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

Re: Public Workshop to Discuss Linking the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation to Western Climate Initiative Jurisdictions

Dear Madame Chairman:

Calpine Corporation ("Calpine") appreciates the opportunity to provide these written comments on the California Air Resources Board ("CARB" or the "Board") February 3, 2012 workshop and presentation titled "Cap-and-Trade Workshop: Regulation for Linking California's and Quebec's Cap-and-Trade Programs" (hereinafter the "California-Quebec Program Linkage Presentation"). Calpine looks forward to working with CARB Staff to make important amendments to the Cap-and-Trade Program Regulation (Cal. Code Reg., tit. 17, §§ 95800 *et seq.*) ("Regulation") in 2012 to assure a successful launch of the first compliance period in 2013.

I. INTRODUCTION

Calpine is a long-time advocate for low-carbon and renewable energy resources and has consistently supported state and federal carbon legislation, including California's Global Warming Solutions Act (Assembly Bill ("AB") 32). Calpine is the state's largest independent power producer, the state's largest provider of renewable energy and owner of the state's largest fleet of combined heat and power ("CHP") or cogeneration facilities. Calpine applauds CARB's adoption in October 2011 of the first economy-wide cap-and-trade regime to regulate emissions of greenhouse gases ("GHG") and address climate change. Calpine believes that putting a price on carbon emissions will encourage investment in efficient and low-emitting generating sources.

While CARB's adoption of California's Cap-and-Trade Regulation is significant and groundbreaking, several critical issues should be addressed prior to the first auction slated for August 2012. As noted by Calpine's earlier comments submitted throughout the Cap-and-Trade rulemaking process (which are incorporated by reference herein[1]), Calpine recognizes that

[1] *See* Letter to Hon. Mary D. Nichols, Chairman, from Kassandra Gough, re: Proposed Regulation to Implement the California Cap-and-Trade Program, December 9, 2010 ("December 2010 Comments"), available at: http://www.arb.ca.gov/lists/capandtrade10/253-carb_letter_re_cap-and-trade_20101209.pdf;

CARB Staff could not, due to litigation concerning approval of the Scoping Plan, develop solutions to these issues through formal rulemaking. As a consequence, upon finalizing the Regulation, the Board directed CARB Staff to work with stakeholders to address problems related to, among other things, allowance holding limits, auction purchase limits, and long-term contracts that do not have a mechanism for recovering carbon costs associated with the Cap-and-Trade Regulation. Resolution 11-32, 10, 12.

Several of these issues are directly implicated by CARB's proposed linkage to Quebec's cap-and-trade program. *See* California-Quebec Program Linkage Presentation, 16-17 (noting that auction purchase limits, allowance holding limits and beneficial holding provisions under the California and Quebec systems must be reconciled). For this reason, Calpine strongly encourages CARB to begin to address these issues now as part of the forthcoming linkage rulemaking. As discussed below, Calpine believes that CARB should make the following changes to the Regulation:

- The limited exemption from the allowance holding limit needs to be broadened, so that it includes a covered entity's verified emissions from the prior year, even before they are deposited into its compliance account, or a separate exemption for covered entities' legitimate hedging activity needs to be adopted.

- Assuming no such changes are made to the holding limit, the beneficial holdings provisions need to be amended, so they do not unduly restrict independent generators' ability to take advantage of the limited exemption and possibly preclude them from participation in future auctions.

- The current vintage auction purchase limit applicable to covered entities – albeit improved from CARB's original proposal – should be increased and the limit for future vintage allowances should not be the same for both covered and non-covered entities.

For those issues not directly implicated by the linkage rulemaking of continued importance to Calpine – the impacts to CHP generators subject to long-term contracts that provide for no recovery of allowance costs – Calpine would encourage CARB Staff to continue to monitor the parties' efforts to renegotiate those contracts and consider proposing amendments that would

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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, August 11, 2011 ("August 2011 Comments"), available at: http://www.arb.ca.gov/lists/capandtrade10/1450-8-11-2011_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: Second Proposed 15-Day Amendments to the Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, September 27, 2011 ("September 2011 Comments"), 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.

assure that steam hosts who face no increase in their energy costs do not receive a free allocation of allowances.

