The Clean-Up Amendments fail to clarify the meaning of "resource shuffling" and CARB Staff recently indicated that it will provide only "limited guidance regarding what is not resource shuffling."[1] The Board should amend the resource shuffling definition and provide detailed guidance to covered entities regarding the scope of the resource shuffling prohibition.
- The Clean-Up Amendments' "Know-Your Customer" requirements would intrude on private, sensitive information. CARB should revise these requirements so that they are less intrusive.
- References to "days" in the Clean-Up Amendments (and Regulation) should be revised to "business days" to avoid administrative confusion and ensure that regulators and entities are operating under the same set of assumptions with respect to regulatory deadlines.
- CARB should clarify the parameters of the August 2012 "practice" auction in order for it to serve as a model for the first real auction of allowances in November 2012.
- CARB should adopt the Linkage Amendments and, in so doing, include appropriate revisions to provide electricity generators subject to long-term contracts that provide no mechanism for recovery of allowance costs with a direct allocation of allowances.

II. DISCUSSION

A. The Beneficial Holding Relationship Provisions Should Be Retained And Amended

The Clean-Up Amendments would delete the beneficial holding relationships provisions wholesale.[2] In proposing this change, CARB Staff states that it "determined that the provisions compromised market monitoring efforts."[3] Staff noted that the beneficial holdings provisions were intended to address the allowance procurement context arising from long-term electricity contracts. However, because the beneficial holdings provisions "did not seem to resolve the keys issues with the electricity contracts, staff determined that the benefit of keeping these provisions was less than the cost of building them into the tracking system and monitoring for abuses."[4]

For such a significant change to the Regulation, CARB Staff does not adequately explain the basis for its proposal. First, CARB does not explain how exactly the beneficial holdings provisions would compromise market monitoring efforts. The Regulation requires that an entity, as part of a transfer request, report the holding account number and authorized representative of the entity for whom a compliance instrument is to be held in benefit prior to the tracking system

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[1] CARB, Presentation, "Cap-and-Trade Program Electricity Workshop" at 23, May 4, 2012 ("Electricity Workshop Presentation"), *available at*: http://www.arb.ca.gov/cc/capandtrade/meetings/050412/may4electricityppt.pdf.

[2] *See generally* Clean-Up Amendments (deleting all references to beneficial holding relationships).

[3] ISOR at 26.

[4] *Id.* at 146.

recording any transfer of allowances.[5] If the Compliance Instrument Tracking System Service ("CITSS"), as currently designed, cannot account for the information associated with beneficial holdings, then covered entities will have little confidence that such a system will be able to track other market transactions. In addition to the proposal below, CARB should work with stakeholders to identify the market monitoring concerns associated with beneficial holdings and improve the CITSS.

Second, CARB does not elaborate on the "key issues" that the beneficial holdings provisions failed to solve. Previously, Calpine indeed recommended that the Regulation be amended so that the allowances held by a utility on a generator's behalf not count against the holding limit of either the utility or the generator, provided the generator confirms that it will transfer the allowances to a compliance account within three days of receipt of such allowances from the utility.[6] Calpine never suggested that this outstanding issue warrants deleting the beneficial holdings provisions in their entirety.

Finally, CARB does not even attempt to provide an alternative mechanism for addressing the unique allowance procurement context arising from long-term electricity contracts. If the benefit of the beneficial holdings provisions is less than their cost, as CARB Staff asserts, then the solution is to improve these provisions or construct a workable alternative, not delete the provisions entirely. The Clean-Up Amendments would leave investor-owned utilities ("IOUs") and generators in a much worse position than the Regulation would.

As Calpine recommended in its April 13, 2012 comments, CARB should retain, *but revise*, the beneficial holdings provisions so that allowances held by a utility on the generator's behalf count against the holding limit of neither the utility nor the generator.[7] Alternatively, if CARB removes the beneficial holdings provisions from the Regulation, the Clean-Up Amendments' holding limit exemption petition procedure should be expanded, so that it also authorizes CARB to increase an IOU's limited exemption by the number of allowances purchased and held on behalf of contracted generators. Finally, at the very least, CARB should delete proposed section 95921(f)(1), which could prohibit much more lawful conduct than CARB Staff intended.

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[5] Regulation § 95921(c)(7).

[6] *See* 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, September 27, 2011 ("September 2011 Comments"), 6, *available at*: http://www.arb.ca.gov/lists/capandtrade10/1658-9-27-2011_calpine_comments_re_proposed_15day_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, February 17, 2012 ("February 2012 Comments"), 7, *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.

[7] *See* 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, April 13, 2012 ("April 2012 Comments"), 2, *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.

These proposals are described in more detail below.

1. CARB Should Amend The Beneficial Holdings Provisions To Provide That The Holdings Do Not Count Against The Holding Limit Of The Agent Or The Principal

Given the burdens caused by the holding limit,[8] CARB needs to ensure that the largest covered entities have an adequate means of procuring the allowances they will need to meet their compliance obligations and, in the case of the IOUs, that they can also procure allowances on behalf of their contracted generators. While the beneficial holdings provisions need improvement, they at least account for the unique dynamic between IOUs and generators in long-term electricity contracts.

