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VIA ELECTRIC SUBMISSION

October 21, 2013

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

Subject: **Comments on CARB's October 16, 2013 Revised Staff Proposal for Treatment of Legacy Contracts Under The California Cap-and-Trade Program**

Dear Madam Chairman:

We appreciate the opportunity to provide these comments regarding the California Air Resources Board ("CARB") October 16, 2013 proposal to amend CARB's Cap-and-Trade Regulation (the "Regulation")[1] to address legacy contracts.[2]

I. Introduction

We greatly appreciate CARB staff's commitment to addressing legacy contracts and support its Legacy Contract Proposal to provide relief to legacy contract generators through the Regulation's second compliance period (i.e., 2017). While we fully support CARB's proposal in this regard, we encourage CARB staff to propose regulatory amendments that are consistent with the allocations provided to legacy contract generators whose counterparties receive allowance allocations for industry assistance under the Regulation. Such amendments should provide for the use of the most current data available when calculating emission allowances, and include a subsequent "true-up" to account for any shortfall in prior allocations.

II. Treatment Of Legacy Contract Generators Should Be Fair And Consistent With Relief Provided To Generators With Counterparties Receiving Industry Assistance

As CARB staff develops the necessary regulatory amendment to implement the Legacy Contract Proposal, it should ensure that legacy contract generators are treated fairly and provided the same transition assistance provided under the Proposed Regulation Order[3] to legacy contract generators whose

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1 Tit. 17, Cal. Code Reg. §§ 95800 *et seq*., referred to herein as the "Regulation".

2 CARB Staff, "Revised Staff Proposal for Legacy Contract Treatment in Cap-and-Trade" (October 16, 2013) (the "Legacy Contract Proposal"), *available at*: http://www.arb.ca.gov/cc/capandtrade/legacy-contract-proposal.pdf. Legacy contracts are those that do not allow for a pass-through of the cost to purchase greenhouse gas ("GHG") emission allowances to meet generators' compliance obligation under the Regulation.

3 *See* CARB Staff Report: Initial Statement of Reasons, Appendix E, Proposed Regulation Order, *available at* http://www.arb.ca.gov/regact/2013/capandtrade13/capandtrade13isorappe.pdf.

counterparties are receiving free allowance allocations for industry assistance.[4] Specifically, under CARB's Proposed Regulation Order, in calculating the *initial* allowance allocations made to this particular subset of legacy contract generators, CARB staff is proposing to use 2013 data[5] and will provide a subsequent "true-up"[6] to account for any shortfall of allowances not accurately provided for in prior allocations.

In furtherance of the traditional notions of fairness and equity—and consistent with the relief provided to legacy contract generators whose counterparties are receiving industry assistance—,CARB staff should likewise: (1) utilize 2013 data in the initial allowance allocation (and thereafter use data from the calendar year immediately prior to the year in which the allowance allocation is made (i.e., 2015 and 2016)); and (2) provide a subsequent true-up to legacy contracts generators whose counterparty is *not* receiving allowance allocations for industry assistance. As described below, the use of current data and providing a subsequent "true-up" to account for any allowance allocation shortfall is critical to providing complete relief to legacy contract generators.[7]

A. The Most Current Data Available Should Be Utilized To Calculate GHG Emission Allowances

To help ensure that allowance allocations accurately reflect current operating output (and to avoid any shortfall to generators), CARB should use the data available for the facility emissions and the amount of electricity and steam sold in the prior calendar year in which the allocation is made. Under the Proposed Regulation Order, unlike the relief provided to generators whose counterparty receives allowance allocations

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[4] *See* Proposed Regulation Order, § 95802(a)(180) (An "Industrial Sector Legacy Contract Counterparty" means "an entity that has been identified under industrial allocation pursuant to Table 8-1 to receive allowance allocation, and has a contract to purchase Qualified Thermal Output and/or electricity from a Legacy Contract Generator.").