II. DISCUSSION

A. CARB Should Amend The Holding Limit Either By Broadening The Limited Exemption So That It Includes All Covered Entities' Verified Emissions, Prior To Them Being Deposited Into Compliance Accounts, Or By Providing An Exemption For Covered Entities' *Bona Fide* Hedging Activity

In Resolution 11-32, the Board directed CARB Staff to continue discussions with stakeholders to identify and propose potential amendments to several areas of the Regulation during the initial implementation of the Cap-and-Trade program. Among these are the Regulation's "[p]rovisions to balance flexibility and accumulation of market power including auction frequency, and holding or purchase limits..." Resolution 11-32, 10.

Per the Board's instructions, Calpine believes that the Board should consider revisions to the Regulation's holding limit as part of the linkage rulemaking. Upon linking to an external GHG Emissions Trading System ("ETS"), CARB retains discretion to determine the scope of the linkage[2] and, in linking with Quebec, will need to determine whether and how to harmonize California and Quebec's allowance holding limits.[3]

Calpine recognizes that CARB is attempting to strike a balance between promoting market flexibility and preventing market abuse in setting the holding limit. *See* California's Cap-and-Trade Program, Final Statement of Reasons ("FSOR"), Response to Comment L-21, 1671. Calpine believes that the holding limit, as crafted, strikes the wrong balance between flexibility and potential market manipulation and would severely disadvantage the largest covered entities within the State.

As Calpine has previously suggested, CARB should expand the limited exemption to the holding limit, so that it would include the entirety of a covered entity's prior year's emissions without first requiring allowances to be deposited into the entity's compliance account. Alternatively, CARB should consider adopting an exemption for covered entities' *bona fide* hedging activities, as suggested by the analysis that informed CARB's initial development of the holding limit.

1. The Holding Limit Unreasonably And Unfairly Limits The Flexibility Of Covered Entities

As we described during the Cap-and-Trade rulemaking,[4] the allowance holding limit would dramatically limit the ability of large affiliated generators, such as Calpine, to fully utilize the

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[2] Cal. Code Reg., tit. 17, §§ 95940, 95941.

[3] *See* California-Quebec Program Linkage Presentation, 17.

[4] *See* December 2010 Comments, 16; August 2011 Comments, 6-7; September 2011 Comments, 3-4.

flexibility mechanisms the Regulation otherwise provides to covered entities, including unlimited banking of allowances and three-year compliance periods. Greater flexibility is necessary to promote a coherent and cost effective cap-and-trade program and ensure that the Regulation's annual compliance obligation applies fairly to all entities.

As explained in our prior comments, the holding limit effectively increases the 30% annual surrender obligation in section 95855 for large entities because large entities *must* transfer allowances in excess of the holding limit from their holding account to their compliance account, both to avoid penalties and assure participation in future auctions. There is no principled reason why California's largest entities should have a greater annual compliance obligation than smaller entities. Penalizing the largest covered entities in this fashion, due to nothing more than their sheer size and investment in the State, runs afoul of AB 32's mandate that the Regulation should be "equitable, [and] seek[] to minimize costs and maximize the total benefits to California." CAL. HEALTH & SAFETY CODE § 38562(b)(1). This *de facto* penalty on the largest covered entities will only be compounded upon linkage to the Quebec ETS, given that the existing Quebec regulation includes no annual surrender obligation.[5]

2. Application Of The Holding Limit To Covered Entities Lacks Analytical Support

Calpine also urges CARB to reconsider the holding limit in light of CARB's erroneous reliance on Western Climate Initiative ("WCI") analysis. CARB imposed the holding limit formula based on a report by a consultant to the WCI Markets Committee.[6] However, the referenced report concludes that the recommended holding limit should not apply to entities with compliance obligations. *See* Jeffrey H. Harris, *Western Climate Initiative Markets Committee Report on Holdings Limits*, 17 (2010) (hereinafter, "WCI Report"). The WCI Report also notes that most holding limits in practice exempt commercial entities engaged in the market for *bona fide* hedging purposes.[7] Beyond CARB's reference to the WCI Report and its statement that it is attempting to balance the risk of market manipulation against the need for liquidity and flexibility,[8] CARB offers no justification for imposing such a holding limit on covered entities or

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[5] *See* Regulation respecting a cap-and-trade system for greenhouse gas allowances (hereinafter, "Quebec Regulation") §§ 20-21, *available at:*
http://www.mddep.gouv.qc.ca/changements/carbone/reglementPEDE-en.pdf.

