SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT
The Power To Do More.℠

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LEG 2011-0450

August 11, 2011

Clerk of the Board
California Air Resources Board
1001 I Street
P.O. Box 2815
Sacramento, CA 95812

Re: Sacramento Municipal Utility District's Comments on Proposed 15-Day Modifications to California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation

Clerk of the Board,

SMUD appreciates the opportunity to comment on the 15-day language for the cap and trade regulation. SMUD continues to support the overall approach the ARB has taken in the implementation of AB 32 and the cap and trade program, and continues to appreciate the hard work of your staff and the openness of your process to stakeholder interaction. It is partly through these interactions, with openness and listening on all sides, that good and lasting regulations can be adopted.

A. Summary

The cap and trade program is intended to be a backstop to a variety of complementary measures to ensure that the state achieves the overall greenhouse gas reduction goals of AB 32. The "price on carbon" that the cap and trade program will establish will provide incentives to find the lowest cost additional GHG reductions.

As the scoping plan laid out, the vast majority of the reductions in the State will take place through complementary programs, and as a result, it is imperative that the cap and trade program ensure compatibility with, and support for, those programs as the primary mechanisms for reducing emissions in California. In particular, as explained in detail below, the cap and trade program should work hand-in-hand with California's renewables portfolio standard. As currently drafted, the cap and trade regulations will have significant negative impacts on the RPS and on RPS structures in other states, as well as voluntary renewable energy programs. Similarly, there are disincentives in the regulation to continued development and use of cogeneration resources – a second AB 32 complementary program. SMUD believes that these incompatibilities must be corrected prior to final enactment of the regulations.

Our comments cover the following significant areas, as well as listing a variety of more minor corrections that help to clarify the regulations:

- The treatment of GHG emissions associated with renewable imports and consistency with the cap and trade program with the RPS, including treatment of biogas and resource shuffling issues;
- The treatment of emissions from cogeneration, particularly in situations where the cogeneration facility sells steam to the industrial host;
- The provision of allowances to utilities, including the eligibility to receive free allowances and the flexibility to move allowances to specific associated compliance accounts;
- The treatment of violations and penalties in the cap and trade program, and
- The structure and timing of the various auctions of allowances in the cap and trade program.

SMUD's comments related to offset provisions in the regulations will be filed with the Offset Working Group comments, of which SMUD is a member. SMUD also supports the comments of the Joint Utility Group.

B. Renewable Import Issues

SMUD appreciates the additional treatment in the 15-day language that provides for zero or reduced GHG treatment of the "replacement energy" sometimes used with procurement of renewables for the State's RPS. However, SMUD strongly asserts that the cap and trade program is still substantially inconsistent with the RPS, and with other RPS structures around the West. The following changes are necessary to achieve significant consistency.

B1. Definition of "Replacement Energy":

The definition of "replacement electricity" [Section 95802 (237)] should be modified in two ways: first, to remove the word "variable" throughout the definition; and second to remove the artificial constraint of limiting replacement electricity to come from the same balancing authority as the underlying renewable resource.

Limiting the definition of replacement electricity to association with variable renewable resources is inconsistent with the RPS, which currently allows substitute energy to be associated with renewables whenever there is a need for such energy, regardless of the intermittent or non-intermittent nature of the renewable resource. Using "firming and shaping", or substitute electricity, to effectively bring the energy from renewables into California and use the transmission network most efficiently to do so is most often needed for intermittent resources such as wind power. However, there are circumstances where the underlying electricity from a baseload resource cannot always or easily be transmitted directly from the source into California, and substitute energy is used in those cases for compliance with the RPS. For example, SMUD currently has a contract for biomass power in the state of Washington, but cannot always get firm transmission through intervening balancing authorities to bring the power to the state. There is no reason why this kind of "firming" – using substitute energy to bring firm baseload power to the State, should not be considered to have zero or reduced GHG for the associated energy delivered, as the action is functionally equivalent to the firming and shaping necessary for intermittent resources.

In addition, there is no need for the replacement electricity being used in these circumstances to be sourced from the same balancing authority of the underlying renewable resource. The RPS allows firming and shaping resources to be procured and associated with renewable procurement as necessary without consideration of the location of these resources. Entities are free to procure the least cost firming and shaping energy on the market, or to supply firming and shaping from their own resources. Since the default emission rate is the same for any unspecified electricity imported, and this rate is the calculated reduction in GHG emissions allowed for replacement electricity, it does not matter from an emissions perspective which balancing authority the replacement power comes from. In fact, a dynamic scheduling agreement approved by CAISO implies that any firming and shaping necessary for an intermittent renewable resource will occur within CAISO, not from the balancing authority in which the resource is located. Tracking replacement energy is a matter of contracts and tags, and is not any more or less complicated when the replacement energy comes from the same balancing authority or another.

The definition of "replacement energy" should read:

> (237) "Replacement Electricity" means electricity delivered to a first point of delivery in California to replace electricity from ~~variable~~ renewable resources in order to meet hourly load requirements. The electricity generated by the ~~variable~~ renewable energy facility and purchased by the first deliverer is not required to meet direct delivery requirements. ~~The physical location of the variable renewable energy facility busbar and the first point of receipt on the NERC E-tag for the replacement electricity must be located in the same Balancing Authority Area.~~

B2. Definition of "Variable Renewable Resource":

With the removal of the word "variable" in the definition of Replacement Electricity, there is no longer a need for a definition of "Variable Renewable Resource". Even if there were yet a need for the definition, it is restrictive in mentioning just three renewable resources – wind, solar, and run-of-the-river hydro. Other renewable resources may be considered variable at times, for example tidal power and in some cases landfill gas generation. The definition should simply be stricken:

> ~~(272) "Variable Renewable Resource" means run-of-river hydroelectric, solar, or wind energy that requires firming and shaping to meet load requirements.~~

B3. Requirement for "Direct Delivery" for voluntary renewable eligibility:

SMUD has long supported the concept of a set-aside of allowances for the voluntary renewable market, where those allowances are retired as voluntary renewable procurement occurs. SMUD appreciates and supports the addition of specific voluntary renewable provisions in the 15-day language. SMUD has additional comments about the voluntary renewable provisions below, but here simply asserts that the restriction in the provisions to only renewable energy that is "directly delivered" to California is inconsistent with the practice in voluntary renewable markets and is unnecessary in the cap and trade program. Allowances should be retired, ensuring GHG reductions in California, regardless of whether or not renewable electricity was directly delivered to California or is associated with replacement power delivered to California consistent with the allowed flexibility in the RPS and the voluntary renewable market. The first paragraph in Section 95841.1 should read:

(a) Program Requirements: The end-user, or VRE participant acting on behalf of the end-user, must meet the requirements of this section. Generation must be new and not have served load prior to July 1, 2005. Allowance retirement for purposes of voluntary renewable electricity will begin in 2013 for 2012 generation. ~~Eligibile renewable electricity, or renewable electricity associated with RECs, must provide direct delivery of electricity to California.~~

B4. Remove restriction to "Variable" resources of zero or reduced GHG treatment of replacement electricity:

Consistent with the recommendations above regarding treatment of replacement electricity associated with renewable procurement, there should be no restriction in the regulations of associating the emission factor of the underlying renewable resource solely to cases involving variable renewable resources. Two parts of the section should be changed to read:

(3) Replacement electricity that substitutes for electricity from a ~~variable~~ renewable resource qualifies for the ARB facility specific emission factor specified pursuant to MRR section 95111 of the ~~variable~~ renewable resource under the following conditions:

(A) First deliverers of replacement electricity have a contract, or ownership relationship, with the supplier of the replacement electricity, in addition to a contract with the ~~variable~~ renewable resource; and

(B) The amount of the reported replacement electricity does not exceed the amount for the reported annual ~~variable~~ renewable resource.

