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By *Electronic Submission*: <http://www.arb.ca.gov/lispub/comm/bclist.php>

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 to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

Dear Madame Chairman:

Calpine Corporation (hereinafter, “Calpine”) appreciates the opportunity to provide these written comments on the California Air Resources Board’s (“CARB” or the “Board”) January 8, 2013 Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information (“Linkage Notice”) regarding the 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”).¹

Introduction and Background.

Calpine congratulates CARB on completing the work that needed to be done to conduct the first auction of allowances under the Cap-and-Trade Program Regulation (Cal. Code Reg., tit. 17, §§ 95800 et seq.) (“California Regulation”) in November 2012 and begin implementing the first compliance period on January 1 of this year. Calpine also commends the Québec Ministry of Sustainable Development, Environment, Wildlife and Parks for its promulgation of the Regulation Respecting a Cap-and-Trade System for Greenhouse Gas Emission Allowances (“Québec Regulation”).² Calpine supports the goal of establishing a broad national or regional greenhouse gas (“GHG”) emissions trading program and looks forward to development of such a program in the near future. However, Calpine remains concerned with certain deficiencies within the California Regulation, the impact of which may only be amplified by the proposed Linkage Amendments.

¹ CARB, Proposed Modified 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/capandtrade12/2nd15dayattachment1.pdf>.

² The Quebec Regulation was formally amended on December 19, 2012 by Decree No. 1184-2012. *See* Québec Official Gazette, Part 2, number 51, p. 3485 (Dec. 19, 2012) (English version).

The California Legislature enacted SB 1018 in June 2012³, which established procedures governing any decision to link market-based compliance programs under AB 32 with a program in another jurisdiction. Under SB 1018, prior to linking the California Regulation with any other cap-and-trade program, CARB must notify the Governor, who then has 45 days in which to make (or decline to make) four specified findings which are to be submitted to the Legislature. The Board directed CARB staff to formally request that the Governor make the required findings regarding the Québec Regulation and provide those findings to the Legislature.⁴

The Linkage Notice states that it provides support for CARB's future request that the Governor make the SB 1018 findings and indicates that certain documents are added to the record, which will, in turn, be provided to the Governor along with the comments that CARB receives on the Linkage Amendments.⁵ Among those documents is a CARB analysis of the findings required by SB 1018.⁶ The SB 1018 Analysis outlines CARB's rationale for its plan to request that the Governor make the required SB 1018 findings. Of the four required findings, the most relevant for present purposes relates to program equivalency.⁷ CARB staff states that all four findings, including the one relating to program equivalency, are satisfied and, accordingly, recommends that the Governor make the SB 1018 findings.⁸

In light of CARB's determination that the Québec Regulation and California Regulation are equivalent for SB 1018 purposes, Calpine offers the following specific comments relating to program equivalency.⁹

Legacy Fixed-Price Contracts.

The SB 1018 Analysis states that "[t]he California and Québec program regulations include identical features to ensure the efficacy of the emissions cap and to facilitate fair and equitable

³ The SB 1018 provisions were codified in section 12894 of the Government Code.

⁴ See CARB, Board Resolution 12-28, at 2 (June 28, 2012).

⁵ Linkage Notice, at 2.

⁶ See CARB, Discussion of Findings Required by Government Code section 12894 (Jan. 2013), available at: <http://www.arb.ca.gov/regact/2012/capandtrade12/2nd15dayatta6.pdf> (hereinafter, "SB 1018 Analysis").

⁷ Gov't Code § 12894(f)(1) ("A state agency, including, but not limited to, the State Air Resources Board, shall not link a market-based compliance mechanism...with any other state, province, or country unless the state agency notifies the Governor that the agency intends to take such action and the Governor, acting in his or her independent capacity, makes [] the following finding[]...The jurisdiction with which the state agency proposes to link has adopted program requirements for greenhouse gas reductions, including, but not limited to, requirements for offsets, that are equivalent to or stricter than [California's].").

⁸ SB 1018 Analysis, at 12.

⁹ See Linkage Notice, at 8 (providing that written comments will be accepted on the documents identified as being added to the record, including, *inter alia*, the SB 1018 Analysis).

access to an efficient market for compliance instruments.”¹⁰ However, despite the fact that the Québec Regulation provides for an allocation of allowances to generators for fixed-price electric power contracts executed before January 1, 2008,¹¹ the California Regulation still provides no relief to generators subject to long-term contracts that provide no mechanism for recovery of GHG allowance costs. Calpine has worked diligently with its counterparties to renegotiate contracts where possible; however, a number of remaining fixed-price contracts cannot be renegotiated.¹²

Calpine maintains that CARB should amend the California 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.¹³ The need for such amendments is only underscored by the proposed linkage with Québec. Similarly situated covered entities should not be subject to such disparate treatment within linked programs, as exemplified by Québec’s allocation of allowances to legacy contract generators and the California Regulation’s allocation of none to the same.

