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May 21, 2013

*By Electronic Submission:*

[http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=may1-unilegbutforws&comm\\_period=1](http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=may1-unilegbutforws&comm_period=1)

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

Re: Comments on CARB Staff Workshop regarding Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, "But For" CHP<sup>1</sup>, and Legacy Contracts

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") May 1, 2013 Staff Workshop regarding Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, "But For" CHP, and Legacy Contracts.

## I. INTRODUCTION AND SUMMARY OF COMMENTS

Calpine has been a longtime supporter of market-based solutions to reduce greenhouse gas ("GHG") emissions and congratulates CARB on successfully commencing implementation of the regulation entitled California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Cal. Code Reg. tit. 17, §§ 95800 *et seq.*, hereinafter, "Cap-and-Trade Regulation" or "Regulation"). Calpine also thanks CARB for conducting the May 1, 2013 workshop to address, *inter alia*, remaining deficiencies in the Regulation with respect to long-term contracts that provide no mechanism for recovery of Cap-and-Trade Regulation compliance costs (i.e., legacy contracts). Calpine has been an active participant throughout the rulemaking process for the Cap-and-Trade Regulation and, throughout the process, has repeatedly urged CARB to provide relief to CHP generators subject to legacy contracts.<sup>2</sup>

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<sup>1</sup> CHP refers to combined heat and power facilities.

<sup>2</sup> See Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed Regulation to Implement the California Cap-and-Trade Program, at 3-10 (Dec. 9, 2010), *available at*: [http://www.arb.ca.gov/lists/capandtrade10/253-carb\\_letter\\_re\\_cap-and-trade\\_20101209.pdf](http://www.arb.ca.gov/lists/capandtrade10/253-carb_letter_re_cap-and-trade_20101209.pdf) (hereinafter, "December 2010 Comments"); Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed 15-Day Modifications to the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, at 10-12 (Aug. 11, 2011), *available at*: [http://www.arb.ca.gov/lists/capandtrade10/1450-8-11-2011\\_calpine\\_comments\\_re\\_proposed\\_15-](http://www.arb.ca.gov/lists/capandtrade10/1450-8-11-2011_calpine_comments_re_proposed_15-)

As described in more detail below, Calpine provides the following comments on the legacy contract issues addressed during the workshop:

- CARB should adopt Option One because it would incentivize the most efficient legacy contract generators and is therefore consistent with the overall Program goals.
- CARB should not adopt Option Two because it would provide little to no relief for the most efficient legacy contract generators who also sell power and/or steam pursuant to contracts that allow for the recovery of GHG costs.
- Likewise, CARB should not adopt Option Three because, by excluding the electricity benchmark from the calculation, it would provide no incentive to promote efficient generation of power and is therefore inconsistent with CARB's overall approach to awarding allocations for industrial assistance.
- Finally, coverage of natural gas suppliers during the second and third compliance periods does not obviate the need to provide relief for legacy contract generators.

## II. BACKGROUND

As the operator of the largest fleet of CHP facilities in both California and the nation, Calpine has a strong interest in assuring that the Cap-and-Trade Regulation does not pose disincentives to existing and future investments in CHP, but rather promotes the Scoping Plan's goal of

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day modifications to proposed ca cap on ghg emissions.pdf; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Second Proposed 15-Day Amendments to the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, at 7-9 (Sep. 27, 2011), available at: <http://www.arb.ca.gov/lists/capandtrade10/1658-9-27-2011 calpine comments re proposed 15-day modifications to proposed ca cap on ghg emissions.pdf>; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Public Workshop to Discuss Linking the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation to Western Climate Initiative Jurisdictions, at 9-11 (Feb. 17, 2012), available at: <http://www.arb.ca.gov/lists/feb-3-link-wci-ws/7-2-17-2012 calpine comments re cap and trade workshop.pdf>; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Draft of Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions, at 12-14 (Apr. 13, 2012), available at: <http://www.arb.ca.gov/lists/april-9-draft-reg-ws/14-4-13-2012 calpine comments re draft amendments to ca cap on ghg emissions-linked jurisdictions.pdf>; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms, at 19-20 (June 21, 2012), available at: <http://www.arb.ca.gov/lists/capandtrade2012/9-6-21-2012 calpine comments re cap-and-trade.pdf>; Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments issued by Linked Jurisdiction, at 3-4 (Jan. 23, 2013), available at: <http://www.arb.ca.gov/lists/capandtradelinkage12/25-1-23-2013 calpine comments- linked jurisdictions.pdf>.