(C) Replacement electricity with an emission factor greater than the default emission factor for unspecified electricity specified pursuant to MRR section 95111 is not eligible to receive an emission factor of zero metric tons CO_2e/MWh. For contracts that use replacement electricity for which the emission factor is greater than the default emission factor for unspecified electricity, the difference between the emission factor from the replacement electricity and the default emission factor for unspecified electricity will be used to calculate emissions with a compliance obligation.

95852(b)(4) Claims to resources with zero direct emissions, emissions without a compliance obligation, or emissions calculat~~l~~ed using a lower emissions factor than the default emissions factor for unspecified electricity specified pursuant to MRR section 95111, ~~including renewable resources other than variable renewable resources must demonstrate,~~ pursuant to MRR, direct delivery of electricity as defined in section 95802.

B5. Treatment of RECs should be consistent with pre-existing state regulatory and voluntary market precedent:

SMUD understands that the WCI has recommended abandoning the renewable energy tracking system WREGIS for the purposes of tracking purchases of renewable energy under a First Jurisdictional Deliverer framework. SMUD, and other stakeholders in the electricity sector have pushed back against this arbitrary decision given the harm that it does to REC markets, impacting both the cost-effectiveness of the RPS and the credibility of the voluntary renewable energy market.

SMUD strongly encourages the ARB to fully vet this topic before making a final decision. The decision reverses legal definitions of Renewable Energy Credits set forth in the Public Utilities Code, and relied on in energy contracts by dozens of entities. It throws into question the underlying value of the RECs tracked by WREGIS, effectively voiding the WREGIS definition, thereby creating further confusion about legal claims that can be made regarding contracts involving this commodity. The reasoning offered by the WCI decision, primarily the administrative burden of tracking REC ownership and claims made by purchasers of null power, ignores the new administrative burden that is created for the reporters of these transactions, who now have the very tool that was created to track renewable energy claims taken away, leaving them in a predicament of relying on vague language in a reporting regulation to base long term contracts on. The decision calls into question the claims that are made in the voluntary renewable energy markets around the benefits that are embedded in REC's, thereby undermining the value of this market perhaps in a bigger way than the decision of whether or not to create a set-aside.

In addition to fully capturing stakeholder input on this important topic, the ARB should consider the cost implications of adopting this policy on REC's. The use of REC's for RPS compliance was intended to help reduce the need for building high cost and difficult to permit transmission for renewable energy, as well as to make tracking of renewable claims easier. By requiring entities to purchase both the energy and the REC in order to receive the specific emission signature of the renewable resource, the ARB is effectively eliminating, or greatly limiting the viability of, using unbundled REC's for RPS compliance. This policy is not only inconsistent with the RPS but will either increase costs under the RPS or increase costs under the cap and trade program as entities opt to purchase REC's and are required to come up with additional allowances. Considering the RPS is one of the most expensive policies under the full set of AB 32 policies, and was expected to result in substantial reductions in the scoping plan, the ARB should give strong consideration to policy decisions which either inflate its cost or reduce its effectiveness in contributing to statewide emissions reductions.

Specific changes to the cap and trade regulation would be to recognize that all state-recognized renewable energy resources procured for the RPS should be exempt from a compliance burden associated with their purchase. SMUD recommends adding a subsection (g) to Section 95852.2 (emissions without a compliance obligation), as follows:

> 95852(g) Reserved for future consideration of treatment of combustion emissions associated with power delivered along with RECs.

An example of how RECs could be more consistently incorporated into the cap and trade program is a modification of Section 95852(b)(2)(D), which could be modified to read:

> (D) If there are other parties within the contract chain of custody, then the original source of generation and quantity of MWhs to be delivered under the original contract must be identified within the entire contract chain. RECs in the form of WREGIS certificates are sufficient to meet this documentation requirement. The quantity of electricity delivered, and for which an ARB facility specific emission factor specified pursuant to MRR section 95111 is claimed, cannot exceed the original amount under ownership or contract rights reported pursuant to section 95852(b)(2)(A).

B6. Resource Shuffling Issues:

SMUD believes that the 15 Day language covering Resource Shuffling in sections 95802 and 95852 has potential to significantly and negatively impact the current operation of electricity markets and distribution and transmission operations. Appearing without a workshop, other notice or public discussion, a long definition of "Resource Shuffling" has been added to the regulation [sec 85802 (245)] along with prohibitions against use of resource shuffling in section 95852(b), and addition of a requirement for a personal attestation that resource shuffling, as defined, has not occurred. There are several levels at which this set of newly introduced concepts and regulatory language is unworkable. Prior public discussion would certainly have disclosed this. SMUD recommends that the ARB hold a public workshop in the near future giving stakeholders the opportunity to discuss and provide input on the issue of the treatment of out-of-state renewable and other electricity resource purchases under the cap and trade and mandatory reporting regulations.

Additionally, various other portions of this and other regulations address specific issues associated with emission claims due to expiring coal contracts and out-of-state renewable energy contracts. For example, SB 1368 prevents California utilities from contracting with or extending long-term, baseload contracts for new or existing generation with emissions factors greater than 1,100 lbs/MWh. Legacy out-of-state nuclear and hydro are prevented from being contract shuffled via the mandatory reporting regulation. Existing out of state eligible renewable energy sources that commenced operation prior to 2005 are ineligible for the state's RPS unless imported to California prior to 2010. It is unlikely that regulated parties would have incentives to engage in a type of resource shuffling with existing out of state renewable resources that will not provide eligibility for RPS compliance.

For the most part, then, only existing natural gas fired resources are at issue, and these are marginal resources active in high volume in short and long term markets that have emissions profiles relatively close to and both above and below the current CARB defined default emissions factor. It would be impossible for a power purchaser in this market to predict the emissions consequence, beyond their own emissions liability, of any transaction. The counterfactual nature of the "Resource Shuffling" definition renders its application impractical. Faced with potential personal allegations of fraud for consequences beyond the contractual horizon and beyond control, contracting for resources would be negatively impacted. Liquidity in this market is essential to the normal operation of the electric transmission and distribution systems.

This rulemaking has had much deliberation on the use and setting of a default emissions value for imported power. This long process has resulted in workable values and application within the regulation which define the emission obligation for imported power. The new resource shuffling language, both in definition and regulatory application, defines emissions obligations and "acceptable" emissions reductions in a way that essentially ignores this good work and places stakeholders participating in normal electricity markets at risk of significant legal consequence for normal market actions that have unknown and essentially unknowable, but relatively minor, GHG emission consequences.

SMUD suggests that the cap and trade regulatory language in this regard revert to the 45 Day language in the October 2010 regulation, without reference to resource shuffling, as most transactions that are truly worrisome are already prohibited or greatly discouraged by existing law, and the remaining transactions are too indistinguishable from normal market transactions to clearly delineate without implications that will curtail normal market transactions and potentially affect the reliability of the electricity system. Alternatively, SMUD would significantly restrict the overly broad definition of Resource Shuffling in the 15-day language, and the language describing Resource Shuffling restrictions in the regulations, as follows:

> (245) "Resource Shuffling" means any plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid, for which:

(A) An emission factor below the default emission factor is reported by a first deliverer of electricity pursuant to MRR for a generation source that has not historically served California load (excluding new or expanded capacity). And, during the same interval(s), the same first deliverer of electricity knowingly and actively participated in transactions resulting in delivery of electricity from a source with higher emissions ~~was delivered~~ to serve load located outside California and in a jurisdiction that is not linked with California's Cap-and-Trade Program; or

(B) The default emission factor or a lower emissions factor is reported pursuant to MRR, for electricity that replaces electricity with an emissions factor higher than the default emission factor that previously served load in California; except when the replaced electricity no longer serves Californa load as a result of compliance with the Emission Performance Standards adopted by the California Energy Commission and the California Public Utilities Commission pursuant to Senate Bill 1368 (Perata,Chapter 598, Statutes of 2006).