Absent the beneficial holdings provisions, the IOUs may have no means to procure allowances on behalf of both their own generating resources and unaffiliated generators for which the IOUs have contractual dispatch rights, especially in light of the Clean-Up Amendments' proposed section 95921(f)(1).[9] The utilities could decide that, for those contracts where the utility has the right to either procure allowances or reimburse the generator for its own allowance procurement costs, it would procure no allowances. The generator would then be required to procure allowances, which would likely result in inefficient allowance procurement decisions because IOUs are in a better position to accurately estimate which generating units will be dispatched to meet demand based on their relative thermal efficiency, cost, and GHG emissions.

This problem would be compounded by the 15% auction purchase limit for covered entities. The auction purchase limit effectively forces large covered entities, like Calpine, to participate in every auction. Combined with the deletion of the beneficial holdings provisions, the auction purchase limit incents large covered entities to place bids at levels assured to exceed the auction clearing price, which could artificially raise the clearing price for all auction participants. The end result is a suboptimal carbon market and higher allowance prices, which will then be passed onto California consumers in the price of goods and services.

For these reasons, removal of the beneficial holding relationship provisions—absent an alternate mechanism for IOUs to procure allowances on behalf of contracted generators—will severely hinder the proper functioning of the allowance market. Rather than remove the beneficial

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[8] *See* Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed Regulation to Implement the California Cap-and-Trade Program, December 9, 2010 ("December 2010 Comments"), 16, *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, August 11, 2011 ("August 2011 Comments"), 6-7, *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; September 2011 Comments, 3-4; February 2012 Comments, 3-6; April 2012 Comments, 8-10.

[9] This subsection appears to prevent an entity from ever purchasing allowances that could later be transferred to the holding account of a counterparty to an electricity contract. *See* Section II.A.3 below for discussion on this issue.

holdings provisions completely, Calpine proposes that the existing beneficial holding provisions be restored, with amendments so that the allowances held by a utility on a generator's behalf count against the holding limit of neither the utility nor the generator, so long as the generator confirms that it will transfer the allowances to its compliance account within three days of receipt of such allowances from the utility.[10] Specifically, Calpine proposes that the existing Regulation's beneficial holding relationships provisions be retained, with the following modifications:

§ 95834. Disclosure of Beneficial Holding Relationships.

. . .

(b) Disclosure of Beneficial Holding.

. . .

(4) In the case of an electric distribution utility holding allowances on behalf of a second registered entity with whom it has a contract for the delivery of electricity pursuant to section 95834(a)(3), such allowances will not count against the holding limit of either the electric distribution utility or the second registered entity, so long as the second registered entity confirms upon submitting the confirmation required by section 95834(b)(2) that it will transfer the allowances to a compliance account within three (3) business days of receipt from the utility.

2. Alternatively, CARB Should Expand The Petition Procedure For Adjusting The Limited Exemption To The Holding Limit In Order To Alleviate The Harsh Result Of Deleting The Beneficial Holdings Provisions

The Clean-Up Amendments propose a new process, whereby a covered entity can petition the Executive Officer ("EO") to adjust the limited exemption to the holding limit based on evidence of an increase in emissions over the previous year.[11] If CARB does not retain the beneficial holding provisions with appropriate revisions, as described above, Calpine would propose to expand upon the process provided by the Clean-Up Amendments, so that an electric utility could petition the EO to increase its limited exemption to the holding limit by the number of allowances the utility is holding on behalf of another covered entity with whom it has a contract for the delivery of electricity.

The purpose of the limited exemption is to assure that covered entities can obtain the number of allowances needed to assure compliance. As CARB Staff states in its rationale for the exemption petition procedure, "[t]he provisions are needed to deal with facilities that may experience an increase in emissions that would not be reflected in the limited exemption because the exemption

[10] *See* September 2011 Comments, 6; February 2012 Comments, 7.

[11] Clean-Up Amendments § 95920(d)(3).

is calculated on lagged emissions reports...The minimum increase is designed to limit the requests to increases that are so large that they could not be accommodated under the holding limit."[12]

Consistent with these goals, Calpine's proposal would appropriately amend the procedure for expanding the limited exemption, so that utilities could also procure allowances on behalf of contracted generators whose dispatch they control and for whom they have therefore agreed to assume financial responsibility for GHG emissions. If accepted by the EO, this petition would adjust the limited exemption, even though the allowances so held by the utility would not (and indeed could not) be transferred to its compliance account (given that they will ultimately be transferred to the generator actually subject to the compliance obligation).

§ 95920. Trading.

...

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

...

(1) The number given by the following formula

...

(2) A Limited Exemption from the Holding Limit is calculated as...

...

(3) Petition to Adjust the Limited Exemption.

(A) Prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating (1) an increase in emissions for that year over the previous year or (2) that the covered entity is an electric distribution utility holding allowances it has acquired on behalf of a second registered entity with whom it has a contract for the delivery of electricity and request a temporary increase in the limited exemption until verified data for that year are available. In the case of an electric distribution utility holding allowances on behalf of a second registered entity pursuant to § 95920(d)(3)(A)(2), the limited exemption shall include, upon the approval of the Executive Officer, the number of allowances that the utility has acquired on behalf of the second registered entity, regardless that the allowances will not be transferred to the electric distribution utility's compliance account, as would otherwise be required by § 95920(d)(2)(A) to qualify for the limited exemption.

