BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON THE MARCH 30, 2012 DISCUSSION DRAFT OF THE CAP AND TRADE REGULATION

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I. INTRODUCTION AND SUMMARY.

The Southern California Public Power Authority ("SCPPA") [1] respectfully submits this comment on the proposed amendments to the regulation entitled *California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms*, Title 17 California Code of Regulations, Subchapter 10, Article 5, released by the California Air Resources Board ("ARB") for public comment on March 30, 2012 ("Discussion Draft").

In summary, SCPPA approves of many of the changes proposed in the Discussion Draft. However, certain issues should be addressed before the Discussion Draft is finalized and issued for 45-day public comment. SCPPA considers that:

- Linking should be approached with caution. The ARB should consider delaying linking until after the California and Quebec programs have started operating. Before working on linking provisions, other key provisions in the California regulation should be finalized.
- Certain provisions of the California and Quebec regulations should be harmonized before the programs are linked. Caps should be equally stringent in each jurisdiction; the prices of allowances in the allowance price containment reserves should be harmonized; offset supply under each program should be approximately equivalent; and compliance instrument transfer provisions should be the same.

[1] SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, the Imperial Irrigation District, Pasadena, Riverside, and Vernon.

- Linking should not result in an increase to the auction reserve price. The auction reserve price should be the lower of the Quebec and California prices, not the higher.
- The ARB should track market performance and flows of compliance instruments between jurisdictions, for early warning of potential issues caused by linking. A process for delinking should also be included in the regulation, to enable a quick response to any severe issues that occur and to mitigate the damage caused by improperly functioning markets.
- Linking appears to involve delegating authority on market operations to WCI, Inc. Given its important role, this organization should become more transparent and allow more public scrutiny and input.
- Circumstances in which applicants may be denied registration should be clarified.
- The procedures for designation and delegation relating to account viewing agents appear to overlap and should be clarified.
- The definition of "corporate association" should be expanded to allow publicly-owned utilities the benefit of the account consolidation provisions.
- The know-your-customer requirements are intrusive and will cause difficulties in practice. The type of information required should be less sensitive. Alternatively, the ARB should rely on employee screening procedures used by registered entities. No in-person presentation of documents should be required.
- The method of determining the amount of the bid guarantee should be clarified.
- The holding limit provisions should be amended. Penalties for breaching the holding limit should only be imposed after notice and a cure period. The limited exemption in

2012 should be calculated after 2011 emission reports have been verified, and the holding limit for corporate associations should not be restricted to the limit for future allowances.

- The provisions on compliance instrument transfers should be amended. The references to "settlement" of transaction agreements should be removed. No penalties should be imposed if the seller's transfer request and confirmation and the buyer's confirmation are not received within the required timeframes. Requirements for transfers from an entity's holding account to its compliance account should be reduced.

These issues are discussed in more detail below. Issues relating to linking are addressed first and subsequent sections address issues in the order in which they arise in the Discussion Draft.

II. LINKING SHOULD BE APPROACHED WITH CAUTION.

SCPPA supports linking California's cap-and-trade program to cap-and-trade programs in other jurisdictions, initially Quebec, after issues associated with linkage have been fully vetted and some practical experience with the respective cap-and-trade programs has been gained, and only to the extent that linkage can help to contain the costs of the linked programs.

In theory a larger market for allowances would be a more liquid market, and having a larger market would make available more lower-cost opportunities to reduce greenhouse gas ("GHG") emissions. The call to link with Quebec would be more persuasive if this theory is supported by empirical evidence, relating to the particular circumstances of the California and Quebec programs, that linkage will indeed produce the intended benefits. SCPPA encourages the ARB to seek such evidence and disseminate it to stakeholders.

A. Consider delaying linking until after each program has started operating.

The ARB appears focused on linking California's cap-and-trade program with Quebec's in 2012, before either program has become operational. Linking will unavoidably result in

making California's program – which is already complex and rife with uncertainties as to how it will operate in practice – even more complicated and less predictable, particularly given that the linked jurisdiction is outside the United States. Linking at this early stage increases the number of issues that may arise with the new programs, raising the risk that significant problems will occur that would necessitate delinking or major revisions to the programs.

For these reasons, the ARB should consider delaying linking until the California program and the Quebec program have started operating, any initial problems have been resolved, and the programs have demonstrated that they are stable and effective.

B. Before working on linking provisions, other key provisions in the California regulation should be finalized.

ARB staff are evidently spending considerable time and effort in developing the amendments to the California cap-and-trade program that are required for linking. While this level of effort is to be commended, the priority accorded to these amendments should be reconsidered. Prior to linking with another cap-and-trade program, outstanding issues with the California program should be addressed. Specifically, priority should be given to resolving electricity issues, including resource shuffling, the position of publicly-owned utilities that sell electricity to the California Independent System Operator, and the treatment of electricity imports. Electricity issues were specifically noted in Resolution 11-32 approving the cap-and-trade regulation in October 2011. These issues affect emissions reports due this year, as well as important decisions regarding the allocation of allowances between a utility's accounts (decisions which must be made by September 1, 2012, under section 95892(b)(3) of the Discussion Draft). These are not issues that can be delayed until next year. Furthermore, they should not be delayed due to the fact that all ARB efforts are concentrated on linking, which SCPPA considers a lower priority that does not need to be completed this year.