(1) Resource shuffling is prohibited~~,~~ and is a violation of this article ~~and is a form of fraud~~. ARB will not accept a claim that emissions attributed to electricity delivered to the California grid are at or below the default emissions factor for unspecified electricity specified pursuant to MRR July 2011section 95111 if that delivery involves resource shuffling. The following attestations must be submitted to ARB annually in writing, by certified mail only:

(A) "I certify under penalty of perjury of the laws of the State of California that [facility or company name] has not engaged in the activity of resource shuffling to reduce compliance obligation for emissions, based on emission reductions that have not occurred as an active and knowing part of my transaction."

(B) "I understand I am participating in the Cap-and-Trade Program under title 17, California Code of Regulations, article 5, and by doing so, I am now subject to all regulatory requirements and enforcement mechanisms of this program and subject myself to the jurisdiction of California as the exclusive venue to resolve."

B7. Biogas/biomass Issues:

Section 95852.2 describes emissions for which there is no compliance obligation. These are generally emissions from combustion of biogenic fuels, which are reasonably excluded from a compliance obligation because their combustion offsets fossil fuel combustion while also eventually or even simultaneously reducing the release of methane gas to the atmosphere. SMUD has several recommendations for clarification of this section to assure that biogas and biomethane based fuels can be used and accounted for properly without creating double-counting or contract shuffling concerns.

The first issue relates to the timing of gas flow for new contracts with out-of-state biomethane resources. Section 95852.1.1(a)(1)(A) requires that physical transfer of fuel must begin no later than 90 days after the contract is signed. In paragraph 1, immediately above this section, a one year grace period is offered for renegotiating contracts that have expired. It seems reasonable to align the fuel flow requirements with the contract expiration requirements such that fuel must flow within one year of the contract being signed. This limits any risk of delay due to testing, physical changes required onsite to cleanup equipment, or any regulatory or permitting requirements that may occur in the state in which the resource is located. Given that flowing biomethane in the interstate pipeline system is a relatively new type of gas transaction, delays should be expected, and some leeway in the initial years of this program seems warranted. Further, given the small size of existing pipeline biomethane resources that could be available, concerns about contract shuffling in this still short, 1-year timeframe are unwarranted.

Beyond extending the timeframe for flowing gas under such a contract, it is important to also recognize that utilities use long planning horizons to be able to meet resource needs cost-effectively. As such, we frequently contract for resources to be delivered several years in the future. SMUD's Board approved such a contract in 2010 for delivery of biomethane beginning in 2014 to meet our renewable resource demand. With the clause as written, any signed contract that will not commence delivery until such a future date will not qualify as an eligible biomass-derived fuel. Since such a restrictive clause had not been contemplated at the time SMUD's Board approved this contract, we request that the ARB allow for contracts already approved prior to the release of the Discussion Draft that these be exempt from the requirements set forth in 95852.1.1(a). Specific language could be included to accomplish this as follows:

(6) The biogas or biomethane contract for delivery after January 1, 2012 was approved by the PUC or POU governing Board prior to January 1, 2011

The third issue for this section has to do with clarifying the referencing of Section 95852.1.1(a)(1) in Section 95852.1.1(a)(3). Paragraph (3) is intended to allow an entity to contract with a biomethane provider who was previously under contract with another California entity prior to January 1, 2012 – the once in California, always in California rule. However, the requirements in paragraph (a)(1) are not clear as the text requires the contract to remain in effect with the same California operator. We offer the following clarification.

(1) The contract for purchasing any biomass-derived fuel must be in effect prior to January 1, 2012 ~~and remain in effect~~ or have been renegotiated with the same California operator within one year of contract expiration. The delivery of the fuel under the contract must meet the following requirements;

(A) Physical transfer of the fuel must begin no later than 90 days after a signed contract; ~~and~~ or

(B) If physical transfer of the fuel begins more than 90 days after the contract is signed then for the purposes of this provision the first date of physical fuel transfer shall be considered the contract signing date.

The fourth issue for this section relates to clarifying section 95852.1.1(a)(3) to allow biogas-derived fuels combusted at a California site of production prior to January 1, 2012 to be burned in a more efficient combined cycle generator. SMUD has a specific example wherein a unit that was previously generating electricity from landfill gas in our service territory may be put into a SMUD-owned gas pipeline to deliver its biogas directly to our highly efficient Cosumnes Power Plant. Allowing this fuel to qualify is consistent with the once in California always in California rule. Language to allow this type of shift in one California location to another location would be:

(3) The fuel being provided under a contract dated after January 1, 2012 is for a fuel that was previously eligible under sections 95852.1.1(a)(1), ~~or~~

(2) or (5), and the verifier is able to track the fuel to the previously eligible contract or project;

The fifth issue for this section relates to clarifying section 95852.1.1(b). If the intent of this section is to enable the producer of biogas-derived fuels to generate carbon offsets as well as a REC from the production of renewable energy, which SMUD supports, then SMUD recommends the following clarification:

(b) ~~An entity may not sell, trade, give away, claim or otherwise dispose of any of the carbon credits, carbon benefits, carbon emissions reductions, carbon offsets or allowances, howsoever entitled, attributed to the fuel production that would otherwise result in holding a compliance obligation for combustion CO_2. Generation of Renewable Energy Credits is allowable and will not prevent a biomass-derived fuel that meets the requirements in this section from being exempt from a compliance obligation.~~ The producer of a biogas or biomethane fuel may be eligible to generate carbon offsets for destruction of methane, as well as Renewable Energy Credits from the production of renewable electricity. The separate sale of a carbon offset from the destruction of methane shall not negatively impact the right of the user of the fuel to claim a zero compliance obligation for its combustion in a covered facility. The separate sale of a REC, containing all environmental attributes associated with the fuel, will result in a compliance obligation for imported electricity produced at a biofuel-fired facility located outside the state of California.

Our final comment on this section 95852.1.1 relates to the combustion of biomethane in a more efficient facility. In some instances, biogas that is generated onsite at an out-of-state landfill or digester may be able to produce more renewable energy if it is cleaned up and transported to a more efficient natural gas combined cycle unit. Such an action should be encouraged as a way to make the most efficient use of this renewable resource. As such, the ARB should allow increased MWh to be counted with zero compliance obligation whether that increase occurred at the landfill or digester or offsite in a more efficient facility. The ARB should modify section 95852.1.1(a) as follows:

> (7) The fuel was previously combusted onsite, but has since been cleaned up and injected into the interstate pipeline and nominated for a facility that is more efficient than the previous method of onsite combustion. In this case, the reporter may claim only the increase in generation as having zero compliance obligation, and shall calculate the effective increase using the difference in overall MWh generated per unit of fuel combusted for each of the two units.

B8. Voluntary Renewable Energy Provisions Require Clarification:

SMUD has long supported the concept of a set-aside of allowances for the voluntary renewable market, where those allowances are retired as voluntary renewable procurement occurs. SMUD appreciates and supports the addition of specific voluntary renewable provisions in the 15-day language. The purpose of the voluntary set-aside is to assure that renewable generation used to meet voluntary market demand actually results in reductions of greenhouse gases beyond those already required by the cap once a cap and trade program is put in place. The application of this set-aside to renewable projects has been restricted to those projects that are located in the State, or that dynamically transfer their energy into the State, and that have been installed after January 1, 2005.

Given that ARB set the cap based on emissions expected to occur in the State in 2012, the application of the set-aside to projects installed between 2005 and 2012 is not necessary. Such application would potentially create a doubling of the apparent reductions of those projects. Because the projects that were installed in this time-period are already displacing emissions, ARB has already effectively set aside and retired the allowances that would have otherwise been associated with these through its cap-setting process. Had the renewables not been installed, the cap would be higher. So, the renewable projects are already displacing greenhouse gases, and even if they were to go away at some future date, their impact is locked in by virtue of their having impacted the cap at the time it was set.