[12] ISOR at 195.

3. Section 95921(f)(1) Would Be Unworkable And CARB Should Not Adopt It

The Clean-Up Amendments propose a new section 95921(f)(1), which states that "[a]n entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." CARB Staff states that the section "is modified to prohibit beneficial holdings" and that "[t]he change was needed to reflect the removal of all provisions allowing beneficial holding and to add an explicit prohibition of the practice."[13]

However, the proposal, on its face, 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) confirms that the agent (*i.e.*, the electrical distribution utility) is authorized to act on its behalf, the allowances held by the agent will count against the holding limit of the principal.[14] On the other hand, the proposed amendment would 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.

For instance, suppose an IOU acquires allowances and holds them in its own holding account pursuant to a contract with a generator for the future delivery of allowances proportional to the IOU's dispatch of the generator's units. Because the allowances are held in the IOU's holding account and count against the IOU's holding limit, this would no longer constitute a beneficial holding relationship. However, because the IOU and generator entered into the delivery contract, CARB might consider the IOU to be holding allowances "on behalf of" the generator in violation of the proposed section 95921(f)(1).[15]

The proposed section 95921(f)(1) creates an unworkable double-bind for utilities and their contracted generators. As Southern California Edison ("SCE") stated in its comments on this proposal, "[t]he deletion of the Beneficial Holding language, combined with draft language prohibiting an entity from "acquir[ing] allowances and hold[ing] them in its own holding account on behalf of another entity," appear to prevent electrical distribution utilities from *ever* purchasing allowances that could later be transferred to the holding accounts of counterparties in order to satisfy their indirect compliance obligations."[16]

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[13] ISOR at 206.

[14] Regulation § 95834(b)(3).

[15] Indeed, given that every utility has a specific mix of dispatch rights, any allowances that a utility acquires to transfer to contracted generators might be considered "on behalf of" the generators, even if the utility does not designate which allowances are intended to be transferred to which generators. CARB may argue, in this scenario, that the allowances are held on behalf of another entity, regardless of whether the other entity is specified at the time of the utility's acquisition or holding.

[16] *See* Letter from Jennifer Shigekawa and Nancy Allred, re: Comments of Southern California Edison Company on the Draft Amendments to the Cap-and-Trade Program to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions, April 13, 2012, 6, *available at:*

In this case, contracted generators would be forced to purchase allowances covering their entire compliance obligations. However, generators are in a much worse position in terms of estimating dispatch and, therefore, the allowances that they must acquire, leading to suboptimal purchase decisions and carbon market distortions.

Additionally, the likely annual compliance obligation for Calpine is greater than the holding limit. If Calpine were required to procure allowances covering its entire compliance obligation (because utilities cannot purchase allowances covering their indirect compliance obligations under section 95921(f)(1)), it likely would be forced to transfer millions of allowances to its compliance account, simply to comply with the holding limit. No other entity in California is so hampered by the Cap-and-Trade Program. As we have previously described and as described by the following section, this would essentially impose the same penalties CARB has reserved for bad actors upon Calpine for no other reason than its size in the California market.

Calpine recommends that the Board disapprove proposed section 95921(f)(1) when it considers the Clean-Up Amendments. Alternatively, Calpine supports the regulatory language suggested by SCE in its most recent comments.[17]

B. The Holding Limit Provisions Need To Be Reconsidered

Because significant questions remain about the impact that a one-size-fits-all holding limit will have on the largest covered entities, CARB should not apply the holding limit during the first compliance period (2013-2014) to any covered entity or entities linked by a direct corporate association whose annual compliance obligation exceeds the holding limit. Additionally, CARB needs to clarify the holding limit calculation for future vintage allowances purchased at advance auctions. Finally, CARB needs to amend the Clean-Up Amendments' penalty provisions vis-à-vis holding limit violations.

These proposals are described in greater detail below.

1. CARB Should Adopt An Interim Exemption To The Holding Limit For A Covered Entity or a Direct Corporate Association That Has A Compliance Obligation Greater Than The Holding Limit

Under AB 32, CARB must rely upon the best available economic and scientific information when adopting regulations to reduce GHG emissions.[18] Throughout the rulemaking, however, CARB Staff inappropriately relied upon a *single report* by a consultant to the Western Climate

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http://www.arb.ca.gov/lists/april-9-draft-reg-ws/15-2012-04-13_sce_comments_on_linkage_and_discussion_draft.pdf (emphasis added).

[17] *Id.* at 7 (proposing a new subsection 95921(f)(2): "This Section does not apply to any transfers that investor-owned electrical distribution utilities are required to make to satisfy their contractual obligations to supply compliance instruments to satisfy their counterparties' compliance obligations.").

[18] Health & Safety Code § 38562(e).

Initiative ("WCI") Markets Committee to conclude that holding limits are necessary to prevent market manipulation and that such limits are common in commodity markets.[19] As described in Calpine's previous comments,[20] the WCI Report concludes that the recommended holding limit should *not* apply to entities with compliance obligations, and that holding limits in other market contexts *exempt* entities engaged in the market for *bona fide* hedging purposes.[21] Thus, the WCI Report simply does not support the conclusion for which CARB relies upon it.