C. Certain provisions of the California and Quebec regulations should be harmonized.

SCPPA understands the ARB's view that not all of the provisions of the linked programs need to be identical in order for linking to be successful. However, certain features of Quebec's program should be reviewed to ensure that linking Quebec's program to California would not result in exacerbating rather than mitigating allowance prices. Currently, the version of Quebec's cap-and-trade regulation that is publicly available in English is dated July 7, 2011.[2] ARB staff stated at the workshop on the Discussion Draft on April 9, 2012 ("Workshop") that a revised version of the Quebec cap-and-trade regulation will become available in a few weeks. Without access to the revised version to compare its provisions to the Discussion Draft, it is difficult to assess whether key provisions in the two regulations are sufficiently harmonized. The ARB should provide information regarding Quebec's cap-and-trade program to California stakeholders to enable them to better understand Quebec's program and provide informed input, before the decision to link is made.

Currently, it appears that there are several important differences between the two programs. SCPPA considers that certain features of the two programs, discussed in sections II.D to II.H below, should be harmonized in order to prevent linking causing adverse impacts on the programs.

D. Caps should be equally stringent in each jurisdiction.

The ARB should be careful to ensure that Quebec's program will not contain features that would counterproductively result in an increase in the cost of allowances, thereby negating the principal benefit – cost containment – that can be obtained through linkage. A key part of this is ensuring that Quebec's cap-and-trade program is not so short of opportunities to reduce GHG

[2] Available at: http://www.mddep.gouv.qc.ca/changements/plan_action/projet-reglement/droits-emission-ges_an.pdf

emissions that covered entities in Quebec would rely on California disproportionately to generate emissions reductions, potentially causing allowance prices to be higher than they would be if California were not linked to Quebec's program.

As a related issue, California should be careful to ensure that the cap set by Quebec is not more stringent than California's cap. Linking to jurisdictions with more stringent caps would tighten the market for allowances in the linked jurisdictions, driving up allowance prices. ARB staff stated at the Workshop that they believe the California and Quebec caps are equally stringent. SCPPA looks forward to the release of data and analysis to support this contention.

E. Section 95913(e): Prices of allowances in the allowance price containment reserves should be harmonized.

ARB staff indicated at the Workshop that, as each jurisdiction is independently establishing a cost containment reserve, and entities will only be able to access the reserve in their own jurisdiction, it was not considered crucial to harmonize the prices of allowances in the reserves.

However, as the reserve prices function as a soft cap on the price of allowances, differences between the reserve prices in each jurisdiction are likely to affect the unified allowance market. If the administratively established prices for allowances in Quebec's cost containment reserve escalate more rapidly than the administratively established prices for allowances in California's allowance price containment reserve, Quebec could put pressure on prices in the unified allowance market, forcing more reliance by California covered entities on the California allowance price containment reserve than would occur otherwise. This could occur even if, as proposed in section 95913(b) of the Discussion Draft (p. 151), entities registered in Quebec were unable to access California's reserve directly. Thus, the rate of escalation of the prices for reserve allowances should be harmonized.

Section 95913(e)(3) of the Discussion Draft (p. 152) specifies reserve tier prices for 2013 ($40 per allowance for allowances from the first tier, $45 per allowance for allowances from the second tier, and $50 per allowance for allowances from the third tier). The rate of escalation of allowance prices is set in section 95913(e)(4) (p. 152) at five percent annually plus the rate of inflation as measured by the most recently available 12-month value of the Consumer Price Index for all urban consumers. Section 58 of Quebec's regulation sets prices equal to California's prices, but there is no adjustment for differences in currency valuation and no provision for annual increases in prices. If Quebec's revised regulation imposes increases in the reserve price that are greater than California's, or if currency fluctuations cause Quebec reserve allowances to become more expensive than California's, there may be less demand for allowances from Quebec's reserve and greater demand for California allowances which are likely to remain capped at the California reserve prices (at least until the California reserve becomes depleted).

SCPPA suggests that the prices of allowances from the California and Quebec reserves be harmonized by providing that the prices be the lower of, or the average of, the prices that would otherwise apply under the California and Quebec regulations.