increasing reliance upon CHP to achieve the overall goals of the California Global Warming Solutions Act of 2006 (Assembly Bill (“AB”) 32).<sup>3</sup> As recognized by the Scoping Plan, CHP represents a highly efficient and low emissions alternative to meeting the energy needs of industry and consumers alike. It is in no small part due to Calpine’s leadership in CHP that a recent benchmarking report commissioned by the Natural Resources Defense Council and several investor groups and electric utilities recognizes Calpine as having one of the lowest emissions profiles for both GHG and criteria pollutants among the nation’s 100 largest power producers.<sup>4</sup>

In light of its investment in CHP in California, Calpine previously recommended that CARB amend the Regulation to provide a direct allocation of allowances to CHP generators subject to long-term contracts that provide no mechanism for recovery of allowance costs until such time as the existing contract expires or is substantively amended. Under Calpine’s proposed revisions to the Regulation, CARB would provide allowances to qualifying long-term contract generators based upon their emissions, as established by their most recent verified emissions report submitted to CARB pursuant to the Mandatory Reporting Rule (“MRR”).<sup>5</sup>

The prompt resolution of this issue is critically important to Calpine. Calpine is party to four contracts that were initially entered into well before the passage of AB 32—in most cases, *more than 25 years ago*—and, accordingly, do not contemplate the allocation of responsibility for paying for costs pursuant to the Cap-and-Trade Regulation associated with deliveries of electricity and/ or steam.<sup>6</sup> Each contract will expire at a different time subsequent to the commencement of the first compliance period on January 1, 2013 (i.e., 2014, 2016, 2018, and 2019). To date, Calpine has not been able to renegotiate its legacy contracts to allow for the pass-through of compliance costs associated with deliveries of electricity and/ or steam from

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<sup>3</sup> Climate Change Scoping Plan: A Framework for Change, CARB, 2008, 44 (recommending measure no. E-2, “Increase Combined Heat and Power Use by 30,000 GWh”).

<sup>4</sup> M. J. Bradley & Associates, (2013), *Benchmarking Air Emissions of the 100 Largest Electric Power Producers in the United States*; available at: <http://www.nrdc.org/air/pollution/benchmarking/files/benchmarking-2013.pdf> (analyzing 2011 power generation and emissions data among the 100 largest generators, which, combined, represent 86 percent of all power produced, and identifying Calpine as the tenth largest power producer overall and as having among the lowest emissions rates: 81, 79 and 72 out of all 100 producers for each of sulfur dioxide (“SO<sub>2</sub>”), nitrogen oxides (“NO<sub>x</sub>”) and carbon dioxide (“CO<sub>2</sub>”), respectively; and 81, 82 and 89 out of 100 for these same pollutants among fossil fuel fleets).

<sup>5</sup> December 2010 Comments at 5, 7.

<sup>6</sup> See Steam Purchase and Sale Contract between Olam West Coast, Inc. and Calpine Gilroy Cogen, L.P. (dated Jan. 20, 1986); Steam Purchase and Sale Contract between Rava Family Ltd. Partnership and Calpine King City Cogen, LLC (dated July 31, 1987); Cogeneration Project Development and Supply Agreement between Sunsweet Growers Inc. and Calpine Greenleaf, Inc. (dated April 15, 1988); Energy Purchase and Sale Agreement between USS-Posco Industries and Los Medanos Energy Center LLC (dated Dec. 21, 1998). All of Calpine’s legacy contracts, and amendments thereto, have previously been described in submittals to CARB.

Calpine's CHP facilities; this is notwithstanding the fact that some of them are receiving a free allocation of allowances for industrial assistance.