As we described during the Cap-and-Trade rulemaking,[22] the allowance holding limit would dramatically limit the ability of Calpine to fully utilize the flexibility mechanisms the Regulation otherwise provides to covered entities, including unlimited banking of allowances and three-year compliance periods. The holding limit also effectively increases the 30% annual surrender obligation in section 95855 for large entities because large entities *must* transfer allowances in excess of the holding limit from their holding account to their compliance account, both to avoid penalties and assure eligibility to participate in future auctions.[23] While the holding limit would severely hamper the compliance options for large covered entities, it would not achieve benefits that would otherwise justify its application to California's largest covered entities: the underlying concern of the holding limit—preventing market manipulation—is negligible from covered entities that have such large compliance obligations.[24]

Given the negative consequences that an unprecedented holding limit could have on the new allowance market, Calpine urges CARB to adopt an interim measure to protect large covered entities from the harsh results produced by the holding limit for the duration of the first compliance period; *i.e.*, until CARB has had an adequate opportunity to analyze the impacts of the holding limit on smaller entities who will not be so greatly constrained by it.

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[19] Proposed Regulation to Implement the California Cap-and-Trade Program, Staff Report: Initial Statement of Reasons, Summary of Section 95920(b)(3), IX-104; Jeffrey H. Harris, *Western Climate Initiative Markets Committee Report on Holding Limits* (2010) ("WCI Report").

[20] *See* February 2012 Comments, 4-5; April 2012 Comments, 8-9.

[21] WCI Report, 13, 17.

[22] *See* December 2010 Comments, 16; August 2011 Comments, 6-7; September 2011 Comments, 3-4.

[23] This *de facto* penalty on the largest covered entities will be compounded upon linkage to Quebec's cap-and-trade program, given that the Quebec regulation includes no annual surrender obligation. *See* Regulation respecting a cap-and-trade system for greenhouse gas allowances (hereinafter, "Quebec Regulation") §§ 20-21, *available at:* http://www.mddep.gouv.qc.ca/changements/carbone/reglementPEDE-en.pdf.

[24] Additionally, the risk of market manipulation from IOUs procuring allowances to reimburse contracted generators for the generators' GHG emissions resulting from electricity delivered to the utilities is similarly low. The California Public Utilities Commission ("CPUC") has imposed limitations on the IOUs' procurement of allowances, whereby the utilities are subject to both a Direct Compliance Obligation Purchase Limit and a Financial Exposure Purchase Limit. CPUC, Decision on System Track I Rules and Track III of the Long-Term Procurement Plan Proceeding and Approving Settlement, Decision 12-04-046, Apr. 24, 2012, at 54-59. The CPUC's procurement limitations will adequately ensure that the IOUs are not hoarding allowances, such that the holding limit should no longer be necessary to avoid market manipulation by the utilities.

Calpine's proposed revisions to the Clean-Up Amendments are as follows:

§ 95920. Trading.

...

(b) Application of the Holding Limit.

(1) The holding limit will apply to each entity registered as a covered, opt-in covered, or voluntarily associated entity pursuant to section 95830. However, during the first compliance period (2013-2014), the holding limit will not apply to a covered entity or a direct corporate association, as defined in section 95833(a)(2), that has a compliance obligation for each year greater than the holding limit for allowances of the corresponding vintage year.

Calpine also proposes corresponding revisions to sections 95920(f)(1)[25] and (3).[26]

This interim measure would avoid the worst impacts of the holding limit while providing CARB the opportunity to see how the holding limit—unprecedented in its inclusion in a GHG emissions trading system—operates in practice. The proposal would not increase the risk of market manipulation, as entities with compliance obligations greater than the holding limit will be buying allowances to comply with the Regulation, rather than to game the market. In essence, this proposal would effectuate the recommendation suggested by the one report upon which CARB purports to base the holding limit: it would provide an exemption for *legitimate hedging activities* of covered entities. Calpine urges CARB, therefore, to consider this prudent alternative to an across-the-board holding limit upon the commencement of the first compliance period in 2013.

2. CARB Must Clarify The Definition Of "Annual Allowance Budget" In Section 95920(e) To Indicate Which Budget Year Applies For The Future Vintage Holding Limit Calculation

CARB's March 30, 2012 "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" ("Discussion Draft") proposed that the holding limit for allowances purchased at the advance auction that have a vintage year greater than the current year would be

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[25] Regulation § 95920(f)(1) would read: "The total number of allowances held by a group of entities with a direct corporate association pursuant to section 95833 must sum to less than or equal to the holding limits pursuant to sections 95920(d) and (e), except a direct corporate association, as defined in section 95833(a)(2), that has a compliance obligation, during the first compliance period (2013-2014), for each year greater than the holding limit for allowances of the corresponding vintage year."