F. Offset supply under each program should be approximately equivalent.

In addition to allowing the use of offsets, a linked program should facilitate the availability of offsets to avoid increasing demand for the limited number of offsets that will be generated pursuant to the California program. However, Quebec's regulation does not appear to provide for protocols that would result in the generation of offsets in proportion to or exceeding the rate of generation of offsets under California's offset protocols. Accordingly, SCPPA urges California and Quebec to adopt similar offset protocols to ensure that opportunities for the

generation of offset credits under the Quebec program will, at a minimum, be no less than under the California program.

G. Section 95911(c): Linking should not result in an increase to the auction reserve price.

As noted above, one of the key purposes of linking to other cap-and-trade programs is to reduce the cost of compliance. However, one of the changes in the Discussion Draft that was included to facilitate linking may instead increase the floor price of allowances at auction.

Section 95911(c)(1) of the Discussion Draft (p. 138) sets the auction reserve price at $10 per metric ton for allowances auctioned in 2012. In subsequent years, the auction reserve price will be the higher of the prices established under the Quebec and California programs (section 95911(c)(3)(D), p. 139). These prices may differ due to differences in inflation rates and currency fluctuations.[3]

Rather than choosing the higher of the two prices, which may result in increasing the floor price above what it would be in the absence of linking, SCPPA considers that the floor price should be the lower of the two prices. Section 95911(c)(3)(D) should be revised as follows:

> (D) The auction administrator will use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated separately in U.S. and Canadian dollars. The auction administrator will set the Auction Reserve Price equal to the lower~~higher~~ of the two values.

H. Compliance instrument transfer processes should be harmonized.

The new provisions on the transfer of compliance instruments in section 95921 of the Discussion Draft do not match those in Chapter IV of the Quebec regulations. These provisions

[3] SCPPA notes that the Quebec auction reserve price, and the method for increasing it, set out in section 95911(c)(3)(B) of the Discussion Draft differs from the price and method set out in section 49 of the Quebec regulation. Presumably this inconsistency will be addressed in the forthcoming revised version of the Quebec regulation.

need to be identical in order to allow for the smooth functioning of a market that will include transactions between California and Quebec entities.

I. The regulation should provide processes for tracking allowance flows and market performance, and delinking in specified circumstances.

As noted above, linking increases the complexity of the cap-and-trade program and, whether due to linking or to other factors, it is possible that issues with one or both programs may arise. If so, prompt action will be required to identify and address the issues to avoid negative impacts on the markets, including related markets such as the electricity market. For this reason, California's cap-and- trade regulation must contain procedures for tracking the performance of each program, monitoring and reporting on California's and Quebec's markets, including the flows of compliance instruments between the two jurisdictions and the trading activities of covered entities and (separately) non-covered entities, and delinking in specified circumstances.

To provide certainty to the market, the delinking provisions must explicitly allow California entities to continue using Quebec allowances (which will not be identifiable as such by market participants) that have already been issued for compliance after delinking.

J. Greater transparency is needed regarding the operations of WCI, Inc.

Linking with other jurisdictions appears to involve the ARB relying on private entities, in particular WCI, Inc., and indeed delegating some authority regarding the operation of the cap-and-trade program to that entity. This is a concern to SCPPA members given that WCI, Inc., unlike the ARB itself, does not operate in a publicly-accountable manner. SCPPA recognizes that as a private Delaware corporation WCI, Inc. is not subject to the "sunshine laws" that apply to public entities in California. However, SCPPA requests the ARB to ask WCI, Inc to consider operating as if those laws did apply to it – for example, by providing notice of its meetings at

which cap-and-trade operational issues will be decided, and allowing public attendance and input at those meetings. Information on the method by which WCI, Inc. will resolve disputes regarding the operation of the cap-and-trade program should also be provided.

Furthermore, SCPPA considers that the voting power of each participating jurisdiction on the WCI board should be commensurate with that jurisdiction's share of the total emissions covered by the linked cap-and-trade programs.

III. SECTION 95830: CIRCUMSTANCES IN WHICH APPLICANTS MAY BE DENIED REGISTRATION SHOULD BE CLARIFIED.

Section 95830(c)(1)(I) of the Discussion Draft (p. 54) provides that:

> Applicants may be denied registration (i) based on information provided; or (ii) if the Executive Officer determines the applicant has provided false or misleading information, or (iii) has withheld information material to its application.

Given the importance of registration for participating in the emissions market and complying with the cap-and-trade program, any circumstances in which an applicant may be denied registration should be clear. The current drafting does not specify what sort of information, if provided by an applicant, would result in registration being denied. The information that must be provided, as listed in sections 95830(c)(1)(A)-(H), is relatively straightforward and, so long as it is accurate and complete, would not appear to provide any basis for denying registration. Subsections (ii) and (iii) of section 95830(c)(1)(I) address accuracy and completeness. There does not appear to be any need for the ARB to have the broad ability to deny an application for registration that is based on complete and accurate information.