The only renewables that require a voluntary set-aside would be those renewables that were brought online after the cap was set that were then sold to the voluntary market. These renewables would not effect the cap trajectory without a set-aside. Adopting such a policy would also allow for more new renewables to be brought online for the voluntary market, rather than creating a situation where existing renewables were claiming much of the set-aside when it was not necessary. Such a decision would only negatively impact existing renewable projects if Green-e chose to require that they hold set-asides, however such a decision is unnecessary as explained above, the existing renewables are already displacing fossil generation and the cap setting process assures that they will in perpetuity.

In addition there are several small clarifying changes that are necessary in the voluntary renewable provisions. First, Section 95841.1(b)(1)(A) refers to the requirements of "…section 95841.1(b) (3) or (4), as applicable;" but there is no section 95841(b)(4). SMUD believes that the proper reference should be for subparts (2) or (3) as applicable. Second, Section 95841(b)(2)(D) and Section 95841(b)(3)(E) refer to a "REC retirement report", but this report is never defined. If this simply refers to the report required by Section 95841 in general, there is no need for these subsections. Third, while SMUD commends the inclusion of a provision in Section 95841(b)(3) for aggregation of smaller resources (less than or equal to 200 kW), SMUD notes that such resources may not have an RPS generator identification number, particularly since voluntary renewable resources are not part of the RPS. SMUD contends that there is no reason for requiring a specific identification number for these resources.

SMUD recommends the changes shown below:

(a) Program Requirements: The end-user, or VRE participant acting on behalf of the end-user, must meet the requirements of this section. Generation must be new and not have served load prior to ~~July 1, 2005~~January 1, 2012. Allowance retirement for purposes of voluntary renewable electricity will begin in 2013 for 2012 generation. Eligib~~i~~le renewable electricity, or renewable electricity associated with RECs, must provide direct delivery of electricity to California.

(b)(1) By July 1 of each year, provide a written request for allowance retirement for the previous year's generation or REC purchases. Request must be accompanied by the requirements below:

- (A) Report to ARB the quantity of renewable electricity in MWhs, and/or the number of RECs generated during the previous year from an eligible renewable electricity generator that meets the requirements of section 95841.1(b)(2~~3~~) or (3~~4~~), as applicable;

(b)(2) VRE Participants seeking allowance retirement for renewable electricity generation from an eligible facility > 200 KW nameplate capacity must submit the following with the report required in this section:

- (A) Provide the RPS generator identification number, as determined by the California Energy Commission;
- (B) MWhs of renewable electricity generated; and
- (C) Number of RECs, as applicable; ~~and~~
- ~~(D) REC retirement report.~~

(b)(3) VRE participants seeking allowance retirement for renewable electricity generating from an eligible facility ≤ 200 KW nameplate capacity must submit the following with the report required in this section:

(A) Application must be for retirement of more than an equivalent of 150 metric tons CO_2e. Applicants may aggregate eligible systems to meet this threshold requirement, but must submit only one application under one entity;

(B) Provide the RPS generator identification number, as determined by the California Energy Commission;

(C) MWhs of renewable electricity generated; and

(D) Number of RECs, as applicable; ~~and~~

~~(E) REC retirement report.~~

C. Cogeneration issues

SMUD invested in three cogeneration facilities in the 1990's to encourage cleaner electricity generation and low-emissions industrial facilities. The plants jointly produce roughly 1,000,000 tonnes of CO2 per year, nearly 10% of which is associated with steam sales made to four industrial heat hosts. These heat hosts are counterparties in long-term steam sales agreements with no clauses for pass-through of carbon costs associated with cap and trade regulations. Hence, SMUD and SMUD's ratepayers have the obligation of compliance for the emissions associated with the steam sales, but the cap and trade program does not recognize this obligation.

C1. Regulatory treatment of SMUD operated power plants that also supply steam to nearby industrial customers is punitive to SMUD ratepayers.

Treatment of cogeneration in the Cap and Trade regulation penalizes SMUD ratepayers for operating electrical generation facilities as co-generators of electricity for supply to SMUD's electrical grid while also supplying steam to nearby industrial facilities. The specifics of such arrangements at three of SMUD's major electrical generation facilities clearly have energy, environmental and community use benefits, and there are GHG savings for combined production of electricity and steam relative to their otherwise separate production. However, there is nonetheless a marginal additional natural gas use requirement at those facilities needed to supply steam for industrial use. Information to be provided under Mandatory Reporting Regulation (MRR) section 95112 allows for separating the GHG emissions associated with generation of electricity from those associated with supply of industrial heat. However, separate reporting of the two functional emissions is no longer required as part of the MRR and the cap and trade program 15-day language imposes on SMUD and our ratepayers an obligation to provide allowances for all the emissions emitted from the power plant stack, including those calculated as belonging to supply of the industrial heat.

None of the facilities that SMUD sells steam to will be a Covered Entity under the cap and trade regulation, and existing steam sales contracts do not allow for charges for reimbursement to SMUD for allowances obligated by the emissions fairly attributable to the industrial faculties. Without regulatory relief, SMUD's ratepayers will be forced to bear a significant cost burden and three otherwise environmentally beneficial energy arrangements will be forced to carry an unintended economic burden imposed by regulation; an economic burden that penalizes more efficient use of energy and cleaner overall resources in our community. Unfortunately unless SMUD ratepayers obtain relief either through an increased allocation of allowances or a reduction in the cogenerator allowance obligation, the combined 330MW of existing cogeneration will have another economic reason to revert to production of electricity only.

SMUD recommends the ARB allocate a small portion of the industrial allowances to cover emissions associated with provision of steam to these industrial customers. While these arrangements are not common in California, they are no less beneficial than arrangements in which the industrial source owns the generating source and exports electricity to the wholesale market. Given their value is the same, their treatment should be equivalent, so as not to discourage continuation of the arrangements with these facilities or prevent similar future arrangements from being plausible. Considering the efficiency benefits from being able to develop cogeneration using combined cycle technology, ARB should certainly be encouraging this type of arrangement if it wishes to achieve its goals for efficient cogeneration in California.

If for some reason ARB is unable to provide accommodation through provision of industrial allowance allocation, SMUD requests addition of a subpart (8) to Section 95852 to read:

> (8) An operator of a facility covered under sections 95811(b) and 95812(c)(2) that is a cogeneration facility in normal operation prior to 2011 and which sells process heat, under contracts entered prior to 2011, to facilities that are not covered entities shall have a compliance obligation ($CO_2e_{covered}$) that reduces the total reported facility emissions by an amount attributable to combustion emissions for production of the process heat. Partition of Ghg emissions attributable to electricity and process heat production shall be calculated using the efficiency method and verified information reported under MRR section 95112.

D. Allowance Allocation Issues

SMUD strongly supports administrative allocation of allowances to electric distribution utilities on behalf of their customers, as found in Article 8 of the 15 day language. SMUD also appreciates the addition of emissions associated with cogeneration electricity sold to the grid, so that the total amount of allowances initially provided as a base for the electric sector equals 97.7 million metric tons. However, SMUD believes that several changes are needed in the 15-day language to ensure that the allowance allocation policy established for electric distribution utilities works well, as described below:

D1. Direct Allocation Of Allowances Should not be Subject To Compliance With MRR And a Positive or Qualified Positive Emissions Statement For the Prior Year:

Section 95890 on page 109 states that in order to be eligible for direct allocations an electrical distribution utility must have "… complied with the requirements of the MRR…" and "… achieved a positive or qualified positive emissions data verification statement for the prior year pursuant to the MRR." This provision appears to be a holdover from when the ARB was considering an allocation mechanism that depended upon verified sales data and emissions data from prior years. In the 15-day language, the allocation to electric distribution utilities is determined up-front, and does not depend in any way on an entities reported emissions from the prior year, verified or otherwise. While compliance requires surrender of compliance instruments to cover verified emissions, or the amount assigned by the Executive Officer in the event of an adverse verification, this compliance is essentially independent going forward from the allowance allocation process. Section 95890(b) in effect represents a significant implied potential penalty and should be removed from the regulations.

