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Mary Nichols, Chair
Steven Cliff, Chief, Climate Change Program Evaluation Branch
California Air Resources Board
1001 "I" Street
Sacramento, CA 95812

Comments of the California Cogeneration Council on CARB's Proposed Amendments to the Cap-and-Trade Regulation

Thank you for the opportunity to comment on the Air Resources Board's (ARB) July 2013 Discussion Draft which contains proposed amendments to the Cap-and-Trade regulation. The California Cogeneration Council (CCC) represents a number of combined heat and power (CHP) facilities that have legacy contracts with their thermal and/or electricity host, and are unable to recover GHG emission compliance costs due to the provisions in these agreements. The following comments focus on new Section 95894 and related definitions and sections that amend the cap and trade regulation to implement Board Resolution 12-33, which directed the Executive Officer to develop a methodology that provides transition assistance to covered entities that have a compliance obligation cost that cannot be reasonably recovered due to a legacy contract.

Legacy Contract Staff Proposal

Since October 2010, when the ARB published the first draft of the cap-and-trade regulation, the CCC has advocated for a solution to the legacy contract issue. We welcomed the Board Resolution in September 2012 that directed staff to develop a methodology to provide transition assistance to eligible covered entities, and provided comments on earlier drafts of proposed amendments.

While ARB staff has made considerable progress, the CCC believes the proposed amendments require a major policy change and a number of clarifications.

1. Transition Assistance should be provided for the term of the legacy contract

In earlier drafts and at the May 1, 2013 CHP workshop, the CCC and other stakeholders were led to believe that transition assistance allocated to legacy contract generators would be provided until the expiration of the legacy contract or until it is amended to change the terms such that the facility would no longer be eligible for transition assistance. We were surprised to read in the July 2013 Discussion Document that ARB proposes that transition assistance be limited to the 2013 and 2014 emissions for the portion of a generator's output subject to the legacy contract. This is a major policy change that had not been discussed with stakeholders.

In the “Summary of Proposed Modifications”, it is stated that the transition assistance provisions, “...appropriately recognizes those that have remaining legacy contracts concerns while maintaining a strong incentive to continue renegotiation”.¹ While we understand that ARB prefers the parties negotiate a resolution, this 2-year limitation has no impact on the host facility and therefore does not encourage a host to come to the table to renegotiate with 3rd party CHP. The cap decline factor as applied to proposed direct allowances for those under legacy contracts already provides an economic incentive for CHP facilities to negotiate, however, renegotiation requires a willing counterparty. We understand that there are some facilities that have negotiated a solution, but these select few had something additional outside of the legacy contract to use as leverage in negotiations, e.g. legacy contract generators who own other generating facilities where trade-offs could be made. Remaining CHP facilities under legacy contract have no such leverage.

Subsection 95870(e)(4) has been modified to provide a true-up calculation to lessen the industrial allocation if the industrial entity is an Industrial Sector Legacy Contract Counterparty. This could be interpreted as a “strong incentive” to bring the industrial host to the negotiating table. However, the CCC believes that out of the 19 generators currently identified by ARB as potentially eligible for transition assistance, very few have legacy contracts with a host that is also a covered entity receiving allocations. In fact, the CCC has only identified two within its membership that fall into that category. One legacy contract expires in 2013 and the other in 2015, so this true-up provision will have no impact on incenting renegotiations. The majority of the remaining legacy contracts are with counterparties that either are not captured by the cap-and-trade regulation (the host is not a covered entity because its emissions are below 25,000 MTCO₂e), or not an entity in the Industrial Sector and therefore does not receive a free allocation of allowances. Instead the host counterparty may be an institutional or commercial entity that will not receive any free allowances (e.g. universities and prisons). Consequently, nothing has changed to incentivize the counterparty to renegotiate with the CHP facility that is bearing all the costs of compliance with the regulation. It is unfair to penalize the CHP facility for not having a provision in its contract that would enable GHG emissions cost recovery.

Transition assistance should be provided to legacy contract holders until the expiration of the contract or until it is amended in such a way that it no longer meets the eligibility criteria. Post-2014, the number of eligible legacy contract generators will decline, and consequently the total number of allowances that would be allocated as transition assistance will diminish rapidly over time. In the grand scheme of the cap-and-trade program the number of allowances required for transition assistance is not significant in the 2nd compliance period, and probably negligible in the 3rd compliance period.