[5] *See* Definition of "EEm_{lc}" in Proposed Regulation Order, § 95894(c)(1) (emphasis added) (For stand-alone electricity generating facilities, GHG emission allowances are calculated using emissions "associated with electricity sold under the legacy contract ***in 2013***."); *see also* definition of "Q_{lc}" in § 95894(c)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "thermal output . . . sold under a legacy contract ***in data year 2013.***"); *see also* definition of "E_{lc}" in § 95894(c)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "electricity . . . sold under a legacy contract ***in data year 2013.***")

[6] *See* Proposed Regulation Order, § 95894(c)(1) (Providing a subsequent "true-up" to stand-alone electricity generating facilities "[f]or years after 2015."); *see also* § 95894(c)(2) (Providing a subsequent "true-up" to CHP facilities "[f]or years after 2015.").

[7] The proposed 2012 base year may have been intended to disallow profiting from higher energy production. However, as noted above, the profiting marketers would not have their profits diminished because they do not have a GHG compliance obligation under the Regulation, whereas the non-profiting generators would suffer grievous loss.

for industry assistance, the initial allocation for legacy contract generators whose counterparty does *not* receive allowance allocations for industry assistance will use 2012—not 2013 data.[8]

As CARB staff is aware, facility output varies based market demand, production capacity, the specific terms of the legacy contract, and facility downtime and maintenance. In particular, utilizing data from the 2012 recessionary period would result in an under-allocation of allowances to legacy contract generators. Further, the expected shortfall from using such 2012 data will be more pronounced for efficient facilities that experience increased demand as the annual GHG emissions cap declines to incentivize the dispatch of more efficient facilities. Thus, by using the most current data, there is less risk that legacy contract generators would incur the likely substantial costs to purchase allowances in advance of receiving a subsequent true-up (discussed below). Consistent with the provisions of the Proposed Regulation Order regarding generators with a counterparty receiving allowance allocations for industry assistance, CARB staff should use the most current data available for the amount of electricity and steam sold (i.e., 2013 data for the initial allocation and data from the prior calendar year for allocations made thereafter) to help ensure that allowance allocations accurately reflect current operating output and to avoid any inequitable shortfall to such generators.

B. The True-Up Is Critical To Ensuring That Generators Are Not Burdened With Any Allocation Shortfall

As noted above, a shortfall in the allowance allocation will result if there is an increase in legacy contract generators' production or output of electricity or steam and associated emissions compared to prior years. This deficit will be more pronounced for energy efficient facilities that are increasingly utilized as the declining GHG emission cap under the Regulation incentivizes increased dispatch from such facilities. Thus, in order to ensure that emission allowances are provided for all electricity and steam sold pursuant to a legacy contract (and to ensure the fair and equitable treatment of legacy contract generators whose counterparty is not receiving allocations for industry assistance), CARB staff should include a "true-up" for allocating allowances in its forthcoming amendments to implement the Legacy Contract Proposal. As noted above, providing such a true-up is consistent with the allocation calculation methodology in sections 95894(c) of the Proposed Regulation Order for counterparties receiving allowance allocations for industry assistance. Significantly, there is no policy justification for treating legacy contact generators differently in this regard based on the nature of the counterparty. Thus, any such discrimination would arbitrarily and unfairly penalize legacy contract generators whose counterparty is not receiving allocations for industry assistance, and would not provide any GHG emissions reduction benefit.[9]

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[8] *See* Definition of "EEm_{lc}" in Proposed Regulation Order, § 95894(d)(1) (emphasis added) (For stand-alone electricity generating facilities, GHG emission allowances are calculated using emissions "associated with electricity sold under the legacy contract ***in 2012***."); *see also* definition of "Q_{lc}" in § 95894(d)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "thermal output . . . sold under a legacy contract ***in data year 2012.***"); *see also* definition of "E_{lc}" in § 95894(d)(2) (emphasis added) (For CHP facilities, GHG emission allowances are calculated based on "electricity . . . sold under a legacy contract ***in data year 2012.***")

[9] For consistency, we also note that the allocation to University Covered Entities and Public Service Facilities should also use the most current available data and include a true-up for subsequent allocations. *See* Proposed Regulation Order, § 95891(e)(2).

III. Conclusion

CARB staff first identified the legacy contracts issue in October 2010[10] and has worked diligently with stakeholders since then to address this important matter. We recognize the enormity of CARB staff's—and the Board's—efforts and appreciate their perseverance and diligence over the past many months and years to resolve this issue. As described above, we fully support the Legacy Contract Proposal, which is expected to provide the necessary transition assistance to the majority of legacy contract generators. However, we encourage CARB staff—consistent with the treatment of generators whose counterparty is receiving allowance allocations for industry assistance—to provide for: (1) the use of the most current data available when calculating emission allowances; and (2) a subsequent true-up to account for any shortfall in prior allocations. Without such regulatory amendments, legacy contract generators will be unfairly punished without any corresponding GHG emissions reduction benefits.