[6] Initial Statement of Reasons ("ISOR"), Summary of Section 95920(b)(3), IX-104.

[7] *Id.* at 13 ("Most of these limits include exemptive relief for *bona fide* hedging purposes. Commercial entities engaged in the market for hedging purposes are typically exempt from limits since their holdings are presumed to relate to risk management activities emanating from the operation of commercial activities."). In this respect, the WCI Report is consistent with the Commodities Future Trading Commission's ("CFTC") recently promulgated "position limits" for futures and swaps pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010), which provide an exemption from the position limits for "bona fide hedging", as defined by the CFTC. *See* 76 Fed. Reg. 71,626 (Nov. 18, 2011), 71,633, 71,688 (promulgating 40 C.F.R. § 151.5).

[8] *See* ISOR, Rationale for Section 95920(b)(3), IX-104.

for not providing an exemption for legitimate hedging, as suggested by the analysis that supported the limit's adoption. Further, we are aware of no precedent for applying a similar limit to covered entities in other GHG or emissions trading markets.

The Legislative Analyst's Office ("LAO") recently suggested that the Legislature consider eliminating the holding limit, saying, "[t]he particular holding limits chosen by ARB in its design of the cap-and-trade program have not been justified analytically, were set before actual trading in allowances could be observed, and do not adjust automatically with changing market conditions." LAO, *Evaluating the Policy Trade-Offs in ARB's Cap-and-Trade Program*, 29 (2012). The LAO concluded, "[t]herefore, ARB's holding limits are unlikely to be optimal...If set too tightly, they might make trading unnecessarily costly and reduce flexibility regarding when emissions reductions take place." *Id.*

The Board identified the potential need to amend the holding limit after the Regulation was finalized. Calpine believes, consistent with the LAO's suggestion, that the existing holding limit strikes the wrong balance between promoting flexibility and preventing market abuse, and should be modified accordingly. Additionally, CARB has provided no analytical support for applying the holding limit to covered entities or for not providing an exemption for their *bona fide* hedging activity. Nor will the small potential increase in the holding limit attributable to linkage with Quebec's pool of allowances ameliorate Calpine's concerns. Accordingly, Calpine would strongly urge CARB, as part of the linkage rulemaking, to undertake a more rigorous evaluation of the basis for applying the holding limit equally to both covered and non-covered entities alike.

Calpine believes the solution we previously proposed would ameliorate the restrictions that the holding limit currently imposes on the largest covered entities within the State. Under our proposal, the limited exemption from the holding limit would include all of a covered entity's emissions reported during the preceding calendar year, prior to retirement into a compliance account. Thus, the holding limit would equal the amount of allowances derived through application of the subsection 95920(d)(1) formula, plus the entity's verified emissions from the prior year. We proposed the following language to accomplish this change:

§ 95920. Trading.

...

(d) The holding limit will be calculated for allowances qualifying pursuant to section 95920(c)(1) as the sum of:

...

(1) The number given by the following formula

...

(2) A Limited Exemption from the Holding Limit is calculated as:

(A) The limited exemption is the number of allowances which are exempt from the holding limit calculation ~~after they are transferred by a covered entity or an opt-in covered entity to its compliance account~~.

...

We continue to believe that this simple change to the existing Regulation could avoid the harshest impacts on large covered entities and satisfy the Board's mandate to strike the right balance between affording flexibility to covered entities and avoiding market manipulation. As an alternative, however, CARB Staff could consider proposing an exemption for covered entities' *bona fide* hedging activities, as suggested by the WCI Report that supported adoption of the holding limit.

B. CARB Staff Should Amend The Regulation's Beneficial Holdings Provisions So They Do Not Severely Disadvantage The Ability Of Independent Generators To Manage Their Compliance Obligations And Participate In Auctions

Should CARB fail to either broaden the limited exemption from the holding limit or provide an additional exemption for covered entities' *bona fide* hedging activity, Calpine believes that the regulation's beneficial holdings provisions[9] would severely disadvantage independent generators and need to be amended. CARB Staff will need to consider reconciling the Regulation's holding limit and beneficial holdings provisions as part of the linkage regulation.[10] As part of this effort, CARB should revise the beneficial holdings provisions, so they do not unfairly disadvantage independent generators vis-à-vis their utility customers.