### III. CARB STAFF'S APPROACH TO LEGACY CONTRACTS

In the May 1, 2013 workshop, CARB staff proposed providing relief for generator counterparties subject to contracts entered into before AB 32.<sup>7</sup> CARB proposed allocating allowances to CHP facilities for the portion of emissions for which GHG costs cannot reasonably be passed through to the purchaser.<sup>8</sup> The basic formula to allocate such allowances would be  $A = MTCO_2e_{Elec, legacy} + MTCO_2e_{Steam, legacy}$ , where: A equals allowances allocated;  $MTCO_2e_{Elec, legacy}$  equals emissions associated with electricity sold without cost pass through; and  $MTCO_2e_{Steam, legacy}$  equals emissions associated with steam sold without cost pass through.<sup>9</sup>

CARB staff proposes three options for calculating the legacy contract allowance allocation. In summary, these options are:

- Option One: CARB would allocate allowances proportionate to the steam and electricity output pursuant to the legacy contract, using the Regulation's steam and electricity efficiency benchmarks to convert production into the appropriate allowance allocation. Option One includes a true-up to actual production.<sup>10</sup>
- Option Two: CARB would allocate allowances based on historic fuel usage associated with the legacy contract, adjusted for steam and electricity sales that are not subject to a legacy contract. Fuel usage, steam sales and electricity sales would each be multiplied by the appropriate benchmark in the Regulation (e.g., steam sales would be multiplied by the steam efficiency benchmark). The resulting allocation would be subject to no true-up.<sup>11</sup>
- Option Three: CARB would allocate allowances in proportion to the facility's emissions attributable to the megawatt-hours ("MWh") of electricity and millions of Btus ("MMBtus") of steam produced pursuant to the legacy contract. Under this approach, the steam efficiency benchmark would be used to calculate emissions resulting from steam

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<sup>7</sup> CARB, Presentation, Staff Workshop, Proposed Adjustments to the Cap-and-Trade Program's Treatment of Universities, "But For" CHP, and Legacy Contracts, at 21 (May 1, 2013), *available at*: <http://www.arb.ca.gov/cc/capandtrade/meetings/050113/final.pdf> ("Workshop Presentation").

<sup>8</sup> *Id.* at 23.

<sup>9</sup> *Id.* at 26.

<sup>10</sup> *Id.* at 28, 35.

<sup>11</sup> *Id.* at 31, 35. Calpine does not understand why neither of Options Two or Three would incorporate a true-up mechanism. Regardless of the formula and approach CARB should use to calculate the allocation for a particular budget year, any subsequent allocation should be adjusted based on actual generation of steam and electricity during the budget year for which an earlier allocation was provided.

production; however, the emissions from electricity would not be subject to the electricity benchmark.<sup>12, 13</sup>

CARB staff also indicated that, if a customer of non-reimbursed steam or electricity is receiving an industrial allocation, an adjustment would be made to the customer's allowance allocation during the true-up.<sup>14</sup>

#### IV. CALPINE SUPPORTS OPTION ONE FOR PROVIDING RELIEF TO GENERATORS SUBJECT TO LEGACY CONTRACTS

Calpine strongly supports Option One because it appropriately affords relief to efficient generating facilities subject to legacy contracts.

Calpine would propose minor clarifications to Option One to clarify how and when the calculation would be conducted and the "true-up" would occur. First, CARB has indicated that its current plan is to provide "[v]intage year 2015 allowances for 2013 and 2014 legacy contract emissions."<sup>15</sup> For each subsequent budget year, allowances would be provided from the corresponding budget year. To accomplish this, Calpine would propose two separate formulae: The first would allocate 2015 vintage allowances for 2013 and 2014 legacy contract emissions; and the second would allocate allowances for 2015-2020 legacy contract emissions and would also account for any over- or under-allocation in previous years.

Second, the Workshop Presentation does not indicate what data year will be used for calculating the steam and electricity output variables. Calpine recommends that the Option One formulae explicitly be based on the data from the year two years prior to the allocation year. Calpine believes that using actual data from the year two years prior to the budget year is the best approach because it would rely upon the most accurate and reliable data available from CHP generators subject to legacy contracts.<sup>16</sup>

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<sup>12</sup> *Id.* at 34, 36.