Consistent with these comments, we respectfully request that CARB staff incorporate, as technical additions to its amendments to the Regulation, the proposed regulatory amendments included as Exhibit A to this comment letter.[11]

We look forward to working with CARB staff to facilitate the necessary amendments to the Regulation to implement the Legacy Contract Proposal.

Respectfully submitted,

/s/ Peter H. Weiner

Peter H. Weiner

cc: Board Members of the California Air Resources Board
Virgil Welch, Special Counsel to the Chairman
Richard Corey, Executive Officer
Rajinder Sahota, Branch Chief, CARB Cap-and-Trade Program

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[10] CARB Staff Report: Initial Statement of Reasons, Proposed Regulation To Implement California Cap-and-Trade Program, II-32, n.22, *available at* http://www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf; *see also* Appendix J to same, "Allowance Allocation," J-16, n.15.

[11] Recommended insertions are shown in underlined text and deletions are shown in ~~strikethrough~~.

CARB October 2013 Revised Staff Proposal For Treatment Of Legacy Contracts Under The California Cap-and-Trade Program

Exhibit A: Recommended Amendments To Address Legacy Contracts

§ 95856. Timely Surrender of Compliance Instruments by a Covered Entity

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(h) Annual and Triennial Compliance Instruments Requirements

(1) When a covered entity or opt-in covered entity surrenders compliance instruments to meet its annual compliance obligation pursuant to section 95856(d), the Executive Officer will determine compliance with the annual compliance obligation by evaluating the number and type of compliance instruments in the Compliance Account in the following order and ensuring there are enough eligible compliance instruments to cover the annual compliance obligation:

* * * *

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

(2) When a covered entity or opt-in covered entity surrenders compliance instruments to meet its triennial compliance obligation pursuant to section 95856(f), the Executive Officer will retire them from the Compliance Account in the following order:

* * * *

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

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

§ 95870. Disposition of Allowances

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(g) Allocation to Legacy Contract Generators. Allowances will be allocated to legacy contract generators for 2013 ~~and 2014~~ through 2017 for transition assistance. ~~The Executive Office will transfer allowance allocations into each eligible generator's limited exemption holding account by October 15, 2014 for eligible Legacy Contract Emissions~~. The Executive Officer will place an annual individual allocation from budget year 2015 in the holding account of each legacy contract generator for calendar years 2013, 2014, and 2015 on or before October 15, 2014. The Executive Officer will place an annual individual allocation in the holding account of each legacy contract generator on or before October 15, or the first business day thereafter, of each calendar year from 2015-2016 for allocations from 2016-2017 annual allowance budgets pursuant to the methodology set forth in section 95894.

§ 95891 Allocation for Industry Assistance

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(e) Allocation to University Covered Entities and Public Service Facilities. The Executive Officer shall calculate the amount of allowances directly allocated to a University or a public service facility using the following formulas:

(2) Budget Years 2016 to 2020 Allocation. For budget years 2016 to 2020, the Executive Officer shall calculate the amount of California GHG Allowances directly allocated to eligible University Covered Entities or Public Service Facility using the following formula.

$$A_t = (F_{consumed} * B_{Fuel} - e_{sold} * B_{electricity}) * C_t + \mathit{TrueUp}_y$$

Where:

"$TrueUp_y$" is the amount of true-up allowances allocated to account for changes in allocation not properly accounted for in prior allocations. This value is calculated using the following formula:

$$TrueUp_y = (F_{consumed} * B_{Fuel} - e_{sold} * B_{electricity}) * C_y$$

Where:

"y" is the calendar year to which the trueup is correcting, 2016 to 2020.

* * * *

(3) Data Sources. In determining the appropriate baseline values, the Executive Officer may employ all available data reported to ARB under MRR for data years 2008 through 2013 and subsequent years, as appropriate.