Under the beneficial holding relationship provisions, the principal in the beneficial holding relationship (*i.e.*, the contracted generator) must confirm that the agent (*i.e.*, the electrical distribution utility) is authorized to act on its behalf, before any allowances acquired by the agent will be counted against the holding limit of the principal. Cal. Code Reg., tit. 17, § 95834(b)(3). In addition, where a principal is claiming a beneficial holding relationship, such that the allowances held by the agent will count against the holding limit of the principal, the allowances must be transferred to the principal within one year after the agent acquires them. *Id.*

These provisions assure that an electrical distribution utility cannot unilaterally claim a beneficial holding relationship for purposes of avoiding the holding limit. However, they also impose an unreasonable limitation on independent generators' ability to take advantage of th e limited exemption to the holding limit: Because the allowances held pursuant to a beneficial holding relationship remain in the utility's actual possession for up to a year, the generator is denied any ability to transfer them to its compliance account and thereby qualify for the limited exemption throughout that period.

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[9] *See* Cal. Code Reg., tit. 17, § 95920(g).

[10] *See* California-Quebec Linkage Presentation, 17.

As suggested above, Calpine will have a very difficult time managing its compliance obligation under the existing holding limit and will likely need to transfer substantially greater than 30% of its annual compliance obligation to its compliance account each year. Moreover, Calpine can realistically envision a scenario where its holding limit is almost entirely consumed by allowances held on its behalf by utilities. Because the utilities will retain actual possession of the allowances, Calpine will be precluded from qualifying for the limited exemption for any such allowances and, as a consequence, could be closed out of participation in future auctions. This would undoubtedly place independent generators such as Calpine at a competitive disadvantage to their investor-owned utility ("IOU") customers, which are afforded substantial flexibility under the Regulation and subject to no auction purchase limit whatsoever.

To address this issue, Calpine previously proposed that the allowances held by a utility on the generator's behalf not count against the holding limit of either the utility or the generator, so long as the generator confirms that it will transfer the allowances to a compliance account within 3 days of receipt of such allowances from the utility.[11] Specifically, Calpine proposed the following modifications:

§ 95834. Disclosure of Beneficial Holding Relationships.

. . .

(b) Disclosure of Beneficial Holding.

. . .

(4) In the case of an electric distribution utility allowances on behalf of a second registered entity with whom it has a contract for the delivery of electricity pursuant to section 95834(a)(3), the allowances will not count against the holding limit of either the electric distribution utility or the second registered entity, so long as the second registered entity confirms upon submitting the confirmation required by section 95834(b)(2) that it will transfer the allowances to a compliance account within three (3) days of receipt from the utility.

While Calpine has offered workable regulatory language to address this important issue, we remain open to other possible solutions. However, Calpine strongly encourages CARB to only consider amendments that do not unfairly discriminate against independent generators, vis-à-vis their utility customers, by limiting the former's ability to take advantage of the limited exemption and, as a consequence, to participate in auctions. These discriminatory impacts are only amplified by the complete exemption that the Regulation affords IOUs from the auction purchase limit, as discussed below. Contracts between utilities and their counterparties are already complex and are unfortunately being further complicated by the Regulations holding limits, auction purchase limits and the existing beneficial holding provisions.

[11] *See* September 2011 Comments, 6.

Before any changes are made, we strongly urge CARB to convene the impacted parties in a workshop-like forum, so that together we can discuss our issues and concerns and hopefully arrive at a mutually agreeable solution.

