

**Comments of the Western Power Trading Forum  
On the California Air Resources Board's  
Modified Regulation Order  
For a California Cap and Trade Program**

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## **I. Introduction and Overview**

The Western Power Trading Forum<sup>1</sup> (WPTF) appreciates the opportunity to provide comments to the California Air Resources Board (CARB) on its discussion draft proposing “Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions”, issued on March 30, 2012.

The October Board Resolution clearly directed staff to revisit holding limits and auction purchase limits during 2012. WPTF understands from staff explanations at the April 9<sup>th</sup> workshop that staff intend to give further consideration to modifying these limits in a separate rule-making later this year. However, staff also indicated that any changes to the holding limits would require further coordination and harmonization with linked jurisdictions. Deferring consideration of substantive changes to holding and purchase limits to a later rule-making this year would unacceptably delay progress on this issue, since it does not appear possible to complete the rule-making and additional coordination with the Quebec process in time for 2013. Resolution of these issues cannot be put off until the second compliance period. WPTF therefore strongly recommends that CARB address substantive changes to holding limits, purchase limits and beneficial holding arrangements in the current rule-making so as to avoid the need for a separate rule-making for further coordination with Quebec. Our specific comments on these areas are presented below.

WPTF supports CARB’s efforts to ensure that the tracking system for the cap and trade program is secure, and that the program is not subject to fraud. However, in its current form, the

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<sup>1</sup> WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within California, western states, as well as other markets across the United States.

staff proposed “know-your-customer” provisions are onerous , inefficient and would interfere with the legitimate rights of companies to select and appoint their tracking system account representatives. In our comments below, we recommend modifying documentation requirements and making it easier for companies to comply by allowing other means of submitting information.

Finally, WPTF is concerned that CARB’s requirements for reporting of price information related to transactions in the tracking system are unclear and require clarification.

### **Holding limits**

WPTF, many other stakeholders, and market observers, including the California Legislative Analyst’s Office, oppose the establishment of holding limits because of their dampening of market liquidity, because they limit the flexibility of capped entities with high emissions to manage compliance and hedge against allowance price risk, and because there is no empirical justification for their imposition.

WPTF once-again urges CARB to eliminate allowance holding limits in the cap and trade program. We support proposals to increase the frequency of allowance auctions as a means of addressing concerns about market power, in lieu of holding limits.

### **Beneficial Holding Provisions**

The issue of beneficial holdings is directly related to allowance holding limits. If CARB does not eliminate holding limits, then beneficial holding provisions need to be included in the regulation so that the holding limits do not prevent electric utilities from covering their obligation for generation contracted from independent power producers and to ensure that compliance units purchased by the utilities on behalf of generators do not count against the generator’s own holding limit until the units are actually transferred.

WPTF is not persuaded by staff concerns that beneficial holdings would complicate the design of the tracking system. Our understanding is that the U.S. Environmental Protection Agency's Emission and Allowance Tracking System – the platform on which the California Compliance Instrument Tracking System is based – allows for creation of entity sub-accounts. Use of a sub-account structure for beneficial holdings would enable tracking of units in the account, and, because it is already a function of the underlying software, would not require substantial recoding. Further, CARB could address market monitor concerns by requiring that units can only be moved from an agent's beneficial holding sub-account to a principals compliance account. This would prevent allowances designated as beneficial holdings from being resold or used for the agent's own compliance.

WPTF would prefer that holding limits be eliminated. If they remain, however, then WPTF strongly recommends that CARB include provisions for beneficial holding of utilities on behalf of contracted generation and ensure that these provisions are fair and non-discriminatory.

#### **Auction Purchase limits**

WPTF remains concerned that the 15% auction purchase limit is overly restrictive on covered entities with large compliance obligations. As we noted in our February comments, the small increase in the quantity of allowances that may be purchased by any individual entity from a combined Quebec-California, relative to a California auction, is not sufficient to allay concerns about the constraining effect of the purchase limit on large California entities.

WPTF therefore continues to support elimination of the auction purchase limit for the first compliance period. If purchase limits are retained, we recommend raising them to 25% for all market participants in both jurisdictions.