<sup>13</sup> The Workshop Presentation fails to indicate whether the Option 3 methodology would account for the cap decline as specified in Table 9-2 of the Regulation. Options 1 and 2 explicitly account for the cap decline factor. Presumably Option 3 would as well, in order to maintain the integrity of the emissions cap and ensure fairness between types of entities receiving free allowances pursuant to the Regulation.

<sup>14</sup> Workshop Presentation at 37.

<sup>15</sup> *Id.* at 23. While the Workshop Presentation does not specify which vintage allowances will be provided for 2015 and subsequent year emissions, we assume CARB intends that, for each budget year starting in 2015, the allocation will be made in allowances of the same vintage.

<sup>16</sup> For the allocation of 2015 vintage allowances for 2013 legacy contract emissions, our proposal would rely upon 2011 production data, rather than the most recent 2012 data, so as to maintain consistency for the true-up mechanism. *See infra* notes 18-19.

Finally, the Workshop Presentation indicates that Option One would include a true-up, but does not state how the true-up would be calculated.<sup>17</sup> Calpine recommends that the true-up mechanism be incorporated into the Option One formulae for legacy contract emissions that post-date 2014 (see second formula below). To maintain consistency and fairness throughout the Regulation, the true-up should reflect the same true-up mechanism already reflected by the Regulation's Product Output-Based Allocation Calculation Methodology.<sup>18</sup>

Accordingly, Calpine proposes the following calculation for allocating 2015 vintage allowances to generators for 2013 and 2014 legacy contract emissions:

$$A_{2015} = (O_{\text{Steam}, 2011} * B_{\text{Steam}} + O_{\text{Electricity}, 2011} * B_{\text{Electricity}}) * C_{2013} + (O_{\text{Steam}, 2012} * B_{\text{Steam}} + O_{\text{Electricity}, 2012} * B_{\text{Electricity}}) * C_{2014}.$$

Where:

"A<sub>2015</sub>" is the amount of California GHG allowances directly allocated to a generator subject to a legacy contract from budget year 2015 for 2013 and 2014 legacy contract emissions;

"O<sub>Steam, 2011</sub>" is the amount of steam sold pursuant to a legacy contract, measured in MMBtus, in calendar year 2011;

"B<sub>Steam</sub>" is the emissions efficiency benchmark per unit of steam, 0.06244 California GHG Allowances/MMBtu Steam;

"O<sub>Electricity, 2011</sub>" is the amount of electricity sold pursuant to a legacy contract, measured in MWhs, in calendar year 2011;

"B<sub>Electricity</sub>" is the emissions efficiency benchmark per unit of electricity, 0.431 California GHG Allowances/MWh;

"C<sub>2013</sub>" is the adjustment factor for budget year 2013 to account for the cap decline as specified in Table 9-2;

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<sup>17</sup> Workshop Presentation at 35.

<sup>18</sup> Regulation § 95891(b). Calpine bases the true-up portion of its proposed allocation methodology, in part, on the existing Product Output-Based Allocation Calculation Methodology. CARB explains that the true-up mechanism of the Product Output-Based Allocation Calculation Methodology "adjusts for any output in year t not properly accounted for in prior allocations (t-2 minus t-4). The true-up adds allowances if the actual output in a given year is higher than initially estimated. Conversely, allowances are withheld if initial output estimates were too high relative to actual values." See CARB, Final Statement of Reasons, California's Cap-and-Trade Program, at 1225 (Oct. 2011), available at: <http://www.arb.ca.gov/regact/2010/capandtrade10/fsor.pdf> ("FSOR").

“O<sub>Steam, 2012</sub>” is the amount of steam sold pursuant to a legacy contract, measured in MMBtus, in calendar year 2012;

“O<sub>Electricity, 2012</sub>” is the amount of electricity sold pursuant to a legacy contract, measured in MWhs, in calendar year 2012;

“C<sub>2014</sub>” is the adjustment factor for budget year 2014 to account for the cap decline as specified in Table 9-2.