The requirement for "compliance with the MRR" is too vague. An entity could be deemed in non-compliance with the MRR for a variety of reasons, including being late with reports, including inaccurate data in reports, or failure to retain records as required. In each of these cases, the MRR already establishes penalty provisions. This requirement should be removed.

The second requirement is more specific but equally problematic. While electrical distribution utilities expect to achieve positive emission data verification statements in general, the event of an adverse emission data verification statement cannot be ruled out. In such an event, it seems an egregious penalty to not provide direct allocations in the following year, forcing the electrical distribution utility to purchase allowances on the market to cover its compliance obligation. Such a penalty is not consistent with the goal of avoiding an undue compliance burden being placed on utility ratepayers. Section 95107 of the MRR already establishes penalties for submitting verification reports late and for including inaccurate information in such reports. Additional penalties for these violations are not necessary. This requirement should be removed.

Compare the situation of having an adverse verification emissions report to the situation where emissions are reported and verified accurately, but insufficient allowances are surrendered to cover them. In the latter case, an electrical distribution utility must surrender four compliance instruments for every one that is short, and is subject to additional financial penalties. In the former case, an entity could surrender compliance instruments to completely cover the emission obligation for a year with an adverse emissions statement, and in effect be required to surrender an entire year's worth of compliance instruments in the following year, in addition to any penalties for inaccuracy or failure to report properly. This is clearly not a fair penalty.

There is no reason to have an eligibility test for direct allocations that is related to compliance with the MRR or achievement of a positive or qualified positive emissions statement for the prior year. Whether one year's emissions are verified accurately or not, an electrical distribution utility still has a compliance obligation for the following year, and still has ratepayers subject to compliance costs without direct allocations. The best solution to this problem is to simply excise Section 95890(b) in entirety.

> ~~(b) Eligibility Requirements for Electrical Distribution Utilities. An electrical distribution utility shall be eligible for direct allocation of California GHG allowances if it has complied with the requirements of the MRR and has obtained a positive or qualified positive emissions data verification statement on its sales number for the prior year pursuant to the MRR~~

D2. Process For Providing Allowances To Electrical Distribution Utilities Should Be Clarified:

Section 95870(d) states that the Executive Officer will place allocations in the "holding accounts" of each utility, on or before January 15 of each calendar year pursuant to Section 95892. Several clarifications are needed here.

First, Table 9-3 in the 15-day language includes the percentage amounts that take the overall electric sector allocation, 97.7 million metric tons times the adjustment factors in Table 9-2, as stated in Section 95870(d), and allocate these annual amounts to each of the 57 electric distribution utilities identified in the table. However, no language in the regulations themselves states that Table 9-3 is to be used in this manner, and this should be corrected for clarity.

Second, the placement of allowances in the "holding accounts" of each eligible utility is inconsistent with section 95892, in which the Executive Officer is to place allowances in either the "limited use holding accounts" of each utility or, for POUs, in compliance accounts as designated in 95892(b)(2). Per Section 95892, no allowances are to be placed in a utility's "holding account".

Third, it may be useful to specify with more certainty when allowances are to be placed in the appropriate accounts, for two reasons. With the delay of the cap and trade program until 2013, there is some uncertainty about when allowances will be distributed for utilities (and industrial regulated parties) prior to that year. With two advance auctions scheduled for the second half of 2012, the regulations imply that at least for investor owned utilities the Executive Officer will place allowances in their limited use holding accounts at least 6 months prior to January 15, 2012. Presumably, industrial regulated parties would also be distributed allowances prior to the auctions, so that they have certainty about their need for allowances and can decide whether to and how to participate. While this early placement is allowed by the "on or before" language in the regulations, greater certainty about how this will work would be useful.

In addition, given the "or before" language in the regulations, there is a degree of risk for POUs, which are expected pursuant to Section 95892(b)(2) to inform the Executive Officer "..at least 90 days prior…" to receiving a direct allocation of allowances how those allowances should be dispersed to the acceptable accounts. POUs may find themselves in inadvertent violation of the regulations if the Executive Officer decides to exercise the "or before" option and the POU no longer has 90 days with which to inform about proper placement.

Finally, the term "eligible" would no longer be needed here, should ARB accept the proposed change to 95890 above. SMUD recommends that Section 95870(d) be modified to reflect the clarifications described above, as follows:

> ~~(c)~~(d) Allocation to ~~Public Utilities.(1)~~ Electrical Distribution Utilities. The Executive Officer will place an annual individual allocation in the ~~holding~~ appropriate accounts of each ~~eligible~~ electrical distribution utility on ~~or before~~ July 15, 2012, or first business day thereafter, for vintage 2013 allowances and January 15, or first business day thereafter, of each calendar year from 201~~23~~4-2020 pursuant to section 95892. Allowances ~~available for allocation~~ allocated to electrical distribution utilities shall be ~~89~~97.7 million multiplied by the cap adjustment factor in Table ~~9.2~~ 9-2 for each budget year 201~~2~~3-2020, multiplied by the utility allocation factors in Table 9-3 for each year.

D3. Process For POU Allowance Placement Option Should Be Clarified:

Section 95892(b)(2) states that Publicly Owned Utilities must inform the Executive Officer in which accounts they want allowances for the vintage year to be placed, at least 90 days prior to receipt of the allowances. The regulations allow POUs to request placement of allowances in their limited use holding accounts, their compliance accounts, or the compliance accounts of a "Joint Powers Agency in which the electrical distribution utility is a member and with which it has a power purchase agreement". There are two clarifications that would be beneficial here.

First, unlike Section 95892(b)(1), there is no language for the POUs or electrical cooperatives (note there is also a misspelling of the word "cooperative") that states that the Executive Officer shall place allowances in the accounts as previously informed by the POUs.

Second, additional flexibility is necessary for situations in which a publicly owned utility is the sole procurer of power from several JPAs associated with specific power plants. In this situation, the POU is in effect operating and dispatching the facilities, and the amount of allowances needed for compliance by a specific JPA entity may vary significantly from one year to the next depending upon system conditions in the POU's territory, and these system conditions are not well known in advance. For example, it is not known in advance whether a year will be particularly wet or dry or hot or cool, and these differing conditions can lead to large changes in the need to dispatch particular JPA associated units.

Section 95892(b)(2) should be revised to read:

(2) Publicly ~~o~~Owned Electric Utilities or Electrical Coo~~r~~peratives. At least 90 days prior to receiving a direct allocation of allowances, publicly owned electric utilities or Electrical Cooperatives will inform the Executive Officer of the share of their allowances that is to be placed~~:~~ in the allowed accounts in 95892(b)(2) (A) and (B). Upon receiving the publicly owned utility or electrical cooperative's information, the Executive Officer shall place allowances in the accounts as indicated.

(A) In the publicly owned electric utility's or Electrical Cooperative's compliance account~~,~~ or the compliance account of a Joint Powers Agency in which the electrical distribution utility is a member and with which it has a power purchase agreement; or

(B) In the publicly owned electric utility's or Electrical Cooperative's limited use holding account.

(C) With the approval of the Executive Officer, a publicly owned utility or electrical cooperative may move allowances in the compliance account of a Joint Powers Authority with which it alone has a power purchase agreement to the compliance account of another Joint Powers Authority with which it alone has a power purchase agreement prior to the surrender deadlines in Section 95856(d).