[26] Regulation § 95920(f)(3) would read: "Entities that are part of a direct corporate association that choose to opt out of account consolidation pursuant to section 95833(e)(3) must allocate shares of the holding limit among themselves, except in the case of a direct corporate association, as defined in section 95833(a)(2), that has a compliance obligation, during the first compliance period (2013-2014), for each year greater than the holding limit for allowances of the corresponding vintage year."

calculated for each vintage year separately according to the same formula that applies to current vintage allowances, using the current budget year for the "Annual Allowance Budget."[27] Calpine argued that using the current budget year for future vintage allowances would unduly restrict the holding limit for future vintage allowances purchased at advance auctions.[28]

The Clean-Up Amendments define "Annual Allowance Budget" as "the number of California GHG allowances issued for a budget year" rather than the current budget year.[29] The amendments do not indicate which budget year is used to determine the annual allowance budget. The Clean-Up Amendments, therefore, are unnecessarily vague regarding the budget year used to calculate the future vintage holding limit.

Calpine requests that CARB disapprove the Clean-Up Amendments' change to the holding limit calculation for future vintage allowances purchased at advance auctions and, in its place, proposes the following language:

§ 95920. Trading.

...

(e)

...

"Annual Allowance Budget" is the number of California GHG allowances issued for ~~a~~ the budget year~~.~~ for the year from which the allowances are purchased at advance auction.

3. CARB Should Amend The Holding Limit Penalty Provisions To Make Them Coherent

The Clean-Up Amendments propose that if an entity exceeds the holding limit (in the case that the violation is not discovered until after a transfer request is recorded or the holding limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage holding limit), then "[t]he accounts administrator will inform the violator"; and, "[t]he violator will have five business days to bring its account balances within the holding limit."[30] "After that, the Executive Officer may transfer allowances in excess of the holding limit to the Auction Holding Account for consignment to auction..."[31]

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[27] Discussion Draft § 95920(e).

[28] April 2012 Comments, 10, n. 16.

[29] Clean-Up Amendments § 95920(e).

[30] *Id.* § 95920(b)(5).

[31] *Id.*

Additionally, CARB may apply penalties "whenever the holding limit is exceeded or transfer requests are filed with the accounts administrator that would violate the holding limit."[32]

These proposed amendments should be clarified. First, CARB should indicate that the EO may only transfer allowances in excess of the holding limit to the Auction Holding Account if the violator remains in breach of the holding limit after the five business day period. Second, the subsection providing that "[p]enalties may be applied *whenever* the holding limit is exceeded or [noncompliant] transfer requests are filed" wholly contradicts the notice procedure and five business day safe harbor that immediately precedes this language. Thus, this subsection should be deleted.

§ 95920. Trading.

...

(b) Application of the Holding Limit.

...

(5) If the violation is not discovered until after a transfer request is recorded, or the holding limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage holding limit pursuant to section 95920(c)(1)(C), then:

(A) The accounts administrator will inform the violator; and

(B) The violator will have five business days to bring its account balances within the holding limit. ~~After that~~<u>If the violator does not bring its account balances into compliance after five business days</u>, the Executive Officer may transfer allowances in excess of the holding limit to the Auction Holding Account for consignment to auction pursuant to section 95910(d).

~~(6) Penalties may be applied whenever the holding limit is exceeded or transfer requests are filed with the accounts administrator that would violate the holding limit.~~

C. CARB Should Amend The Auction Purchase Limits To Equitably Treat Covered Entities

The purchase limits applicable to the auction of current vintage allowances should be 40% of the allowances offered for auction for covered entities and direct corporate associations that have

[32] *Id.* § 95920(b)(6).

compliance obligations greater than the corresponding holding limit. Additionally, the same purchase limit structure that Calpine is proposing here for current vintage allowances should apply to the advance auction of future vintage allowances.

Both of these proposals are described in greater detail below.

1. The Forty Percent Current Vintage Auction Purchase Limit Proposed For Electrical Distribution Utilities Should Equally Apply To Covered Entities With Compliance Obligations Greater Than The Corresponding Holding Limit

The Clean-Up Amendments would impose a forty (40) percent (%) auction purchase limit on electrical distribution utilities for auctions of current vintage allowances.[33] In imposing an auction purchase limit on utilities (compared to the Regulation, which exempts utilities from the auction purchase limit), CARB Staff explained that it "wants to ensure an equitable process for auctions [by] providing a purchase limit for all auction participants, but set the limit at 40 percent to recognize that electric utilities must consign their allowances and have large exposures to emissions obligations through electricity purchase contracts."[34]

If CARB Staff's rationale for imposing a 40% auction purchase limit on utilities (rather than the 15% auction purchase limit that applies to covered entities generally) is, in part, that utilities have large exposures to emissions obligations, then the 40% purchase limit should apply equally to all covered entities whose compliance obligations are greater than the allowance holding limit. This especially holds true in light of the proposed deletion of the beneficial holding relationship provisions and the Clean-Up Amendments' section 95921(f)(1), which would effectively bar utilities from ever purchasing allowances for contracted generators.

Calpine's direct compliance obligation will be greater than any of the IOUs.[35] Given CARB's willingness to accommodate the large compliance obligations of IOUs, Calpine recommends that CARB apply the same 40% auction purchase limit to other covered entities that have compliance obligations greater than the holding limit. Calpine therefore proposes the following changes to the Clean-Up Amendments:

§ 95911. Format for Auction of California GHG Allowances.

...

(d) Auction Purchase Limit.

...

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[33] *Id.* § 95911(d)(4)(B).

[34] ISOR at 161.

[35] *See* chart supra in cover letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, June 20, 2012, at 1.