Section 95830(c)(1)(I) of the Discussion Draft should be renumbered as section 95830(c)(2), as it does not follow on from the list in sections 95830(c)(1)(A)-(H), and this section should be revised as follows:

~~(I)~~(2) Applicants may be denied registration ~~(i) based on information provided; or (ii)~~ if the Executive Officer determines the applicant (i) has provided false or misleading information, or (ii~~i~~) has withheld information material to its application.

IV. SECTION 95832: THE DESIGNATION AND DELEGATION PROCEDURES APPEAR TO OVERLAP AND SHOULD BE CLARIFIED.

Under section 95832(a) of the Discussion Draft (p. 61-2), an application for registration must designate an authorized account representative, alternate authorized account representatives and account viewing agents, including an attestation from an officer of the relevant entity verifying the selection of those representatives (section 95832(a)(4)). Separately, section 95832(h) of the Discussion Draft (p. 66-7) sets out a procedure for an authorized account representative or alternate authorized account representative to delegate authority to account viewing agents via a notice of delegation, also including an attestation from an officer of the relevant entity (section 95832(h)(2)(C)).

These procedures appear to be duplicative. If a registration application under section 95832(a) includes details of the account viewing agents, complete with attestation, there should be no requirement for the additional delegation procedures set out in section 95832(h). The procedures in section 95832(h) should be reserved for changes to, or additions to, the account viewing agents that the entity has nominated under section 95832(a).

Furthermore, as "account viewing agent" is a defined term, section 95832(h) and the definition in section 95802(a) (p. 3) should be redrafted for increased precision and clarity as follows:

"Account Viewing Agent" means an individual authorized by a registered entity to view all the information on the entity's accounts and transfer records contained in the tracking system.

(h) Changes to account viewing agents~~Delegation by authorized account representative and alternate authorized account representatives~~.

~~(1) An authorized account representative or an alternate authorized account representative for a registered entity may authorize up to five natural persons to view all information contained in the tracking system involving the entity's accounts, information, and transfer records (account viewing authority).~~

(~~1~~2) In order to change an account viewing agent designated under section 95832(a), or designate an additional account viewing agent (up to five in total), an ~~delegate account viewing authority in accordance with section 95832(h)(1) the~~ authorized account representative or alternate authorized account representative~~, as appropriate,~~ must submit to the accounts administrator a notice of delegation, that includes the following elements:

(A) The name, address, email address, and telephone number of such authorized account representative or alternate authorized account representative;

(B) The name, address, email address, and telephone number of the new ~~each such natural person, herein referred to as "~~account viewing agent and any previously-designated account viewing agent who is being removed; and.~~"~~

(C) An attestation verifying the selec~~tee~~tion of the new account viewing agent, signed by the officer of the entity who is responsible for the conduct of the account viewing agent, and is one of the officers disclosed pursuant to section 95830(c)(1)(B).

V. SECTION 95833: THE DEFINITION OF "CORPORATE ASSOCIATION" SHOULD BE EXPANDED TO ALLOW PUBLICLY-OWNED UTILITIES THE BENEFIT OF THE ACCOUNT CONSOLIDATION PROVISIONS.

Section 95833(e) of the Discussion Draft (p. 71) allows for the consolidation of accounts held by entities that are part of a direct corporate association. The SCPPA members would like to be able to utilize these new account consolidation provisions, so that a utility could have one set of accounts covering all power plants it operates in California as well as its electricity imports.

Absent these provisions, ARB staff have informed SCPPA that a utility would have a separate set of accounts for each California electricity generating facility that it operates, as well as a separate set of accounts for its imported electricity. This would result in SCPPA members having up to five sets of accounts each. Under section 95870(d) (p. 105), allowances allocated to

utilities will be distributed into utility accounts prior to the start of each compliance year. Each publicly-owned utility ("POU") must inform the Executive Officer how many of its allocated allowances are to be placed into each of its compliance accounts and limited use holding accounts before the allowances are distributed (section 95892(b)(3), p. 126). In order to properly allocate its allowances between its various accounts, a utility would be required to estimate the future emissions from each of its facilities and its imported electricity over the coming year. Incorrect estimates will result in the utility having too few allowances in one account and too many in another. If allowances are placed in compliance accounts, as many POUs wish to do, the allowances cannot be moved and excess allowances in one account will be stranded, while the POU will be required to purchase additional allowances to make up any shortfalls in other accounts. It is difficult for utilities to accurately forecast emissions from each facility for a year, as emissions will vary depending on factors such as the production of renewable energy, the weather, electricity demand, whether there are any transmission outages, etc.

Therefore, POUs need to be able to consolidate their accounts. However, the facilities operated by SCPPA members do not meet the current definition of "direct corporate association" in section 95833(a) (p. 69). This definition, which refers to concepts such as shareholdings, voting power, appointment of directors, and common parents, does not apply to a POU, such as a SCPPA member, that consists of only one legal entity but operates more than one facility, as well as importing electricity.