C. CARB Should Consider Increasing The Auction Purchase Limit For Covered Entities

CARB Staff stated in the Program Linkage Presentation that the Board will consider revisions to the Regulation as part of its linkage rulemaking, including reevaluating auction purchase limits in response to the Board's direction.[12] The auction purchase limit for covered entities is 15 percent (%) of current vintage allowances offered for auction, and the auction purchase limit for all participating entities is 25% of future vintage allowances offered for advance auction.[13] Although the auction purchase limits in Quebec's and California's existing regulations are similar,[14] nothing within AB 32 or CARB's Regulation requires that they be the same.[15]

As Calpine has previously commented, the auction purchase limit on current vintage allowances poses significant limitations on Calpine's and other large generators' ability to purchase sufficient allowances in the auctions to satisfy their compliance obligations. Moreover, this "one-size-fits-all" limit will deny the largest entities the same flexibility afforded to other entities, who will not be forced to participate in every auction and bid at prices certain to exceed the settlement price, just to assure they can procure sufficient allowances to meet those obligations. This is especially unfair in light of the complete exemption CARB has provided to the IOUs. In this respect, the Regulation gives considerable flexibility to IOUs, but none to the independent generators who are actually subject to its compliance obligations. We continue to believe that the auction purchase limit should not be "one-size-fits-all", but should be based on a covered entity's average annual verified emissions during the preceding three calendar years, plus some additional amount for entities without three years of emissions data.[16]

The auction purchase limit for future vintage allowances should be reassessed as well. This limit – 25% of the allowances offered in any advance auction – applies equally to all entities, even those *without* compliance obligations. Cal. Code Reg., tit. 17, § 95911(c)(3). There is no principled reason for non-covered entities to be able to purchase 25% of future vintage allowances when these entities have no compliance obligations under the Regulation. By also imposing a "one-size-fits-all" holding limit on both covered and non-covered entities alike, the

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[12] California-Quebec Program Linkage Presentation, 12, 16; *see also* Resolution 11-32, 10 (requiring CARB Staff to consider the potential need for amending the Regulation's auction purchase limits).

[13] Cal. Code Reg., tit. 17, §§ 95911(c)(3), (c)(4)(A) .

[14] *See* Quebec Regulation § 50.

[15] *See* CAL. HEALTH & SAFETY CODE § 38564 (requiring consultation with other states and nations to facilitate the development of an integrated regional program); Cal. Code Reg., tit. 17, §§ 95940, 95941 (establishing linkage requirements).

[16] *See* December 2010 Comments, 15-16; August 2011 Comments, 5; September 2011 Comments, 7.

Regulation makes it increasingly unlikely that the largest covered entities will even be able participate in the advance auctions. Thus, the constructive price signal CARB intends to send through the advance auction could be distorted by the bidding activity of a few non-covered speculators. In this respect, Calpine believes CARB again struck the wrong balance between encouraging speculative behavior and preventing market manipulation. At a minimum, CARB should apply a much lower limit to future vintage purchases to non-covered entities, just as it does for the current vintage purchase limit. Calpine looks forward to CARB's resolution of these issues as part of the linkage rulemaking.

D. As Directed By The Board And Consistent With The Quebec Regulation, CARB Staff Should Assure Adequate Resolution Of The Situation Faced By Cogenerators That Cannot Recover The Cost Of Allowances From Their Steam Hosts

As described in CARB's Scoping Plan, CHP or cogeneration facilities represent a highly efficient, environmentally preferable alternative. Thus, CARB made expansion of CHP a significant component of California's efforts to reduce GHG emissions and address climate change.[17] In light of this mandate, the Board directed CARB Staff "to review the treatment of CHP facilities in the Cap-and-Trade program to ensure that appropriate incentives are being provided for increased use of efficient combined heat and power." Resolution 10-42, 11. While the issue of allocations for cogeneration facilities is not directly implicated by CARB's linkage with Quebec, we note below that Quebec has squarely addressed this issue in its regulation. And because of its impacts on the continued viability of CHP generators, Calpine would ask CARB Staff to assure that this issue receives proper attention as soon as possible in 2012.

Since the inception of California's Cap-and-Trade program, CARB Staff recognized that some generators have contracts that do not include provisions that allow for full recovery of allowance costs.[18] Recognizing this issue and the Scoping Plan's goal to increase the use of combined heat and power, CARB Staff committed to "work with interested stakeholders to ensure proper treatment under the regulation of . . . combined heat and power facilities with pre-AB 32 long-term contracts that do not allow for pass-through of costs associated with greenhouse emissions." Resolution 10-42, Attachment B, 8. Then, upon finalizing the Regulation, the Board directed CARB Staff to address the issue of long-term contracts with industrial hosts that do not allow for a pass-through of the costs. Specifically, CARB Staff was directed to "monitor progress on bilateral negotiations between counterparties with existing contracts that do not have a mechanism for recovery of carbon costs associated with cap-and-trade for industries receiving

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[17] *See* Climate Change Scoping Plan: A Framework for Change, CARB, December 2008, 44 (recommending measure no. E-2, "Increase Combined Heat and Power Use by 30,000 GWh").