§ 95894. Allocation to Legacy Contract Generators for Transition Assistance

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(d) For legacy contracts not covered in 95894(c), the following formulae shall apply:

(1) For stand alone generation facilities:

$$TrueUp_{2015} = (EEm_{lc} * c_{2013}) + (EEm_{lc} * c_{2014}) \underline{+ (EEm_{lc} * c_{2015})}$$

Where:

"$TrueUp_{2015}$" is the amount of true up allowances allocated and allowed to be used for budget year "t-2"~~, and~~ "t-1", and "t" pursuant to sections 95856(h)(1)(D) and 95876(h)(2)(D) in vintage 2015 allowances based on calendar year ~~2012~~2013 Legacy Contract Emissions reported and verified pursuant to MRR;

"EEm_{lc}" is the emissions reported, in MTCO2e, associated with electricity sold under the legacy contract in ~~2012~~2013; and

"c_t" is the adjustment factor for budget year "t".

For years 2016 and 2017, the following equation applies:

$$\underline{A_t = (EEm_{lc,t-2} * C_{a,t}) + TrueUp_t}$$

Where:

"A_t" is the is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t";

$$\underline{TrueUp_t = (EEm_{lc,t-2} * C_{a,t-2}) - A_{t-2,\textit{no trueup}}}$$

Where:

"$A_{t-2,\textit{no trueup}}$" is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t-2" not including the true-up for that budget year.

(2) For legacy contract generators not covered in 95894(c) or 95894(d)(1):

$$TrueUp_{2015} = ((Q_{lc} * B_s + E_{lc} * B_e) * c_{2013}) + ((Q_{lc} * B_s + E_{lc} * B_e) * c_{2014}) \underline{+ ((Q_{lc} * B_s + E_{lc} * B_e) * c_{2015})}$$

Where:

"$TrueUp_{2015}$" is the amount of true-up allowances allocated from budget year 2015 and allowed to be used for budget years 2013~~, and~~ 2014, and 2015 pursuant to sections 95856(h)(1)(D) and 95856(h)(2)(D);

"Q_{lc}" is the Legacy Contract Qualified Thermal Output in MMBtu sold under a legacy contract in data year ~~2012~~2013, as reported to MRR;

"E_{lc}" is the electricity, in MWh, sold under the legacy contract in data year ~~2012~~2013;

"B_e" is the emissions efficiency benchmark per unit of electricity sold or provided to off-site end users, 0.431 California GHG Allowances/MWh;

"B_s" is the emissions efficiency benchmark per unit of Legacy Contract Qualified Thermal Output, 0.06244 California GHG Allowances/MMBtu thermal; and

"c_t" is the cap decline factor for budget year "t" as specified in table 9-2.

For years 2016 and 2017, the following formula applies:

$$A_t = ((Q_{lc,t-2} * B_s + E_{lc,t-2} * B_e) * C_t) + TrueUp_t$$

Where:

$$TrueUp_t = ((Q_{lc,t-2} * B_s + E_{lc,t-2} * B_e) * C_t) - A_{t-2,no\ trueup}$$

"A_t" is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year "t";

"$Q_{lc,t-2}$" is the Legacy Contract Qualified Thermal Output in MMBtu sold under a legacy contract in data year t-2, as reported under the MRR;

"E_{lc}" is the electricity, in MWh, sold under the legacy contract;

"B_e" is the emissions efficiency benchmark per unit of electricity sold or provided to off-site end users, 0.431 California GHG Allowances/MWh;

B_s is the emissions efficiency benchmark per unit of Legacy Contract Qualified Thermal Output, 0.06244 California GHG Allowances/MMBtu thermal;

"C_t" is the cap decline factor for budget year "t" as specified in table 9-2;

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

“$A_{t-2,\textit{no trueup}}$” is the amount of California GHG allowances directly allocated to the Legacy Contract Generator subject to a Legacy Contract from budget year “t-2” not including the true-up for that budget year;

* * * *

(e) Data Sources. In determining the appropriate values for section 95894(c) and 95894(d), the Executive Officer may employ all available data reported to ARB under MRR for ~~2012~~ 2013 and subsequent years, as appropriate and all other relevant data, including invoices, demonstrating the amount of electricity and Qualified Thermal Output sold or provided for off-site use that does not include a carbon cost in the budget year for which it is seeking an allocation. If necessary, the Executive Officer will solicit additional data to establish a representative allocation. The operator of the Legacy Contract Generator must provide the additional data upon request by the Executive Officer.