(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 percent of the allowances offered for auction;

(B) The purchase limit for electrical distribution utilities and covered entities or direct corporate associations, as defined in section 95833(a)(2), that have compliance obligations greater than the corresponding holding limit will be 40 percent of the allowances offered for auction; and

(C) The purchase limit for all other auction participants is four percent of the allowances offered for auction.

The language in draft section 95914(d) ("Application of the Corporate Association to the Auction Purchase Limit") should likewise be amended to reflect this equitable change.[36]

Calpine's proposal would strike the right balance between preventing market manipulation by entities seeking to game the market, without imposing unworkable restrictions on entities with large compliance obligations (like IOUs and large generators) that are only attempting to comply with the Regulation. Calpine therefore urges CARB to apply the 40% auction purchase limit to non-IOU covered entities that have compliance obligations greater than the holding limit.

2. CARB Should Amend The Across-The-Board 25 Percent Auction Purchase Limit For The Advance Auction Of Future Vintage Allowances

For the advance auction of future vintage allowances, the purchase limit is 25 percent of the allowances offered for auction.[37] This limit applies equally to all entities, even those without compliance obligations. There is no principled reason for non-covered entities to be able to purchase 25% of future vintage allowances when these entities have no compliance obligations under the Regulation. The risk of market manipulation from these entities—ostensibly CARB's rationale for having an auction purchase limit in the first place—is acute, unlike the risk stemming from covered entities with large compliance obligations. Therefore, Calpine proposes that the auction purchase limit structure applicable to current vintage allowances likewise apply to the purchase limits for the advance auction of future vintage allowances:

§ 95911. Format for Auction of California GHG Allowances.

...

(d) Auction Purchase Limit.

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[36] Clean-Up Amendments § 95914(d)(3)(A) would read: "The total purchase limit for the association is 15 percent, unless some of the included covered entities are electrical distribution utilities or direct corporate associations, as defined in section 95833(a)(2), that have compliance obligations greater than the holding limit, in which case the purchase limit is 40 percent."

[37] *Id.* § 95911(d)(3).

...

(3) For the advance auction of future vintage allowances conducted pursuant to section 95910(c)(2): ~~the purchase limit is 25 percent of the allowances offered for auction.~~

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

(B) The purchase limit for electrical distribution utilities and covered entities or direct corporate associations, as defined in section 95833(a)(2), that have compliance obligations greater than the corresponding holding limit will be 40 percent of the allowances offered for auction; and

(C) The purchase limit for all other auction participants is four percent of the allowances offered for auction.

If CARB denies Calpine's recommendation, CARB should, at a minimum, apply a much lower limit for non-covered entities' purchase of future vintage allowances, just as it does for the current vintage purchase limit.

D. CARB Should Clarify The Scope Of The Resource Shuffling Prohibition

Resource shuffling is defined as "any plan, scheme, or artifice to achieve credit based on emissions reductions that have not occurred, involving delivery of electricity to the California grid."[38] Resource shuffling is prohibited by the Regulation and all first deliverers of electricity must submit annual attestations, wherein an individual represents, under penalty of perjury, that the company for which he or she is acting as agent, "has not engaged in the activity of resource shuffling to reduce compliance obligation for emissions, based on emission reductions that have not occurred as reported under [the Mandatory Reporting Rule ("MRR")]."[39]

In Resolution 11-32, the Board directed CARB to consider amendments to the "[d]efinition of Resource Shuffling to: (a) provide appropriate incentives for accelerated divestiture of high-emitting resources by recognizing that these divestitures can further the goals of AB 32; and (b) ensure changes in reported emissions from imported electricity that serves California do not result merely in a shift of emissions within the Western Electricity Coordinating Council region, but reduces overall emissions."[40] Despite the Board's directive, CARB Staff has made no changes to the resource shuffling definition in the Clean-Up Amendments. Rather, at the May 4, 2012 Public Meeting to Discuss Compliance Requirements for First Deliverers of Electricity in the Cap-and-Trade Program ("Electricity Workshop"), CARB Staff announced that its

[38] Regulation § 95802(a)(251).

[39] *Id.* § 95852(b)(2).

[40] CARB, Resolution 11-32 at 11.

measures for addressing resource shuffling would extend only to "provid[ing] *limited* guidance regarding what is not resource shuffling" and "work[ing] with stakeholders to help inform [them] whether specific actions constitute resource shuffling."[41]

Thus, the central problem remains that the resource shuffling definition is extremely vague and will create regulatory uncertainty in the electricity market.[42] This uncertainty arises from the conflict between the purpose of the Regulation and the resource shuffling definition. The underlying theory of the Cap-and-Trade Program is that pricing carbon will increase the costs of high-emitting generating sources, and thereby incentivize divestiture in these sources.[43] The rational market behavior of an electricity importer would be to purchase electricity from sources that emit less carbon, therefore. On the other hand, the resource shuffling definition may chill an electricity importer from importing from low-carbon resources because the Regulation requires that an electricity importer attest that its electricity market transactions do not constitute resource shuffling, despite the fact that CARB has not clarified the meaning of resource shuffling.