## **“Know your customer” Requirements**

WPTF recognize that the know-your-customer provisions are modeled on similar provisions developed in the European Union Emissions Trading System in response to incidents of fraud and theft of compliance instruments in that program. However, the European Commission directive<sup>2</sup> establishing these requirements makes critical distinctions between the documentation requirements for *nomination* of account representatives and the documentation requirements for account *registration* that are not reflected in CARB’s approach. For nomination of account representatives, the EU requires notarized documentation of the identify and address of the nominee, but does not require bank account information or other employment information. In contrast, bank account information is required for account registration by a trading entity (not a covered entity) or by an individual (‘natural person’ in the Directive’s language). In the latter case, the directive also requires employment information.

WPTF considers the proposed requirement that entity-nominated account representatives provide bank account information and employment information to be inappropriate. WPTF agrees that it is in CARB’s interest to verify the identity of individuals nominated to serve as account representatives and supports a requirement for provision of documentation of identity and address. However, we do not believe it is appropriate or necessary for CARB to impose additional criteria. Rather, the entity’s judgment in selecting and nominating individuals to serve as account representatives should be sufficient. In the case of individual or entity account registration as a voluntary associated entity, additional information requirements would be appropriate.

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<sup>2</sup> Commission Regulation No 1193/2011 of 18 November 2011 establishing a Union Registry for the trading period commencing on 1 January 2013, and subsequent trading periods, of the Union emissions trading scheme pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council and amending Commission Regulations (EC) No 2216/2004 and (EU) No 920/2010 (OJ L 315, 29.11.2011, p. 1)

WPTF is also concerned that the proposed requirement that hard-copy documentation must be submitted in person by the nominated individual or registering individual. This requirement is unnecessary and would impose excessive costs on out-of-state entities. We note that the EU requires documentation to be notarized, but does not require in-person delivery. CARB should adopt the same approach.

WPTF recommends that CARB align the know-your-customer provisions in the regulation with those of the EU in order to facilitate entity compliance. Specifically, we recommend that:

- Documentation requirements for nomination of account representatives should be different from those for account registration. Bank account information and criminal background checks should not be required for nomination of account representatives, as these individual will have been subject to whatever checks the entity considers appropriate as a condition of employment.
- Additional documentation should be required as part of the registration process for legal-entities that seek to be voluntary associated entities. This documentation should include bank account information and instruments establishing the legal entity.
- CARB should provide an option for provision of documentation via mail or electronically, rather than require in-person delivery.

### **Reporting of Price Information and documentation of Transactions**

WPTF has not previously objected to the requirement that entity's report price information as part of a transfer request. However, with the additional detail added in the proposed revisions and lack of clarity regarding how price should be determined, we now have concerns that it will be difficult for entities to comply and that reporting of price erroneous

information could lead to financial penalties. For instance, because of the nature of various contract agreements and market practices, it may not be clear what value should be reported into the tracking system. In just one example, an entity may enter into three different contracts through the Intercontinental Exchange (ICE) at three different time for delivery on the same day: a contract buy 10,000 units at \$15 on day one, another to buy 20,000 units at \$17 on day, and another to sell 25,000 units on day three at \$18. For purposes of as well as the tracking system, these three contracts will net out to a single transfer of 5000 units. But it is not clear what price the entity should report for the transaction, since the final delivery could have been sourced from either the day one or day two contracts. Swaps and various permutations of carbon in power sector contracts also pose questions.

Given these complexities, and the fact that better and more up-to-date information on market prices will be available from brokers and exchanges (where prices will reflect all transaction prices and volumes, rather than only netted transactions), WPTF questions the value of requiring price information for transactions and recommends its deletion. If CARB chooses to retain the requirement for price information, then the regulation should clarify how the entity should determine the price for a transaction.

WPTF is also concerned about the new requirement for Parties to a transfer request to provide documentation on underlying transaction to CARB upon request. WPTF believes that, in general, it is inappropriate for CARB to request bilateral market transaction information. We recognize that in cases where there is a discrepancy or dispute over a transaction in the tracking system, it may be necessary for CARB to verify records of the underlying contracts in order to sort out the discrepancy. We therefore recommend that CARB modify this provision to clarify that such documentation will requested only as necessary, and will not generally be required.

Finally, we appreciate CARB's efforts to improve the protection of confidential information related to the tracking system. Given sensitivities to the disclosure of information related to bilateral transfers, WPTF requests that CARB further modify this section to ensure that only *aggregate* information on price and quantity of instruments be published.