D4. Changes are required to adequately address the beneficial holding of compliance instruments by a Publicly Owned Utility

In a normal hydro year, SMUD meets about half of its retail load with energy delivered from four separate natural gas fired electricity facilities located in SMUD's territory. Though SMUD supplies all the natural gas used by the facilities, controls the output of each generator, and receives all of the power delivered from them, each facility is formally owned by a separate Joint Powers Agency or JPA. Similar JPA and multiple supply agreements are common in the POU governance and ownership relationships. Language in the October 2010 version of the regulation implied and did not rule out that SMUD could act as an agent for these JPA covered entities that supply us power; this would include holding in a common compliance holding account all of the compliance instruments to be used to satisfy SMUD's compliance obligations for imported power as well as those for the SMUD JPA's. Instruments held in a common Compliance Holding Account would not be transferable to a Holding Account. However the addition in the 15 Day language of Section 95834 "Disclosure of Beneficial Holding", and a wording change to Section 95892(b)(2)(A) have the likely unintended consequence that beneficial holding of JPA compliance instruments by SMUD would not be a specified option.

To remedy this, SMUD proposes an addition to Section 95834 Beneficial Holdings (page A-72), a change to Section 95892(b)(2)(A) on (page A-121), and a concomitant change to definition (27) “Beneficial Holding” (page A-7) as follows:

Add to Section 95834 a paragraph:

95834(a)(4) A Publicly Owned Utility informs the ARB that it will be holding compliance instruments obtained through Section 95892(b)(2) in its compliance account for its own obligations and/or for the eventual transfer to compliance account(s) of a Registered Entity (Entities) that is (are) a Corporate Association, and to be used for that entities’ compliance obligation.

Change Paragraph 95892(b)(2)(A) to read:

In the publicly owned electric utility’s or electric cooperative’s compliance account which may be a Beneficial Compliance Holding Account; or

Change definition Section 95802 (27) “Beneficial Holding” to:

“Beneficial Holding” means the holding of a compliance instrument in the holding account or Beneficial Compliance Holding Account by one entity in which another has an ownership interest.

D5. Reporting On Use Of POU Allowance Value Should Be Clarified:

Section 95892(e)(2) states that Publicly Owned Utilities must calculate the value of allowances placed into their compliance accounts directly, and report annually on the use of that allowance value. SMUD believes that the calculation of allowance value is vague, and should be clarified, and that the ARB must clarify that the use of allowance value for retail compliance, as established in 95892(b)(2). ARB can avoid differential calculation of ‘allowance value’ by the POUs in the state, each using a different averaging technique (e.g. –weighted differentially) by performing the calculation averaging the four quarterly auction prices itself, and providing the result to use. Section 95892(e)(2) should be modified to read:

(e) Reporting on the Use of Auction Proceeds and Allowance Value. No later than June 30, 2013, and each calendar year thereafter, each electrical distribution utility shall submit a report to the Executive Officer describing the disposition of any auction proceeds and allowance value received in the prior calendar year. This report shall include:

(1) The monetary value of auction proceeds received by the electrical distribution utility;~~.~~

(2) How the electrical distribution utility’s disposition of such auction proceeds complies with the requirements of this

section and the requirements of California Health and Safety Code sections 38500 et seq~~.~~;

(3) The monetary value of allowances received by the electrical distribution utility which were deposited directly into its compliance account. ~~The~~ ARB shall calculate the value of these allowances ~~shall be quantified~~ based on the average market clearing price of the four quarterly auctions held in the same calendar year ~~that the~~ of the vintage of the allowances ~~are allocated~~; and

(4) How the electrical distribution utility's disposition of the monetary value of allowances, deposited directly into its compliance account, complies with the requirements of this section and the requirements of California Health and Safety Code sections 38500 et seq. Use of allowance value for compliance associated with retail load of the publicly owned utilities complies with the requirements of this section.

D6. There Should Be Additional Flexibility Regarding Compliance Instrument Surrender:

Section 95856 delineates the protocols for timely surrender of compliance instruments for a compliance period. To fulfill the concept of having multiple year compliance periods, as well as to provide additional flexibility in the transition between compliance periods in certain circumstances, SMUD recommends specific changes to Section 95856(b)(2).

First, compliance instruments for any year during a compliance period should be eligible for surrender for any obligation in that compliance period. Otherwise, the cap and trade program inappropriately sets up a series of unexpected annual tranches within the expected compliance periods. Compliance periods are an appreciated mechanism to provide market flexibility to smooth out potential year by year conditions that can lead to a lack of balances between the compliance instruments needed in a year and the annual supply of those instruments. The annual compliance obligation is only 30 percent of verified emissions for the year, intended to ensure ongoing attention to compliance, not to establish an inflexible annual compliance structure. The annual obligation is well below the expected distribution of annual allowances, so allowing vintages within the compliance period to be used for compliance cannot disrupt the expected 'balance' between the need for and supply of compliance instruments on an annual basis. ARB can allow compliance flexibility among the years within a compliance period, establishing true compliance periods in the cap and trade program.

Even then, however, and particularly with the initial two-year compliance period that results from the delay in the cap and trade, removing 2012 as part of the first compliance period, there may be adverse circumstances that invoke a need for additional flexibility as the market moves from one compliance period to another. SMUD does not support, in general, allowing borrowing between compliance periods, as we believe this may result in a lack of balance between the amount of compliance instruments available in early years and the amount needed for compliance, in effect causing delays in investments that may be needed to achieve compliance by 2020. However, adverse circumstances could cause allowance prices to spike in the last year of a compliance period, and then fall as a new compliance period affords additional flexibility. SMUD believes that a mechanism to smooth the change between the first and second compliance periods would be particularly beneficial to the market.

SMUD suggests the following changes to Section 95856(b)(2):

> (2) To fulfill any compliance obligation, a compliance instrument must be issued from an allowance budget year within or before the ~~year~~ compliance period ~~during~~ for which the compliance obligation is calculated, unless:
>
> (A) T~~t~~he allowance was purchased from the Allowance Price Containment Reserve pursuant to section 95913; ~~or~~
>
> (B) T~~t~~he allowance is used to satisfy an excess emissions obligation~~.~~; or
>
> (C) The compliance instrument is from vintage 2015 and is used for compliance for the first compliance period.

D7. Consider Adding Provisions For Additional Allowances Due To Transportation Electrification:

Perhaps the largest potential for emissions reductions in the state in the long-term lies in electrification of the transportation sector. However, these reductions are by no means assured given the high costs of infrastructure investment that the electricity sector and customers will need to make, as well as the costs of the vehicles themselves. Given these up-front cost-barriers, significant incentives will likely be needed to induce the early adoption of electric vehicles needed to establish a rapidly growing, vibrant electric transportation sector. SMUD strongly encourages the ARB to consider that the reduction in compliance need that will arise in the transportation sector as liquid fuel transportation emissions are shifted to the electric sector imply an increase in electric sector compliance obligation that is not currently covered in the sector allowance allocation structure laid out in the 15-day language.

The ARB should ensure that the increased emissions obligations that result from increasing electric transportation loads do not create a cost burden on utility ratepayers, in contradiction to the rationale for providing allowances to electrical distribution utilities. The amount of allowances added to the electric sector allocation should cover the potential increased compliance obligation associated with producing electricity for transportation loads.

Of course, the cap and trade program in this aspect needs to be coordinated with the Low Carbon Fuel Standard program. LCFS credits are expected to provide a valuation of the difference between the emissions from electricity generation for transportation and the reduction in liquid fuel emissions, and this value is expected to be traded in the LCFS marketplace. This calculation "nets out" the increased electricity sector emissions, so the LCFS credit value does not reflect this increased obligation in the electricity sector.

The ARB should reflect the increased electricity sector emissions, and corresponding reduced transportation sector emissions, by adjusting the allowance allocations for the electric sector commensurate with the growth in electric transportation load. This load growth is different from any other load growth, as it corresponds to less energy use and dramatically fewer emissions in the transportation sector, and is the only load growth strongly supported by the state's energy and transportation policies and by the ARB's own climate policies. The additional electric sector allowances would be calculated each year based upon the previous year's measured load for electric transportation, multiplied by the default emission factor in the electric allocation spreadsheet or the default emission factor established for unspecified power in the cap and trade program. A new subpart should be added to the calculation for allowances

95870(f) Increased Allocation to Electrical Distribution Utilities For Electric Transportation Growth. The Executive Officer will place an additional annual individual allocation in the appropriate accounts of each electrical distribution utility on July 15 of each calendar year from 2013-2020, calculated as the amount of measured electric transportation load in the previous year, as reported by each electrical distribution utility, multiplied by the default emissions factor.