Correspondingly, Calpine proposes the following calculation for allocating allowances to generators for 2015 and each subsequent year’s legacy contract emissions:

$$A_t = (O_{\text{Steam}, t-2} * B_{\text{Steam}} + O_{\text{Electricity}, t-2} * B_{\text{Electricity}}) * C_t - (O_{\text{Steam}, \text{trueup}} * B_{\text{Steam}} + O_{\text{Electricity}, \text{trueup}} * B_{\text{Electricity}}) * C_{t-2}.$$

Where:

“A<sub>t</sub>” is the amount of California GHG allowances directly allocated to a generator subject to a legacy contract from budget year “t”;

“t” is the budget year from which the direct allocation occurs;

“t-2” is the year two years prior to year “t”;

“t-4” is the year four years prior to year “t”;

“O<sub>Steam, t-2</sub>” is the amount of steam sold pursuant to a legacy contract, measured in MMBtus, in the year two years prior to year “t”;

“B<sub>Steam</sub>” is the emissions efficiency benchmark per unit of steam, 0.06244 California GHG Allowances/MMBtu Steam;

“O<sub>Electricity, t-2</sub>” is the amount of electricity sold pursuant to a legacy contract, measured in MWhs, in the year two years prior to year “t”;

“B<sub>Electricity</sub>” is the emissions efficiency benchmark per unit of electricity, 0.431 California GHG Allowances/MWh;

“C<sub>t</sub>” is the adjustment factor for budget year “t” to account for the cap decline as specified in Table 9-2;

“O<sub>Steam, trueup</sub>” adjusts for any steam sold pursuant to a legacy contract in year “t-2” not accurately accounted for in prior allocations. The Executive Officer will calculate this term using the difference between (1) the amount of steam sold pursuant to a legacy contract reported in data year “t-2” and (2) the amount of steam sold pursuant to a legacy contract reported in data year “t-4”;

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

“ $C_{t-2}$ ” is the adjustment factor for the budget year two years prior to year “t” to account for the cap decline as specified in Table 9-2.

Calpine believes Option One will best balance the goals of incentivizing efficient energy technologies and compensating CHP generators unable to renegotiate their legacy contracts. The true-up mechanism will also assure that providing the allocation based on historic operations does not result in any windfall to legacy contract generators.<sup>19</sup>

#### V. CARB SHOULD NOT ADOPT OPTION TWO OR OPTION THREE

Calpine strongly urges against the adoption of either Option Two or Option Three as the methodology for providing relief to legacy contract generators.

Option Two would allocate allowances based on historic fuel usage associated with the legacy contract, adjusted for steam and electricity sales that are not subject to a legacy contract.<sup>20</sup> Significantly, the way Option Two would accomplish this adjustment is by subtracting the emissions associated with steam and electricity sales made pursuant to non-legacy contracts (i.e., those sales for which the generator can recover its GHG costs), calculated using the steam and electricity benchmarks in the Regulation.<sup>21</sup> Because emissions attributable to non-legacy contract steam and electricity sales are *subtracted* from total emissions to derive the legacy contract allocation, Option Two would punish those generating resources whose emissions rates are lower than the steam or electricity benchmarks and who are also selling power pursuant to

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<sup>19</sup> CARB staff has indicated that it will provide “[v]intage year 2015 allowances for 2013 and 2014 legacy contract emissions.” Workshop Presentation at 23. While the Workshop Presentation does not state when allowances will be distributed for 2015 and subsequent year legacy contract emissions, presumably it would be on the same schedule as the Allocation to Industrial Covered Entities, whereby CARB allocates allowances on or before November 1 of each calendar year for allocations from the following year’s annual allowance budget. Regulation § 95870(e)(1). Accordingly, the allocation for 2015 legacy contract emissions should occur in 2014. According to the allocation and true-up allocation methodology proposed above, the allocation of 2015 allowances for 2015 steam or electricity emissions would be based on data from 2013. The corresponding true-up in 2015 allowances would be the difference in emissions occurring two years prior to the budget year and four years prior to the budget year (i.e., 2013 emissions minus 2011 emissions).