While CARB Staff indicated during the Electricity Workshop that market behavior in response to a carbon price signal would *not* be resource shuffling, the resource shuffling definition arguably encompasses otherwise lawful market behavior. The Electricity Workshop's cursory discussion of "examples" of prohibited (i.e., "Cherry Picking," "Facility Swapping," and "Laundering") and permissible (i.e., "[c]hanges in delivery of electricity pursuant to state or federal laws and regulations" and "[d]eliveries of emergency power")[44] conduct provides little comfort to covered entities: these examples are so conceptual that they do not flesh out the resource shuffling definition. (They certainly provide cold comfort to the individuals within corporations who are charged with executing the required attestations.)

Additionally, the Quebec Regulation contains *no* prohibition on resource shuffling. While it may not be prudent to delete the resource shuffling provisions wholesale, the Board can create a more coherent linkage with Quebec's ETS by shrinking the scope of the Regulation's resource shuffling prohibition.

To effectively link with Quebec's ETS and assure a smooth launch of the Cap-and-Trade Program, it is critical that CARB continue to engage with stakeholders to provide greater clarity regarding the contours of resource shuffling, prior to the beginning of the first compliance period. Calpine recommends, therefore, that CARB clarify the meaning of resource shuffling by (1) providing detailed regulatory guidance regarding the scope of the resource shuffling

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[41] Electricity Workshop Presentation at 23 (emphasis added).

[42] *See* Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Comments on Public Meeting to Discuss Compliance Requirements for First Deliverers of Electricity in the Cap-and-Trade Program, May 11, 2012, 3-4, *available at*: http://www.arb.ca.gov/lists/5-4-electricity-ws/6-5-11-2012_calpine_comments_on_public_meeting_-_first_deliverers_.pdf.

[43] FSOR, Response to Comment P-2, at 2307 ("[p]roper carbon pricing is the primary way in which the cap-and-trade program achieves emissions reductions.").

[44] Electricity Workshop Presentation at 24.

prohibition (including concrete examples of permissible market conduct and impermissible resource shuffling) and (2) amending the resource shuffling definition.

Calpine recommends the following change to the definition of resource shuffling, in order to clarify that the resource shuffling prohibition is not intended to deter the divestiture of high-emitting resources, as directed by CARB in Resolution 11-32, as well as the procurement of resources to fulfill any need created by this divestiture:

§ 95802. Definitions.

...

(251) "Resource Shuffling" means any plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid. Resource Shuffling does not include the accelerated divestiture of high-emitting resources (resources with emissions greater than the default emissions rate for unspecified power of 0.428 MT CO2e/MWh, as provided by MRR section 95111(b)(1)) and the procurement of electricity from generating resources that is needed to replace any divested resources.

E. CARB Should Amend The Unnecessarily Intrusive Know-Your-Customer Requirements

The Clean-Up Amendments propose extensive "Know-Your-Customer" requirements. Prior to the accounts administrator providing access to the tracking system to any individual (including any individual representing a covered entity),[45] the EO must determine that the individual has complied with the requirements, which includes the individual providing documentation of the individual's date of birth, a passport number or driver's license number, and an open bank account in the United States.[46]

Calpine is concerned that the Know-Your-Customer requirements are unduly intrusive. CARB is requesting that individuals representing covered entities produce a set of personal data that is sufficient for identity theft. If CARB proceeds with these requirements, Calpine requests that CARB explain, in detail, the safeguards it intends to create to prevent the submitted information for individuals representing covered entities from being compromised. Calpine takes seriously the obligation to safeguard its employees' personal information and seeks assurance from CARB that it will protect such information if needed to participate in the Cap-and-Trade Program.

F. The Regulation's References To "Day(s)" Should Be Changed To "Business Day(s)"

[45] ISOR at 147.

[46] Clean-Up Amendments §§ 95834(b)(3), (5), (6).

The Clean-Up Amendments (and Regulation) refer to deadlines using the terms (1) "day" or "days,"[47] (2) "calendar days,"[48] or (3) "working days."[49] There does not appear to be any rationale for CARB's differential use of these terms.

Calpine recommends that all references to "days" (as well as "calendar days" and "working days") be revised to "business days." Covered entities already operate on a business schedule, and the Program will operate more smoothly when there is a common understanding of deadlines. Indeed, CARB Staff uses the term "business days" in the Clean-Up Amendments' proposed penalty provision for violating the holding limit[50] and the Regulation uses the term in referring to the timing of allowance auctions.[51] The Board should similarly amend the Regulation's other references from "days" to "business days."

If CARB considers the administrative burden of amending all references to "days" in the Regulation too great, then Calpine requests that, at a minimum, CARB revise the "days" references in Clean-Up Amendment sections 95912(i) and 95921(a)(1) to "business days." These provisions, relating to providing a bid guarantee to the financial services administrator (section 95912(i)) and transfers of compliance instruments between accounts (section 95921(a)(1) or the "push-push-pull approach"), pertain to financial transactions, where the *lingua franca* is "business days." It is especially important that the term "business days" be used in these transactional contexts, therefore.