E. Penalty Structure Issues

SMUD appreciates the changes to the proposed penalty structures for the cap and trade program that are captured in the 15-day language. In particular, allowing an effective 'grace period' while the untimely surrender process is dealing with a shortfall of surrendered emissions, prior to establishing daily penalties for each compliance instrument remaining short helps to ensure a reasonable and effective penalty structure for the cap and trade program. However, some additional changes are necessary to further ensure reasonable penalties, while maintaining the necessary deterrent effect of a penalty structure to ensure maximum compliance. These changes are described below.

E1. Violations should be defined in units of 1,000 compliance instruments and 45- day period for additional violations should be reincluded:

Section 96014 describes the violation procedures for the cap and trade program, establishing the amount of violations that a regulated party may be subject to if insufficient compliance instruments are surrendered to cover the compliance obligation that remains after the untimely surrender obligation process. Several changes are beneficial in this section.

First, SMUD believes that removing the reference to Section 95856 here clarifies the basic violation as occurring only after untimely surrender has been dealt with, and renders moot the added language "… the procedures in 95857(c) have been exhausted…" The 15-day language states that when the requirements of Section 95856 are not met, Section 95857 is invoked, and it is only if the requirements of that section are not met that there is a violation. Section 96014 should clearly reflect this sequence for clarity. In addition, the term "… Untimely Surrender Period…" appears to refer back to 95857(b)(4), but is not defined nor used elsewhere. It is best here to just refer to the date established by 95857(b)(4).

Second, SMUD continues to believe that with a basic penalty amount per violation under Health and Safety Code § 40402(b) of "up to $10,000", the potential penalties when each ton is a violation remain egregious at 200 to 1000 times higher than expected allowance prices. There is no need for such extreme penalties, but the prospect of them has market impacts. Using each 1,000 instruments as way to limit the number of violations yields maximum penalties equivalent to expected allowance prices, and these are sufficient on top of the 4-1 excess surrender requirement established in Section 95857.

Third, Section 96014(b) of the Discussion Draft of the cap-and-trade regulation (released 07/07/11) included a reference to a 45-day period for violation accrual, rather than the daily accrual or multiplication that was proposed in the December 2010 Proposed Regulation Order. This 45-day period was also referred to in the ARB' summary of the 15-day changes: "The section was also clarified to allow the violation to accrue every 45 days instead of each day the compliance instrument remained unsurrendered." (Page 41, section FFFF.) It would appear that the intent was to continue to include the 45-day period in the 15-day language, and SMUD supports that inclusion.

Section 96014 should read:

§ 96014. Violations.

(a) If an entity fails to surrender a sufficient number of compliance instruments to meet its compliance obligation as specified in section~~s 95856 or~~ 95857, ~~and the procedures in 95857(c) have been exhausted,~~there is a separate violation of this article for each 1,000 required compliance instruments, or portion thereof, that have~~s~~ not been surrendered~~, or otherwise obtained by the Executive Officer under 95857(c)~~.

(b) ~~There is a separate violation for each day or portion thereof after the compliance date that each required compliance instrument has not been surrendered.~~There is a separate violation for each 45-day period or portion thereof after the date determined pursuant to section 95857(b)(4)~~end of the Untimely Surrender Period~~ that each required 1,000 compliance instruments, or portion thereof, have~~s~~ not been surrendered.

E2. The Untimely Surrender requirements need further clarification:

SMUD appreciates the changes in the untimely surrender requirements included in the 15-day language. However, some additional changes would add clarity to how the untimely surrender requirement works, provide for a clear opportunity to procure and surrender the excess emissions requirement, and make clear exactly when a regulated party may have basic surrender violations subject to Health and Safety code penalties. Although not strictly a "penalty" provision, the operation of the untimely surrender obligations has significant interaction with the violation and penalty structure in the cap and trade program.

First, SMUD notes that the term "within" in the regulation could be interpreted to be either before or after the events mentioned, and believes that the intent is "after". Second, SMUD suggests that a regulated party subject to untimely surrender be afforded the opportunity to procure allowances in ***both*** a regular auction or a reserve sale, not one or the other. In most circumstances, the first regular auction will present an opportunity to procure allowances at market prices, leaving it unnecessary to consider the higher priced allowances in the reserve sale. However, in the circumstance that allowances are not available in the auction or are not well-priced, the reserve sale would provide a final opportunity for compliance prior to being subject to penalties. Accessing both events may be intended by the "whichever is the latter" language, but SMUD believes the intent could be clarified. Finally, SMUD believes that ARB should clarify further what happens when an entity fails to surrender the untimely obligation as required, so that a double violation is not implied. Sections 95857(b)(4) and 95857(c)(2) should read:

95857(b)(4) The untimely surrender obligation is due ~~within~~ five business days after the occurrence of the first auction ~~or~~and first reserve sale conducted by ARB following the applicable surrender date~~, whichever is the latter,~~ and for which the registration deadline has not passed when the untimely surrender obligation is assessed.

95857(c)(2) If a portion of the untimely surrender obligation is not surrendered as required, the entity will have a new untimely surrender obligation (replacing the previous surrender obligation calculated under section 95857(b)(2)) equal to the amount of the previous untimely surrender obligation which was not satisfied by the deadline stated in section 95857(b)(4) upon which the number of violations will be calculated pursuant to section 96014. The new untimely surrender obligation is due immediately; and

F. Auction Structure and Timing Issues

The auction structure and timing in the cap and trade program is among the most complicated parts of the proposed 15-day language. SMUD believes that the changes made from the December Proposed Regulation Order take the cap and trade program in the right direction. However, additional changes are necessary to ensure a well functioning auction program, and to provide clarity to the overall structure.

F1. Transfers Of Allowances Into The Allowance Price Containment Reserve Holding Account Should Be Clarified and Modified:

SMUD appreciates the change in the 15-day language that allowances associated with the excess emissions obligation under the untimely surrender provisions (Section 95857(d)) are now transferred to the Auction Holding Account rather than the Containment Reserve Account. A small clarification is necessary to conform to this recognition that taking allowances away from the market was an implicit penalty on all market participants. In addition, SMUD appreciates the change in Section 95911 that states that future vintage allowances that remain unsold will be returned to the Auction Holding Account. However, SMUD continues to suggest that current vintage allowances that remain unsold at auction remain in the Auction Holding Account for a reasonable period, rather than being transferred to the Containment Reserve Account.

The slight change necessary for conformance with the change in Section 95857(d) is to Section 95831(4), which establishes an Allowance Price Containment Reserve Account, and states that the serial numbers of allowances used to fulfill an entity's excess emissions obligation pursuant to Section 95857(d) will be transferred to this account. This subpart of 95831 is no longer necessary and should be deleted. In addition, SMUD suggests that allowances that remain unsold in a quarterly auction should be returned to the Auction Holding Account unless the unsold allowances are from a vintage at least one year prior to the auction in which they remain unsold. Unsold allowances in one auction do not necessarily imply that subsequent auctions will also have unsold allowances, particularly with lumpiness in allowance allocations and in investments that reduce need for allowances. Here, and in Section 95911, the regulations should be modified to keep unsold allowances in the Auction Holding Account until it is reasonably clear that they are not required in current auctions. Transferring to the Allowance Price Containment Reserve Holding Account prematurely simply is a recipe for ratcheting up allowance prices unnecessarily. Section 95831(4) and Section 95991 should read:

95831(4) A holding account to be known as the Allowance Price Containment Reserve Account:

(A) Into which the serial numbers of allowances allocated by ARB for auction that remain unsold at auction in the year following their vintage year will be transferred~~.~~;

~~(B) Into which the serial numbers of allowances directly allocated to the Allowance Price Containment Reserve under subarticle 8 pursuant to section 95870(a) will be transferred.;~~

(B~~C~~) Into which the serial numbers of allowances submitted to fulfill an entity's excess emissions obligation pursuant to section 95857(d)(c) will be transferred~~.~~; and

(C~~D~~) From which the Executive Officer will authorize the withdrawal of allowances for sale ~~to sell~~ to covered entities pursuant to section 95913.