[18] *See* ISOR, II-32, n.22 ("Some generators have reported that some existing contracts do not include provisions that would allow full pass-through of cap-and-trade costs . . . Staff is evaluating this issue to determine whether some specific contracts may require special treatment on a case-by-case basis."); *see also* ISOR, Appendix J, "Allowance Allocation," J-16, n.15.

free allowances pursuant to section 95891, and identify and propose a possible solution, if necessary." Resolution 11-32, 12.

To-date, Staff has proposed no such solution, but has instead taken the position that it is the responsibility of the contracting parties to resolve this problem. Staff has therefore encouraged the parties to renegotiate these types of agreements.[19] Should such negotiations fail, Staff has held out the prospect of facilitating negotiations between the parties.[20] Calpine would welcome CARB Staff's assistance in this regard.

Consistent with CARB Staff's recommendation, Calpine has worked diligently with its counterparties to renegotiate contracts where possible. In cases involving the IOUs or where the contract was already undergoing amendment, Calpine has amended the contract to address the parties' respective obligations for compliance with the Regulation. However, a number of remaining fixed-price contracts provide no similar opportunity for renegotiation.[21]

As suggested by Calpine previously, CARB should amend the Regulation to address this problem by providing 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.[22] Indeed, the Quebec Regulation provides just such an allocation for fixed-price electric power contracts executed before January 1, 2008, as well as for steam suppliers.[23] This follows the example of both the proposed legislation passed by the House of Representatives in 2009 and existing emissions trading programs in the U.S., all of which provide for a special exemption or free allocation for long-term contracts that

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[19] *See* FSOR, Response to Comments D-62, 357; G-24, 514; I-104, 654; I-118, 1568; I-120, 1572-73; I-131, 1588-89; I-50, 2153-2156.

[20] FSOR, Response to Comment I-50, 2156 ("For parties that have not been successful with renegotiation, we will provide support by facilitating discussions between parties so that they too will be able to support a successful program.").

[21] Calpine disputes the suggestion made by CARB Staff in the FSOR that these contracts reflected the risk of GHG regulation. *See* FSOR, Response to Comment I-50, 2153 ("[g]enerally, we believe contract negotiation discussions included which party would bear future costs, and the price agreed upon in the contract reflected this risk."). Contrary to CARB Staff's suggestion, Calpine's long-term contracts to supply steam from its CHP facilities were negotiated as early as the 1980's—well before a program to regulate carbon emissions was ever contemplated.

[22] December 2010 Comments, 3-10; August 2011 Comments, 10-12; September 2011 Comments, 7-9.

[23] *See* Quebec Regulation, App. C, Pt. 1, Table A (providing for eligibility for an allocation without charge for, *inter alia*, "[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 "[s]team and air conditioning supply").

do not allow for recovery of allowance costs.[24] We continue to believe that CARB should follow these examples and provide a direct allocation to generators subject to such contracts.

At the very least, the Cap-and-Trade Regulation should be amended so that, where entities receiving an allocation for industrial assistance will experience no increase in their energy costs due to a pre-AB 32 contract, the allowances will be awarded, not to that entity, but to its counterparty instead. CARB Staff held out the prospect of just such a rulemaking upon finalizing the Regulation, saying CARB is "still considering withholding allowances from [energy-intensive/trade exposed steam hosts] that do not face carbon costs in cases where long-term contracts prevent thermal energy sellers from recovering these costs."[25] Calpine strongly encourages CARB Staff to continue monitoring the counterparties' negotiation efforts and to consider proposing such a change to the Cap-and-Trade Regulation as part of its forthcoming rule amendments as soon as possible in 2012.

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Calpine looks forward to working with the Board and Staff to amend the Cap-and-Trade Regulation to address these outstanding issues and ensure timely and successful implementation of the program. 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

Kassandra Gough
Director, Government and Legislative Affairs

cc: James Goldstene, Executive Officer
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[24] *See* December 2010 Comments, 4.

[25] FSOR, Response to Comment I-104, 655.