We look forward to CARB’s fulfillment of its commitment to address the legacy contract issue, as reflected by Board Resolution 12-33 (requiring CARB staff “to develop a methodology that provides transition assistance to covered entities that have a compliance obligation cost that

¹⁰ SB 1018 Analysis, at 4.

¹¹ See Quebec Regulation § 39 (“An emitter operating a covered establishment and pursuing an activity referred to in Table A of Part I of Appendix C is eligible for the allocation of emission units without charge.”); see also *id.*, 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).

¹² In this regard, Calpine disputes the suggestion made by CARB Staff in the Final Statement of Reasons (“FSOR”) for the California Regulation that these contracts reflected the risk of GHG regulation. See, e.g., FSOR, Response to Comment I-50, at 2153. Calpine’s long-term contracts to supply steam from its combined heat and power (“CHP”) facilities were negotiated as early as the 1980’s—long before a program to regulate GHG emissions was ever contemplated.

¹³ See, e.g., 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: 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 (“June 2012 Comments”).

cannot be reasonably recovered due to a legacy contract” and “return to the Board with proposed regulatory amendments in mid-2013.”¹⁴ To that end, CARB staff should move forward with development of a formal notice and proposal of appropriate regulatory amendments as soon as possible. Calpine looks forward to working with CARB staff to develop appropriate regulatory amendments that will resolve this issue at the earliest opportunity.

Auction Purchase Limits.

Calpine believes that linkage would best be served by aligning the auction purchase limits of the California and Québec Regulations and thereby resolving remaining fairness issues in California’s auction purchase limit, as CARB staff has been directed by the Board.¹⁵ We are glad CARB will be addressing this remaining concern with the California limit and look forward to its resolution as early as possible within 2013.

If conjoined, the California and Québec Regulations do not “facilitate fair and equitable access to an efficient market for compliance instruments.”¹⁶ In particular, the California Regulation establishes a 40 percent (%) auction purchase limit for electrical distribution utilities for the auction of current vintage allowances; a 15% limit for covered entities; and, a 4% limit for all other auction participants.¹⁷ For the advance auction of future vintage allowances, the auction purchase limit is 25% for all entities.¹⁸

In contrast, under the Québec Regulations, entities scheduled to receive a free allocation may only purchase up to 15%, while those not receiving a free allocation may purchase up to 40% of the current vintage allowances.¹⁹ The Québec Regulations similarly provide a 4% limit on current vintage allowances for all other participants and a 25% limit on future vintage allowances for all participants.²⁰ Thus, under the Québec Regulations, covered entities, such as Calpine, who will not receive a free allocation could purchase up to 40% of current vintage allowances available.

Calpine believes the contrast between the California and Québec programs illustrates the inherent unfairness of holding a covered entity such as Calpine, which needs to purchase all the allowances it needs to comply, to a 15% purchase limit, while the electrical distribution utilities which are often its largest customers and competitors can purchase more than two and half times that amount. This denies Calpine the flexibility the Regulation affords to the utilities to decide

¹⁴ CARB, Board Resolution 12-33, at 3 (Sep. 20, 2012).

¹⁵ *See id.*

¹⁶ SB 1018 Analysis, at 4.

¹⁷ California Regulation § 95911(d)(4).

¹⁸ *Id.* § 95911(d)(3).

¹⁹ *See* Quebec Regulations, Section 50, subparagraphs (1) and (2) of third paragraph.

²⁰ *Id.*, Section 50, subparagraph (4) of third paragraph; fourth paragraph.

when and whether to participate in auctions: To obtain all the allowances it will need to meet its compliance obligation for the first compliance period from the auctions, Calpine would need to participate in every auction and submit high enough bids to assure it was awarded nearly as many allowances as it could purchase without exceeding the 15% limit.

In recognition of the fairness concerns posed by this issue, the Board has directed CARB 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 regulation was designed to provide all covered entities."²¹ We are glad the Board has provided this direction to CARB staff and look forward to CARB's fulfillment of its commitment to propose appropriate amendments.

While linked programs need not be identical, linkage would best be served by aligning the auction purchase limits of the California and Québec Regulations for those covered entities which are not receiving a free allocation of allowances. Accordingly, the current vintage auction purchase for such covered entities in the California Regulation should be increased to 40%. This would make the auction purchase limit provisions more equitable, both as between covered entities in linked jurisdictions and as between generators such as Calpine and its customers and competitors (the electrical distribution utilities). We would urge CARB staff to develop appropriate amendments as early as possible in 2013, so they can be finalized prior to holding the first joint auction.

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Please feel free to contact me with any questions or concerns regarding these comments.
Thank you for the opportunity to submit these comments.

Sincerely,



Kassandra Gough
Director, Government and Legislative Affairs

cc: James Goldstene, Executive Officer
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²¹ CARB, Board Resolution 12-33, at 3.