G. CARB Needs To Specify The Contours Of The "Practice" Auction In Order For It To Successfully Serve As A Model For The First Real Auction In November 2012

The Clean-Up Amendments strike the Regulation's reference to the August 15, 2012 allowance auction.[52] CARB has indicated that the August 2012 auction will now be a "practice auction" without any real consequences.[53]

Calpine urges CARB to structure the practice auction in a manner that best reflect the first real auction of allowances in November 2012. At a minimum, CARB should (1) provide the appropriate number of practice allowances, (2) enforce auction purchase and holding limits, and

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[47] *See, e.g., id.* § 95833(e)(3) (an entity must disclose a corporate association within 30 days of a change to the information).

[48] *See, e.g., id.* § 95921(h)(1) ("Holders of exchange clearing holding accounts must make the transaction records available to ARB within 10 calendar days of a request").

[49] *See, e.g., id.* § 95830(f)(1) ("Registrants must update their registration information within 10 working days of changes").

[50] *Id.* § 95920(b)(5) (any violator of the holding limit "will have five business days to bring its account balances within the holding limit").

[51] *Id.* § 95910(a)(2).

[52] *Id.* § 95910(a)(1).

[53] *See, e.g.,* CARB – Auction Information, http://www.arb.ca.gov/cc/capandtrade/auction/auction.htm.

(3) ensure that CITSS is properly functioning. Additionally, CARB Staff should produce the planned Instructional Guidance Document for the allowance auctions as soon as possible.

In the event that the August 2012 practice auction is unsuccessful to any degree, Calpine recommends that CARB have a contingency plan for the intervening period between August 2012 and the first real auction on November 14, 2012. All stakeholders hope to have a seamless auction experience both in August and November 2012, and CARB should take the appropriate measures to ensure this occurs.

H. CARB Should Revise The Linkage Amendments To Provide Appropriate Relief To Electricity Generators Subject To Long-Term, Fixed-Price Contracts

Despite the fact that the Quebec Regulation provides for an allocation of allowances to generators for fixed-price electric power contracts executed before January 1, 2008,[54] neither the Linkage Amendments, nor the Clean-Up Amendments would provide *any* relief to generators subject to long-term contracts that provide no mechanism for recovery of allowance costs. Calpine has worked diligently with its counterparties to renegotiate contracts where possible; however, a number of remaining fixed-price contracts provide no opportunity for renegotiation.[55]

As suggested by Calpine previously, CARB should amend the Regulation to provide a direct allocation of allowances to generators subject to long-term contracts that provide no mechanism for recovery of allowance costs only until such time as the existing contract expires or is substantively amended.[56] Consideration of the Linkage Amendments provides an appropriate opportunity for the Board to address this outstanding issue because the Quebec Regulation does indeed provide a free allowance allocation to generators subject to fixed-price electricity contracts. California cogeneration facilities should be treated equally vis-à-vis their Quebec counterparts, and the most reasonable way to achieve equitable treatment is for CARB to provide a direct allocation of allowances to generators subject to these long-term contracts.

At the very least, the Linkage Amendments should be revised prior to Board approval so that, where entities receiving an allocation for industrial assistance will experience no increase in their

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[54] *See* Quebec Regulation, App. C, Pt. 1, Table A (providing for eligibility for an allocation without charge for "[e]lectric power generation sold under a contract signed prior to 1 January 2008, that has not been renewed or extended after that date, in which the sale price is fixed for the duration of the contract, with no possibility of adjusting the price to take into account the costs relating to the implementation of a cap-and-trade system for greenhouse gas emission allowances" and for sale of steam for industrial purposes).

[55] Calpine disputes the suggestion made by CARB Staff in the Final Statement of Reasons that these contracts reflected the risk of GHG regulation. *See* FSOR, Response to Comment I-50, 2153 ("[g]enerally, we believe contract negotiation discussions included which party would bear future costs, and the price agreed upon in the contract reflected this risk."). Contrary to CARB Staff's suggestion, Calpine's long-term contracts to supply steam from its CHP facilities were negotiated as early as the 1980's—well before a program to regulate carbon emissions was ever contemplated.

[56] *See* December 2010 Comments, 3-10; August 2011 Comments, 10-12; September 2011 Comments, 7-9; February 2012 Comments, 9-11.

energy costs due to a pre-AB 32 contract, the allowances will be awarded, not to that entity, but to its counterparty instead. CARB Staff held out the prospect of such a rulemaking upon finalizing the Regulation, saying CARB is "still considering withholding allowances from [energy-intensive/trade exposed steam hosts] that do not face carbon costs in cases where long-term contracts prevent thermal energy sellers from recovering these costs."[57] Calpine strongly encourages the Board to adopt such a change (in the event the Board does not provide for a direct allocation of allowances to generators) as part of its consideration of the Linkage Amendments. There can be no principled reason why a counterparty who will experience no increase in its energy costs due to a fixed-price contract with a CHP facility should receive a windfall in the form of a direct allocation of allowances. Given the Board's direction to Staff to address this issue, absent a change in the Regulation at this time, we would urge CARB to enjoin the deposit of allowances into the account of any counterparty poised to experience such a windfall.

This truly may be the last opportunity for CARB to address this outstanding deficiency before the first allocation of allowances for industry assistance on or before November 1, 2012 for the 2013 annual allowance budget allocation.[58] We urge CARB to act now to avoid this fast-approaching problem.

[57] FSOR, Response to Comment I-104, 655.

[58] *See* Regulation § 95870(e)(1).