A new subsection 95833(a)(7) should be included to provide for all of the facilities operated by the same utility, as well as its imports, to have direct corporate associations with each other:

> (a)(7) The operator of an electricity generating facility in California has a direct corporate association with the operator of another electricity

generating facility in California if the same entity (for example a publicly-owned electric utility or joint powers agency) operates both generating facilities. The operator of an electricity generating facility in California has a direct corporate association with an electricity importer if the same entity (for example a publicly-owned electric utility or joint powers agency) operates the generating facility and imports electricity.

VI. SECTION 95834: THE KNOW-YOUR-CUSTOMER REQUIREMENTS ARE NOT APPROPRIATE AND SHOULD BE AMENDED.

A. The draft Know-Your-Customer requirements are intrusive and impractical.

Section 95834 (p. 73-75) requires all individuals seeking access to the tracking system, which would include authorized account representatives, alternate authorized account representatives, and account viewing agents, to provide extensive personal information (including passport numbers and personal bank account details) to the Executive Officer. Furthermore, this information is to be presented in person at a location designated by the Executive Officer (section 95834(c)(1)).

SCPPA understands that the ARB wishes to be able to confirm the identity of individuals to avoid the problems with fraud and market manipulation that have occurred in the European emissions trading system. However, the proposed Know Your Customer requirements are intrusive. It would be difficult for an entity to require up to 10 of its staff to provide this personal information to the ARB. In addition, presenting documents in person will be expensive and time-consuming for both the ARB and for participating entities, particularly if the entity is required to send up to 10 of its staff to Sacramento for this purpose, taking time away from their office duties. If it obtains all this personal information, the ARB should recognize the potential for significant liability if there is a breach of the security of the ARB's records.

There are several ways in which the Know-Your-Customer requirements could be revised to avoid the issues outlined above while still ensuring the security of the tracking system.

B. The requirements could be changed to reflect the requirements of the Acid Rain Program.

A more reasonable approach would be to require account representatives and account viewing agents to disclose only the type of information required under the Acid Rain program run by the US Environmental Protection Agency. This program requires agents to answer several questions known only by the agent. (For example: In what city was your first job? What was the name of your high school? What was the name of your first pet?)

Once this process is completed, the individual would receive a password to enable them to access the tracking system in the future, and to enable the system to track which individuals have accessed the system at what times. For additional security, representatives could be required to change their password periodically (the Acid Rain Program, for example, requires password changes every 90 days), and in order to change the password the individual could be prompted to answer one or more of their security questions.

C. The ARB's requirements could apply only if the registered entity has not undertaken an equivalent checking process prior to employing the relevant representative.

If the ARB does not wish to adopt a model similar to the Acid Rain Program and instead wishes to retain requirements similar to those in the Discussion Draft, the ARB should give registered entities an opportunity to provide information to the ARB on the processes those entities use to vet potential employees. For example, POUs typically require potential employees to go through a screening process. We can provide examples of these processes if required. The screening process may include providing fingerprints through the Live Scan program, which transmits fingerprints to the California Department of Justice and the Federal Bureau of Investigation for a review of the applicant's criminal record. If an account representative was

employed after passing these requirements, the ARB should rely on these procedures and should not impose any additional requirements on that person.

If registered entities do not have acceptable screening methods in place, or if they do not provide information on their screening methods to the ARB, the ARB could continue to request that representatives of those entities provide the information in section 95834.

D. Know-Your-Customer requirements should not apply to account viewing agents.

While it is important that the identity of authorized account representatives and alternate authorized account representatives be verified in a reasonable manner as discussed above, there does not appear to be a need for account viewing agents to be subject to the same requirements. These agents cannot undertake any transactions on the tracking system – they can only view it (section 95832(h)) – and so they cannot commit fraud involving compliance instrument transfers. SCPPA considers that extensive Know-Your-Customer requirements should not apply to account viewing agents.

E. The process for submitting information should be clarified and streamlined.

No presentation of documents in person should be required; rather, information should be able to be submitted online as part of the registration process. If necessary, notarized copies of documents could be sent by mail; this is contemplated as an option under section 95834(c)(2) (p. 75).

The regulation should clarify the process for providing this information as it relates to the registration process set out in sections 95830-95832. It should also be clarified that each individual will only be required to provide this information once, not every time that person wishes to access the tracking system.

VII. SECTION 95911: CROSS-REFERENCES SHOULD BE CORRECTED.

A. The cross-reference in section 95911(e)(5)(B) should be corrected.

Section 95911(e)(5)(B) of the Discussion Draft (p. 142) refers to the bidding entity's share calculated in section 95912(e)(4)(A). However, there is no section 95912(e)(4)(A) in the Discussion Draft. The correct cross-reference should be inserted.