95911(b)(4) Disposition of Allowances Allocated for Auction when an Auction Settlement Price Equals the Reserve Price. ~~Allowances designated by ARB for an auction which remain unsold when the auction settlement price equals the auction reserve price shall be transferred to the highest priced tier in the Allowance Price Containment Reserve Account.~~

(A) Unsold ~~current vintage~~ allowances from a vintage prior to the current year shall be transferred equally to the three tiers in the Allowance Price Containment Reserve Account. If the number of allowances unsold is not divisible by three, the transfer of the final allowances shall be to the lowest priced tier.

(B) Unsold future and current vintage allowances auctioned pursuant to section 95910(c) will be returned to the Auction Holding Account for sale at the next auction.

F2. Floor Price Escalation Beyond Inflation Until 2020 Is Not Necessary:

SMUD understands the desire, with a new market, to provide market certainty to those making determinations about whether to invest in a given reduction measure. We also understand that a floor price for allowances offered at auction is one way to ensure certainty, and that normal market discounting of future payoffs implies a need for an escalation of that floor price beyond normal inflation in immature markets. However, as markets mature, such investment signals will no longer be necessary. The 5% escalator in the proposed regulations will eventually result in excessive prices for allowances, in particular if carried beyond the 2020 timeframe. For a program with such strong complementary policies, the notion of forcing the floor price up to arbitrarily high levels seems punitive towards market participants who are trying to balance the high costs of complementary programs with the cap and trade costs. SMUD would recommend that the ARB signal its intent to reflect maturing markets by tapering the ‘above inflation’ escalation off over time so that the escalation ends at no greater than the rate of inflation in the last year of the program. Section 95911(b)(6) should read:

95911(6)(B) For auctions conducted in calendar years after ~~2012~~2013 the Reserve Prices shall be the Auction Reserve Prices for the previous calendar year increased annually by 5 percent plus the rate of inflation as measured by the Consumer Price Index for All Urban Consumers. Beginning in 2016, the adjustment beyond the rate of inflation shall be reduced by 1 percent annually, leading to an increase in 2020 equal to the rate of inflation.

F3. Clarification Of No Annual Compliance Obligation In The Same Year As The Triennial Compliance Obligation:

SMUD appreciates the addition in Section 95856 of subsection (d)(3), which is intended to indicate that there is no annual compliance obligation in the same year as a triennial compliance obligation. SMUD recommends a slight language change for clarity here, as follows:

> 95856(c)(3) In years 2015, 2018, and 2021 there is no annual compliance obligation for the preceeding year~~compliance period~~, only a triennial compliance obligation for the preceeding compliance period.

G. Additional Issues In The Proposed Regulation

G1. Possibly Confusing Term In Definition Of "Compliance Instrument":

SMUD sees no need for the term "up to" to be included in the definition of compliance instrument, as there seems to be no case where a compliance instrument represents less than 1 metric ton of CO_2e. The definition should read:

> ~~(36)~~(52) "Compliance Instrument" means an allowance, ARB offset credit or sector-based offset credit. Each compliance instrument can be used to fulfill a compliance obligation equivalent to ~~up to~~ one metric ton of CO_2e.

G2. Possibly Confusing Term In Definition Of "Compliance Instrument":

SMUD believes that the definition of "direct delivery" should be as close as possible to the definition of category 1 resources in the recently passed RPS bill – SBX1 2. The definition only requires a slight change, as follows:

> (68) "Direct Delivery of Electricity" means electricity that meets any of the following criteria:
>
> (A) The facility has a first point of interconnection with a California balancing authority;
>
> (B) The facility has a first point of interconnection with distribution facilities used to serve end users within a California balancing authority area;
>
> (C) The electricity is scheduled for delivery from the specified source into a California balancing authority without replacement electricity from another source, except for that needed for hourly or interhourly balancing requirements; or
>
> (D) There is an agreement to dynamically transfer electricity from the facility to a California balancing authority.

G3. Error In Definition Of "Electric Distribution Utility":

SMUD points out a slight error in the definition of electric distribution utility. This definition should read:

~~(57)~~(82) "Electrical ~~d~~Distribution ~~u~~Utility(ies)" means an Investor Owned Utility (IOU) as defined in the Public Utilities Code sections ~~and~~ 216, and 218, or a local publicly owned electric utility (POU) as defined in Public Utilities Code section 224.3, or an Electrical Cooperative as defined in Public Utilities Code section 2776, that provides electricity to retail end users in California.

G4. Typo in Definition of "Voluntary Renewable Energy":

SMUD points out a typographic error in the definition of voluntary renewable energy. The definition should read:

(280) "Voluntary Renewable Electricity" or 'VRE' means electricity produced or REC~~D~~s associated with a voluntary renewable electricity generator, and which will not be sold or used to meet any other mandatory requirements or voluntary program in California or any other jurisdiction.

G5. Incorrect Reference In Holding Account Section 95831(b)(2)(B):

SMUD points out that this section should refer to 95921(f)(3) rather than 95921(e)(3). The section should read:

(B) T~~t~~he holding accounts of those entities for which allowances are being auctioned on consignment pursuant to section 95921(f~~e~~)(3)~~95831(b)(1)(B)~~; and

G6. Incorrect References In Compliance Obligation Section 95852(b)(3) and (5)(A)(4):

SMUD points out that parts (5) and (7) of Section 95852(b) refer to Section 95852.2, while the correct reference should be 95852.1.1. These sections should read:

(5) Electricity generated from use of biomethane must comply with section 95852.1.1~~95852.2~~, and must meet verification requirements for use of biomethane pursuant to MRR.

(7)(A)4. The specified electricity generated from the use of biomethane which meets the requirements pursuant to section 95852.1.1~~95852.2~~.

G7. Incorrect Specifications in Section 95852(a):

SMUD points out that Section 95852 incorrectly includes items (9) through (12) under subpart (a). These categories of emissions are not combustion emissions associated with biomass fuels, and these sections should be renumbered to be part of subpart (b), fugitive emissions without a compliance obligation. In addition, in subpart (b), there appear to remain some duplicative sections covering the same emissions twice. For example, Section 95852(b)(2) exempts fugitive emissions from a variety of categories at refineries, but these emissions are also excluded in (b) (9) and (10). A general review and elimination of duplication of section 95852 is in order for clarity.

H. Closing

In summary, SMUD strongly encourages the ARB to ensure alignment between the cap and trade program and the State's RPS, given the crucial role the RPS plays in reducing overall statewide emissions as well as its substantial costs. We recommend the ARB eliminate the specific section related to resource shuffling, as the issue is well-covered by existing regulations and creates unnecessary inefficiencies and risk in the dispatch of natural gas fired units. We also would like to make sure the ARB's allowance allocation policies send the right incentive signals to cogeneration stakeholders, such that existing arrangements are not encouraged to dissolve, or new arrangements prevented by being implemented under new ownership structures. Finally, we strongly encourage ARB to develop policies that support the use of pipeline biomethane as a way to reduce California's electricity carbon footprint under the cap and trade program. This resource is a critical contributor to meeting the state's future carbon goals, and the cap and trade regulation should aim to accommodate it rather than attempting to restrict its use.

Respectfully submitted,

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