September 27, 2011

James Goldstene
Executive Officer
California Air Resources Board
1001 "I" Street Sacramento, CA 95812

Re: Comments on Second Notice of Proposed 15-Day Changes to the AB 32 Cap-and-Trade Regulation

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Dear Mr. Goldstene,

The undersigned organizations appreciate the opportunity to comment on the second set of proposed 15-day changes to the cap-and-trade regulation developed by the Air Resources Board (ARB). We strongly support ARB's continued efforts to develop a cap-and-trade program to back up the robust package of clean energy policies in the Scoping Plan and ensure we achieve AB 32's greenhouse gas emission reduction target. Our comments below touch on four provisions of the rule modified through the latest 15-day process.

Our comments are summarized as follows:

1. We support ARB's revised approach to account for imported renewable electricity;
2. We ask that ARB direct at least half of allowances unsold at auction to the Allowance Price Containment Reserve to ensure the program retains a provision to backfill Reserve allowances;
3. We reiterate our concern that ARB's decision to remove the limited restrictions on the investor-owned utilities' (IOUs) use of allowance value is unwarranted and potentially detrimental to the ongoing process to allocate allowance value in furtherance of the objectives of AB 32; and
4. We oppose ARB's proposal to calculate violations of the cap-and-trade rule every 45 days rather than daily, as is standard practice under the Health and Safety Code.

DISCUSSION

1. We support ARB's revised approach to account for imported renewable electricity.

We support ARB's retooled approach to address various concerns surrounding the treatment of imported electricity, including the possibility of double counting the environmental benefits of Renewable Energy Credits. We find the proposed modifications in section 95852(b) and the accompanying definitions in section 95802 offer a clearer path forward, and effectively resolve the outstanding tensions between maintaining proper incentives for renewable energy development and ensuring accurate emissions accounting.

2. We ask that ARB direct at least half of allowances unsold at auction to the Allowance Price Containment Reserve to ensure the program retains a provision to backfill Reserve allowances.

We ask that ARB direct at least half of all unsold allowances when an auction clears at the reserve price to the Allowance Price Containment Reserve (Reserve). In place of the Reserve, staff is now proposing

to make these allowances available at subsequent auctions.[1] We support staff's proposal to hold back any unsold allowances from auction until two consecutive auctions clear above the reserve price to guard against the risk of consistent over-allocation.[2] By directing *all* unsold allowances back into the auction holding account, however, ARB has left the program without a provision to backfill the Reserve. We are concerned this could expose the program to undue political pressure should market conditions lead to the Reserve being accessed. With no other mechanism built-in to resupply the Reserve, stop-gap proposals to provide additional cost containment will in all likelihood seriously undermine the integrity of the cap.

We are also not persuaded by ARB's rationale for making the proposed change. ARB cites to stakeholder concerns that directing unsold allowances to the Reserve would unnecessarily reduce the supply of allowances to the market. [3] In our view, the very fact that allowances are remaining unsold at auction provides clear indication that the market is *already* oversupplied. Entities can also readily guard against the risk of future allowance shortages through the program's unlimited banking provisions. Accordingly, we maintain that the most appropriate use of unsold allowances is to backfill the Reserve, and ask that ARB direct at least half of unsold allowances to that end.

3. ***We reiterate our concern that ARB's decision to remove the limited restrictions on the investor-owned utilities' (IOUs) use of allowance value is unwarranted and potentially detrimental to the ongoing process to allocate allowance value in furtherance of the objectives of AB 32.***

We disagree with ARB's decision to remove the provisions in the rule providing guidance to the electric IOUs on how to return auction revenue for the benefit of their retail customers.[4] The provisions simply ensure that the IOUs' use of allowance value will not mute the carbon price signal embedded in retail rates or be tied exclusively to a utility customers' energy consumption. Maintaining the carbon price at the retail level is at the heart of ARB's allocation scheme for the utility sector and reflects the consensus recommendation of nearly every expert body that has examined the issue.[5] Moreover, as designed, it is our view that the provisions would not unduly interfere with the California Public Utilities Commission's (CPUC) jurisdiction over rate setting.[6]

Although ARB's rationale to remove the provisions rests on questions of legal authority, we are concerned that stakeholders will attempt to construe ARB's decision as signaling a change of position from a policy perspective. Past CPUC decisions have called for ARB's judgment on this issue,[7] and ARB's position will be significant in shaping the ultimate resolution for allocating allowance value from the electricity sector. Should ARB proceed with the proposed changes, we therefore ask that ARB reaffirm unequivocally its expert conclusion that "staff believes that any rebates to residential customers should

[1] Section 95911(b)(4)(A).
[2] Section 95911(b)(4)(B). We similarly support ARB's proposal in section 95911(b)(4)(C) to limit the amount of allowances re-designated for auction to 25% of the amount already scheduled for auction.
[3] ARB, "Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information," p.6, available at: http://www.arb.ca.gov/regact/2010/capandtrade10/2nd15daynotice.pdf.
[4] Section 95892(d)(3).
[5] See NRDC et al., "Comments on Proposed 15-Day Changes to the AB 32 Cap-and-Trade Regulation," at 3, n.9 (August 11, 2011).
[6] Id. at 3-5.
[7] See CPUC, D.08-10-037 "Final Opinion on Greenhouse Gas Regulatory Strategies," at 228 (October 22, 2008).

be made as separate payments and not simply deducted from customer bills. *The purpose of this restriction is to ensure the carbon price is reflected in residential electric rates*" (emphasis added). [8]

4. We oppose ARB's proposal to calculate violations of the cap-and-trade rule every 45 days rather than daily, as is standard practice under the Health and Safety Code.

We ask that ARB reconsider its proposed modification to section 96014(b) to calculate violations every 45 days rather than daily. We find the proposal needlessly curtails ARB's ability to ensure penalty amounts are sufficient to deter non-compliance. On the surface, calculating violations daily allows for large penalty amounts to accrue, but the concern that this will result in gross and excessive penalty amounts belies other requirements in the Health and Safety code and decades of ARB's experience in enforcing regulatory programs under those provisions.

Calculating violations daily is the standard approach to assess penalties under the Health and Safety Code,[9] which are the penalty provisions applicable to violations of the cap-and-trade rule.[10] Before imposing any penalty amount, ARB is required to consider all relevant circumstances for each violation, including a set of criteria that weighs heavily against levying an excessive penalty for failure to meet an untimely compliance obligation.[11] However, the additional leeway afforded by daily calculation of violations would afford ARB greater ability to tailor penalty amounts in proportion to the nature and extent of the violation. Given ARB's extensive experience in enforcing regulatory programs under these provisions, we do not find credible assertions that the cap-and-trade rule warrants special treatment through periodic rather than daily calculation of penalties.

The success of the cap-and-trade program is contingent on ARB ensuring market participants play by the rules. To ensure fair play, it is incumbent on ARB to retain the full range and extent of enforcement tools at its disposal.

CONCLUSION

We continue to support ARB's efforts to refine the cap-and-trade regulation and look forward to participating in the final development of the program.

Thank you for considering our comments.

Sincerely,

Jennifer Martin
Center for Resource Solutions

Barry Vesser
Climate Protection Campaign

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[8] ARB, "Rulemaking to Consider the Adoption of a Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols," Allowance Allocation (Appendix J), at J-61.
[9] See Cal. Health & Safety Code sec. 42400 et seq.
[10] Sec 96013; see also Cal. Health & Safety Code sec. 42400 et seq.
[11] Id.

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