B. The cross-reference in section 95911(f)(2) should be corrected.

Section 95911(f)(2) of the Discussion Draft (p. 143) refers to allowances from a consignment source in section 95911(b)(3)(A). However, there is no section 95911(b)(3)(A) in the Discussion Draft. The correct cross-reference should be inserted.

VIII. SECTION 95912(i): THE METHOD OF DETERMINING THE AMOUNT OF THE BID GUARANTEE SHOULD BE CLARIFIED.

Section 95912(i)(2) (p. 148) sets out the method to be used by an entity that wishes to bid at an auction to determine the amount of the bid guarantee it is required to submit. This section is unclear, particularly the reference to "any potential auction settlement price," as bidders will not know in advance what the auction settlement price will be. However, after reviewing correspondence from ARB staff on this issue, it appears that these provisions are intended to operate as follows: Treating each of its bid prices as if it were the auction settlement price, a bidder should calculate which of its bid prices would yield the highest value after multiplying the settlement price by the number of allowances the bidder would receive at that price. This highest value will be the amount of the bid guarantee.

If, for example, a bidder intends to submit three bids, a bid for 1,000 allowances at $20, a bid for 1,000 allowances at $15 and a bid for 1,000 allowances at $10:

- Assuming the auction settlement price is $20, the bidder's highest bid price, then the bidder would only receive 1,000 allowances (as its other bids were below the settlement

price), and the total value in that case would be 1,000 x $20 = $20,000. This would be the quantity of bids submitted at or above the potential settlement price, times that price (section 95912(i)(2)(A)).

- Assuming the auction settlement price is $15, the bidder would receive 2,000 allowances (since it bid 1,000 allowances at the settlement price and another 1,000 above the settlement price), and the total value would be 2,000 x $15 = $30,000.
- Assuming the auction settlement price is $10, the bidder would receive all 3,000 allowances it bid for, and the total value would be 3,000 x $10 = $30,000.
- Therefore, the highest value of the bidder's set of bids calculated as if the bid prices were auction settlement prices (which seems to be the meaning of section 95912(i)(2)(B)) would be $30,000, and so the bidder would have to provide a $30,000 bid guarantee to cover these bids.

SCPPA does not object to this method of calculating the amount of the bid guarantee. However, the drafting of this section should be clarified as follows, because it is not clear on its face.

(2) The amount of the bid guarantee must be greater than or equal to the maximum value of the set of bids submitted by the auction participant.

(A) The value of a ~~set of~~ bid at a particular price is determined by multiplying that price by the quantity of allowances the auction participant would receive if that price were thes~~, evaluated at any potential~~ auction settlement price~~, equals the~~ , i.e. the quantity of allowances in the auction participant's bids submitted at or above that price ~~times that price~~.

(B) The maximum value of a set of bids is the highest value of the auction participant's bids at each bid price, as determined under section (A)~~a set of bids calculated at any potential auction settlement price~~.

IX. SECTION 95920: THE HOLDING LIMIT PROVISIONS SHOULD BE AMENDED.

A. Penalties for breaching the holding limit should only be imposed after notice and a cure period.

Section 95920(b)(6) (p. 163) provides that an entity may be penalized if it exceeds the holding limit or even if it merely files transfer requests that would violate the holding limit. Although there is a need to enforce the holding limit provisions, imposing penalties in these circumstances may be unreasonable. This is particularly so given that the holding limit and limited exemption calculations are not very straightforward, that each compliance instrument transfer will take up to three days to complete (but may be quicker),[4] and as a result it may be difficult for an entity that is active in the market to know from moment to moment whether it is in breach of the holding limit. Furthermore, expensive penalties may not be necessary given that there is already a provision for the Executive Officer to take the excess allowances and auction them (section 95920(b)(5)), resulting in the entity losing valuable allowances, which is in itself a penalty.

Section 95920(b)(5) also gives an entity that has violated the holding limit a period of five days after being notified of the breach to bring its account balances within the holding limit, before the Executive Office may consign the excess allowances to auction. The same or a similar process should apply before any penalties may be imposed. The entity should first be notified that it has breached the holding limit, be given an opportunity to provide additional information that may exonerate it (for example, relating to an adjustment of its limited exemption under section 95920(d)(3), p. 165), and be given a period of time to bring its account balance within the applicable holding limit, before any penalties may be imposed.

[4] See section 95921(a), setting time limits of 48 hours for actions by the seller plus 24 hours for actions by the buyer. If both buyer and seller in a particular transaction act more quickly, the transaction may be concluded in a shorter period.

Penalties should certainly not be imposed merely for filing transfer requests that would violate the holding limit, because at the stage of filing the transfer request no breach has occurred (as the entity would not yet be over the holding limit). In fact there is no certainty that a breach would ever occur in this situation, as the transfer request may not proceed for any one of several reasons, or before the transfer is completed additional transactions may have taken place that ensure the entity is not in breach of the holding limit.

