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January 11, 2010

Dr. Kevin Kennedy
Assistant Executive Officer
California Air Resources Board
1001 "I" Street
P.O. Box 2815
Sacramento, CA 95812

Subject: RRI Energy Comments on the Cap & Trade Preliminary Draft Regulation

Dear Assistant Executive Officer Kennedy:

RRI Energy appreciates the opportunity to provide these comments to the California Air Resources Board (CARB) regarding its December 14, 2009 workshop on the preliminary draft cap-and-trade regulation.

Introduction

RRI Energy is pleased to work with CARB on developing an economy-wide cap-and-trade program for the state of California. RRI Energy is one of the leading providers of electricity in competitive markets in the United States and is strongly committed to caring for the environment while providing reliable, affordable power to its customers. As a company, we are dedicated to efficiency and effectiveness and are committed to taking actions that improve plant efficiency and reduce emissions through operational excellence and the development and application of cost effective technology. As such, RRI Energy would like to present its commitment as a leading industry example of developing inventive, market-based answers to energy and environmental challenges.

Reporting Threshold

RRI supports maintaining the reporting threshold at 25,000 metric tons CO_2e per year, so that CARB's program is consistent with the US Environmental Protection Agency (US EPA)'s mandatory reporting program.

Compliance Period

RRI supports a three-year compliance period, as it allows regulated entities greater flexibility in meeting compliance. However, if CARB does move towards a one-year compliance period, it should allow for borrowing of allowances from future compliance period(s) in order to maintain the compliance flexibility offered by the three-year period.

Scope of Program in First Compliance Period

RRI is in favor of including as many sectors as possible as early as possible in the program. However, the program should be structured so that power companies are not "double charged" by having to directly pay for their own allowances and then indirectly for allowance costs embedded in the cost of fuel. To mitigate this effect, CARB should require fuel deliverers to back out their embedded allowance cost when selling gas to power companies.

Allowance Distribution

RRI supports a gradual transition from free allocation to auction in the cap-and-trade program, instead of an immediate use of 100% (or near 100%) auction at the program onset as the Economic and Allocation Advisory Committee (EAAC) appears to favor.

Auctioning of allowances increases the overall cost of achieving emission reductions because of price unpredictability, speculative purchases, administrative costs, and hedging. An auction shifts capital from the private to the public sector, where it will likely be used to establish non-market subsidies. However, technological solutions to reduce greenhouse gas (GHG) emissions will ultimately be developed in the private sector. To be effective, cap-and-trade programs need to preserve private capital and allow time for these solutions to develop.

Auction Participation

RRI prefers that the allowance auctions be open to non-regulated entities. Specifically, allowing brokers to participate in the auction and therefore in trading will help to maintain market liquidity. When auctioned, allowances should ultimately be used for compliance, not simply hoarded or retired by non-regulated entities.

Cost-containment Options

To establish a maximum allowance cost to mitigate potential negative economic effects of the program in the event of market volatility, RRI recommends including allowance cost-containment mechanisms. Having these mechanisms in place would also provide California residents with greater price certainty for commodities such as electricity, fuel, and water. It is important that CARB establish cost-containment mechanisms that protect both electricity generators and end-users of electricity from the increased cost of electricity under a cap-and-trade program.

RRI recommends that CARB consider the following cost-containment mechanisms, which would help to prevent significant spikes in allowance prices to ensure low cost, economic stability, and the reliability of electricity supply:

- Tier I (i.e., higher priority/more favorable options): relaxing the offset limit, bringing in allowances from other programs, and allowing borrowing from future compliance period(s).
- Tier II (i.e., lower priority/less favorable option): using price controls, such as a price ceiling. The intent of such a ceiling, should it ever be triggered, would be to preserve the market in the event of potentially catastrophic price excursions. A ceiling should be set high enough so as not to affect the functioning on the free market or prevent investment in GHG reduction alternatives such as energy efficiency or offsets.

Offset Limit and Project Types

A sufficient supply of high quality offsets—including those from international offset projects—must be available in a California cap-and-trade system as a cost-containment mechanism to protect consumers. CARB should carefully consider the implications of the economic analysis on allowance and offset availability, use, and pricing in the early years of the cap-and-trade program. If allowances are plentiful and available at low cost in early years of the program, the incentive to use offsets to meet compliance would be lessened. The four percent limit on offsets, however, should not prevent users from realizing the full benefit of these offsets. Therefore, CARB should allow for banking or carry-over of these offsets for use in future compliance periods.

Furthermore, RRI suggests the following prioritization for offset projects:

1. First and foremost, CARB should allow regulated entities to use compliance-grade offsets from recognized protocols (e.g., VCS or CAR), so that CARB would not need to duplicate the effort to create such protocols. The focus here should be on California projects.
2. CARB should nevertheless give case-by-case consideration to new and different types of offset projects or protocols (within or outside of California) that may be of smaller scale yet are not covered by a current recognized protocol. Regulated entities should be able to approach CARB with these projects and obtain offsets from those that meet the offset criteria specified by AB32. CARB should give special consideration to projects also resulting in environmental or social co-benefits.

Thank you for the opportunity to submit these comments. We look forward to working with CARB to develop an economy-wide cap-and-trade program in the state of California. Please contact me at (702) 407-4861 if you have any questions regarding this matter.

Sincerely,

Brian C. McQuown
Senior Air Quality Specialist
RRI Energy, Inc.