<sup>20</sup> Workshop Presentation at 31, 35.

<sup>21</sup> See Regulation § 95891(c). The Energy-Based Allocation Calculation Methodology actually defines the benchmarks according to the number of California GHG Allowances afforded per MMBtu or MWh. For purposes of the present discussion, the benchmarks are stated in terms of MTCO<sub>2</sub>e per MMBtu or MWh. A California GHG Allowance equals one MTCO<sub>2</sub>e.



non-legacy contracts. As a consequence, Option Two would afford little to no relief for the GHG costs associated with generating steam or electricity pursuant to its legacy contract. Indeed, according to our calculations, *Option Two could realistically result in a negative allowance allocation to a legacy contract generator who is also selling steam and/or power to the grid or other steam hosts, by virtue of the fact that the generator is highly efficient.* A result that would punish the most efficient CHP generators is contrary to both the intention behind awarding an allocation to legacy contract generators in the first place and the overall design and purpose of the Cap-and-Trade Regulation.<sup>22</sup> Accordingly, Option Two should be rejected.

While Option Three is preferable to Option Two (because it would not appear to result in a negative allocation under any conceivable scenario), it is still flawed and should likewise be rejected.

Option Three would employ the steam efficiency benchmark to calculate emissions resulting from steam production. However, the electricity benchmark would play no role in the allocation; rather, a CHP facility would receive allowances for the emissions associated with its pro rata electricity production pursuant to a legacy contract, regardless of the efficiency of the CHP facility.<sup>23</sup> As CARB staff notes, Option Three “[m]ay not incentivize plant efficiency.”<sup>24</sup> Indeed, Option Three would reward inefficient CHP facilities and could incentivize increased generation by some of the least efficient CHP generators. Eschewing any role for the electricity benchmark in the calculation would not only reward inefficiency, but would be inconsistent with CARB’s methodology for allocating allowances for industrial assistance. As a general principle, CARB should strive to apply allocation methodologies that send consistent price signals throughout covered sectors. Accordingly, Option Three fails to effectuate the Cap-and-Trade Regulation’s goals and should be rejected in favor of Option One.

## VI. INCLUSION OF NATURAL GAS DISTRIBUTION IN THE PROGRAM DURING THE SECOND AND THIRD COMPLIANCE PERIODS DOES NOT OBTAIN THE NEED FOR RELIEF FOR LEGACY CONTRACTS

CARB staff posed two questions in its discussion of legacy contracts. CARB staff queried: “[c]ould emissions be captured at the natural gas supplier in the second and third compliance periods?” and “[c]an generators recover costs based on increases in natural gas prices?”<sup>25</sup> While the rationale for asking these questions in this context is unclear, Calpine believes the answer to both is no.

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<sup>22</sup> FSOR at 1074-75 (“Cap-and-trade creates a price signal on fuels to drive long-term investment in cleaner fuels, encourage energy efficiency, and to do so in the most cost-effective manner.”).

<sup>23</sup> Workshop Presentation at 34.

<sup>24</sup> *Id.* at 36.

<sup>25</sup> *Id.* at 24.

To the extent these questions imply that GHG emissions may be accounted for, and allowances provided by, suppliers of natural gas during the second and third compliance periods and, as a consequence, no relief needs to be provided for legacy contract generators burning natural gas, Calpine would reject this implication. Suppliers of natural gas are responsible for the emissions resulting from combustion of all fuel delivered to end users in California, *except* fuel that is delivered to covered entities.<sup>26</sup> Because the CHP generators at issue here (i.e., those which would receive a free allocation for the compliance obligation associated with generation of steam and electricity pursuant to their legacy contracts) are all covered entities, suppliers of natural gas will not have a compliance obligation associated with deliveries of natural gas to legacy contract generators.<sup>27</sup> Accordingly, coverage of natural gas suppliers will not relieve legacy contract generators from the burden of the compliance obligation they cannot pass along to their customers during the second and third compliance periods.