Not resolving the issue for the contract term beyond 2014, however, is detrimental to the CHP generator. The uncertainty of whether a legacy contract generator will be able to recover GHG compliance costs beyond 2014 is a fact that will require disclosure in any commercial transactions regarding the facility. This could significantly affect the value of the asset.

¹ <http://www.arb.ca.gov/cc/capandtrade/meetings/071813/ctnotice0713.pdf>, at page 17.

Recommendations:

The calculation in §95894(6)(d)(1) for A_{2015} , should include compliance year 2015 and beyond, not just 2013 and 2014.

An additional equation should be inserted in §95894(6)(d)(1) that would calculate the allowance allocation for any given compliance year. The CCC supports the proposed new language in the comment letter submitted by Paul Hastings LLP.²

2. Use the most current verified data to calculate allowances and include a True-up

In the Discussion Document, staff has proposed to use 2012 reported and verified emissions data to calculate 2013 and 2014 allowance allocations. The CCC recommends using the most current data available to calculate emissions allowances, and to include in the methodology a true-up consistent with the product output-based allocation methodology, such as provided in 95891(b). While 2012 verified data may be adequate for 2013 and 2014 initial allocations, a true-up must be included in the methodology to fairly account for actual emissions associated with thermal and electricity deliveries. A legacy contract may state a minimum or maximum expected output but actual operating output may differ in any given year. Facility output can vary based on changes in market demand, production capacity, and facility downtime and maintenance. To ensure there is no over or under allocation a “true-up” calculation should be employed, similar to the “true-up” formula defined in §95891(e) for university covered entities and public service facilities.³

Recommendation: In Section §95894(c) and (d), add a true-up variable to the equations, similar to that found in 95891(b).

3. Clarify that 2015 Allowances allocated to Legacy Contract Generators can be used for 2013 and 2014 compliance

At the July 18, 2013 ARB stakeholder workshop, staff clarified the policy intent that 2015 allowances allocated to legacy contract generators in 2014, for 2013 and 2014 emissions, can be used for compliance years 2013 and 2014. The cap-and-trade regulation needs to be amended to reflect this policy.

For example, §95891(e) describes the allocation to University Covered Entities and Public Service Facilities. In this section the term “True-up” is defined as follows:

² August 2, 2013 Letter to ARB by Paul Hastings LLP,
<http://www.arb.ca.gov/lispub/comm2/bccommlog.php?listname=cap-trade-draft-ws>

³ http://www.arb.ca.gov/cc/capandtrade/meetings/071813/ct_reg_2013_discussion_draft.pdf at page 156.

“TrueUp” is the amount of true-up allowances allocated to account for changes in allocation not properly accounted for in prior allocations. This value of allowances for budget year 2015 shall be allowed to be used for budget year 2013 pursuant to section 95856(h)(1)(C) and 95856(h)(2)(C). This value is calculated using the following formula:

$$\text{TrueUp}_y = (F_{\text{consumed}} * B_{\text{Fuel}} - e_{\text{sold}} * B_{\text{electricity}}) * C_y$$

Where:

“y” is the calendar year to which the trueup is correcting, 2013 and 2014.

This definition enables the data true-up we recommend above, and it enables the value of allowances for budget year 2015 to be used for budget year 2013. A similar provision is needed in §95894 (legacy contracts) to enable the value of allowances for budget year 2015 to be used for budget year 2013 and 2014.

Recommendation: In §95894 (legacy contracts), a provision should be included that enables the value of the 2015 allowances to be used for budget years 2013 and 2014 pursuant to section 95856(h)(1)(C) and 95856(h)(2)(C).

4. Protect confidential information

Section 95894(a) describes in detail the documentation required to demonstrate eligibility. The CCC urges the ARB to take all steps to protect confidential and privileged information as provided under California law and regulations, specifically as this applies to the provisions of the legacy contract that must be submitted to the ARB as per Section 95894(a)(2). While we recognize that the ARB wants to see the pricing provisions to ensure the generator is unable to recover GHG compliance costs, at the same time, this information is commercially sensitive and needs to be regarded as proprietary and privileged information that must be protected.

Conclusion

Thank you for the opportunity to comment on the proposed amendments to the Cap-and-Trade regulation. The CCC encourages ARB staff to amend the legacy contract language to enable transition assistance to be provided for the term of the legacy contract. This will provide economic certainty, enabling generators to focus their resources on reducing GHG emissions and planning for the future of their facilities.

Sincerely,



Beth Vaughan
Executive Director