SCPPA recommends deleting section 95920(b)(6) and amending section 95920(b)(5) to include a reference to penalties, as follows:

> (5) If the violation is not discovered until after a transfer request is recorded … then:
>
> (A) The accounts administrator will inform the violator.
>
> (B) The violator will have five business days to bring its account balances within the holding limit. After that period, if the violator remains in breach of the holding limit, the Executive Officer may transfer allowances in excess of the holding limit to the Auction Holding Account for consignment to auction using the procedure pursuant to section 95910(d), and penalties may be imposed pursuant to section 96013.
>
> ~~(6) Penalties may be applied whenever the holding limit is exceeded or transfer requests are filed with the accounts administrator that would violate the holding limit.~~

B. The limited exemption in 2012 should be calculated after 2011 emission reports have been verified.

Section 95920(d)(2)(B) of the Discussion Draft (p. 164) provides for the limited exemption from the holding limit to be calculated on June 1, 2012, as:

> the annual emissions most recent emissions data report that has received a positive or qualified positive emissions data verification statement.

As of June 1, 2012, the most recent verified emissions report will be for 2010, as the verification statement for the 2011 report is not due until September 1, 2012.[5] The 2010 electricity transactions report does not include emissions, only megawatt hours of electricity imported, exported, wheeled, and purchased or sold within California. Therefore, it is not appropriate to use the 2010 reports to establish the limited exemption, as the 2010 reports lack emissions data for imported electricity.

Furthermore, given that allowances will not be distributed until September 14, 2012 (section 95870(d)), and the first auction will take place on November 14, 2012 (section 95910(a)(1)), there appears to be no need to establish a limited exemption in June 2012. Instead, it would be more appropriate to wait until the 2011 reports have been verified, and establish the limited exemption as of September 1, 2012, as follows:

> (B) On September~~June~~ 1, 2012 the limited exemption will equal the annual emissions in the most recent emissions data report that has received a positive or qualified positive emissions data verification statement.

C. The holding limit for corporate associations should not be restricted to the limit for future allowances.

Section 95920(f)(1) of the Discussion Draft (p. 166) requires the total number of allowances held by a group of entities with a direct corporate association to be less than the holding limit for future allowances established under section 95920(e). It is unclear why the holding limit for corporate associations should be established with reference only to the holding limit for future allowances and without reference to the holding limit for current and past allowances established under section 95920(d). The better approach would be to specify that the number of current and past allowances held by a group of entities with a direct corporate association must meet the holding limit established for such allowances under section 95920(d),

[5] Regulation for the Mandatory Reporting of Greenhouse Gas Emissions, Title 17 California Code of Regulations section 95103(f).

and the number of future allowances held by the group must meet the holding limit established for future allowances under section 95920(e), as follows:

> (f) Application of the Corporate Association Disclosure to the Holding Limit.
>
> (1) The total number of allowances qualifying pursuant to section 95920(c)(1) held by a group of entities with a direct corporate association pursuant to section 95833 must sum to less than the holding limit pursuant to section 95920(~~e~~d). The total number of allowances qualifying pursuant to section 95920(c)(2) held by a group of entities with a direct corporate association pursuant to section 95833 must sum to less than the holding limit pursuant to section 95920(e).

X. SECTION 95921: THE PROVISIONS ON COMPLIANCE INSTRUMENT TRANSFERS SHOULD BE AMENDED.

A. The references to "settlement" of transaction agreements should be removed.

Sections 95921(a)(1)(A) and (b)(5) (p. 168-9) refer to the date of "settlement" of an agreement to transfer compliance instruments. Under section 95921(a)(1)(A), the settlement time starts the 48-hour window of time in which the seller must complete its transfer request and confirmation. However, not all agreements may specify settlement dates as such – they may instead refer to delivery dates, transaction dates or transfer dates. Furthermore, the parties may intend the settlement or delivery date to be the date on which the transaction is to be completed, i.e. the instruments transferred to the buyer, rather than the date starting the process of requesting a transfer, which may take up to three days.

While there needs to be a time frame within which the seller must complete the two steps of the transfer request and confirmation, there is no need to tie these steps to a "settlement date." Each agreement to transfer compliance instruments will contain its own provisions to ensure the seller undertakes the necessary steps to transfer the instruments at the agreed time. There is no need for the ARB to police the settlement or delivery date under the agreement. The transfer provisions in the Discussion Draft should not be more prescriptive than necessary.

Therefore, section 95921(a)(1)(A) should be amended to require the seller only to submit its confirmation within 48 hours of submitting the transfer request, without reference to settlement.

> (A) One individual who is the authorized account representative or an alternate authorized account representative of the source account for the transfer submits a transfer request to the accounts administrator, and~~confirmed by~~ another alternate authorized account representative for the same entity confirms the transfer request~~, to the accounts administrator~~ within 48 hours ~~of settlement of the transaction agreement for which the transfer request was submitted~~.