Similarly, because natural gas suppliers will not be subject to a compliance obligation for deliveries to covered entities and legacy contract generators will not therefore be paying an embedded GHG cost for delivered natural gas in the second and third compliance periods, such generators would not be able to recover GHG costs from their customers based on any assumed increases in natural gas prices.<sup>28</sup>

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<sup>26</sup> Regulation § 95852(c). Specifically, CARB will “calculate the metric tons CO<sub>2</sub>e for which the supplier will be required to hold a compliance obligation based on the supplier’s reported emissions less ARB’s calculated emissions from deliveries to covered entities which are customers of the supplier.” *Id.* § 95852(c)(4).

<sup>27</sup> We assume that CARB’s questions in this respect did not mean to suggest such a radical revision of the Cap-and-Trade Regulation as to eliminate the compliance obligation for covered entities receiving natural gas from covered natural gas suppliers, and to shift that obligation to the suppliers of natural gas in the second and third compliance periods.

<sup>28</sup> While some argued during the rulemaking for the Cap-and-Trade Regulation that natural gas suppliers may, regardless of section 95852(c), embed the cost of GHG allowances in natural gas sales to covered entities, there is no evidence to support this contention. *See, e.g.*, FSOR at 1370-71 (comments of United Airlines). Although it is premature to speculate on the influence that coverage of natural gas suppliers will have on natural gas prices and the products available in the commodities markets during the second and third compliance periods, presumably, spot and forward contracts for the sale of natural gas either will or will not reflect GHG costs depending upon whether the contract is for sale to a covered entity or another downstream recipient (contrary to one commenter’s hypothesis). *See id.* at 2038 (comments of Northern California Power Agency).

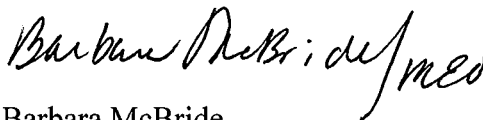
The only conceivable situation whereby the natural gas supplier might pass through its GHG costs would be if it were delivering gas, not to the covered entity, but to the steam host instead. *See* Regulation § 95852(c)(4) (CARB will “calculate the metric tons CO<sub>2</sub>e for which the supplier will be required to hold a compliance obligation based on the supplier’s reported emissions *less ARB’s calculated emissions from deliveries to covered entities which are customers of the supplier*”) (emphasis added). This might conceivably occur if, for example, a legacy contract generator and steam host were counterparties to a legacy contract whereby the steam host was responsible for procuring the natural gas and then redelivering it to the covered entity for combustion. Because the covered entity in this scenario would not

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Please feel free to contact me at 925.557.2238 or [Barbara.McBride@calpine.com](mailto:Barbara.McBride@calpine.com) with any questions or concerns regarding these comments. Thank you for the opportunity to submit these comments.

Sincerely,



Barbara McBride  
Director, Environmental Services – Western Region

cc: Richard Corey, Executive Officer  
Claudia Orlando, Air Pollution Specialist, Office of Climate Change  
Edie Chang, Assistant Division Chief, Stationary Source Division  
Steven S. Cliff, Ph.D., Chief, Climate Change Program Evaluation Branch  
Ray Olsson, Lead Staff, Office of Climate Change  
Rajinder Sahota, Manager, Program Monitoring Section, Office of Climate Change  
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be a “customer[] of the supplier”, the natural gas supplier would still be responsible for the compliance obligation associated with its delivery to the steam host; the supplier would then presumably pass through the associated GHG costs in the price of natural gas delivered, resulting in either the steam host incurring such costs or the generator essentially bearing twice the GHG costs associated with the gas burned (depending upon how the legacy contract was structured).

However, such a scenario is wholly speculative and Calpine is neither subject to, nor aware of the existence of, any such legacy contract, whereby the steam host was responsible for delivering the natural gas and might therefore bear an indirect GHG cost during the second and third compliance periods. Unless CARB is aware of specific legacy contracts where such a scenario might manifest, Calpine does not believe CARB’s questions warrant further consideration as part of the proposed rulemaking.