As settlement is no longer relevant under section 95921(a)(1)(A), the requirement to report the settlement date under section 95921(b)(5) should be deleted.

> (b) Information Requirements. ...
>
> ~~(5) Settlement date, if not the same as the date of the transaction agreement.~~

B. No penalties should be imposed if the seller's transfer request and confirmation and the buyer's confirmation are not received within the required timeframes.

As discussed above, section 95921(a)(1)(A) of the Discussion Draft (p. 167-8) imposes a 48-hour timeframe on the seller to complete its transfer request and confirmation. Section 95921(a)(1)(B) imposes a 24-hour timeframe on the buyer to submit its confirmation of the transfer. At the Workshop, ARB staff noted that penalties may be imposed on entities that do not complete these steps within the required timeframes.

However, it would not be appropriate for the ARB to impose penalties in these circumstances. If the parties fail to comply with these timeframes, the transfer will not proceed and the parties must restart the process of submitting the transfer request and two confirmations (section 95921(c)(1)(C)). This is a sufficient incentive to ensure parties abide by these timeframes. Furthermore, the agreement between buyer and seller to transfer compliance

instruments will contain its own provisions to ensure each party completes the necessary steps at the appropriate times. If the parties do not comply with these timeframes, there may be a contractual reason for this – for example, the agreement may provide for the seller to halt the transaction (e.g. by not providing its confirmation) if it discovers that the buyer's security is inadequate.

For these reasons, the ARB should not impose penalties if the parties do not comply with the 48-hour and 24-hour timeframes in sections 95921(a)(1)(A) and (B).

C. Requirements for transfers from an entity's holding account to its compliance account should be reduced.

Section 95921(a)(3) of the Discussion Draft (p. 168) provides that transfers between a single entity's holding and compliance accounts do not require confirmation pursuant to section 95921(a)(1)(B). However, there is no provision that explicitly sets out the requirements that do apply to transfers between an entity's own accounts. Presumably, such transfers still require a separate transfer request and confirmation from different account representatives pursuant to section 95921(a)(1)(A).

However, it is not appropriate to apply the procedures in section 95921(a)(1)(A) to transfers between an entity's own accounts. Such transfers, being a purely internal function of the relevant entity, do not require the same safeguards as transfers between entities, and so a transfer request should be sufficient without a separate confirmation. If an entity considers that further controls are needed, it is free to impose its own internal controls on such transfers. Given the emissions threshold for coverage, most covered entities are relatively large and are sophisticated enough to have their own risk management procedures in place.

Furthermore, Section 95921(a)(1) is inappropriate as it refers to transfers between two registered entities, whereas transfers between an entity's own accounts involve only one entity.

Section 95921(a)(1)(A) also refers to a transaction agreement (however, see SCPPA's comments in section X.A above), but there will be no transaction agreement for transfers between an entity's own accounts.

Therefore, section 95921(a)(3) should be amended to explicitly set out the single requirement – submission of a transfer request – that applies to transfers between an entity's own accounts. In addition, this section should set out the relevant information that must be reported to the accounts administrator as part of such a transfer request. Section 95921(b)(1)-(6) sets out a list of information requirements, but many of these are inapplicable to transfers between an entity's own accounts. For example, there is no need to designate two individuals initiating the transfer request and one confirming it (sections 95921(b)(1) and (2)), since only one individual should be required; and there is no transaction agreement date or settlement date to report (sections 95921(b)(4) and (5)).

(3) Transfers between a single entity's holding and compliance accounts ~~do not require confirmation pursuant to section 95921(a)(1)(B)~~will be registered in the tracking system when the authorized account representative or an alternate authorized account representative submits a transfer request to the accounts administrator. The following information must be reported as part of the transfer request:

(A) Holding account number;

(B) Compliance account number;

(C) Identification of the authorized account representative or alternate authorized account representative submitting the transfer request;

(D) Serial numbers of the compliance instruments being transferred.

Section 95921(b) (p. 169) will then need to be amended to clarify that this section applies only to transfers between two registered entities, not transfers between an entity's own accounts, and the specific exclusion in section 95921(b)(6)(B) will no longer be needed.

(b) Information Requirements. The following information must be reported to the accounts administrator as part of a transfer request under section 95921(a)(1) before any transfer of compliance instrumentsallowances between two registered entities can be recorded on the tracking system: ...

(6) Price of the compliance instrument in U.S. dollars. ...

(B) Disclosure of price is not required for transfers between entities with a direct corporate association or from an entity's holding account to its compliance account.

XI. CONCLUSION

SCPPA urges the ARB to consider these comments in finalizing the version of the Discussion Draft that will be released for 45-day public comment. SCPPA appreciates the opportunity to submit these comments to the ARB and looks forward to providing further input during the formal 45-day public comment period.

Respectfully submitted,

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