BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON THE MAY 2012 PROPOSED CHANGES TO THE CAP AND TRADE REGULATION

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I. INTRODUCTION AND SUMMARY.

The Southern California Public Power Authority ("SCPPA") [1] respectfully submits this comment on the proposed amendments to the regulation entitled *California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms*, Title 17 California Code of Regulations, Subchapter 10, Article 5, released by the California Air Resources Board ("ARB") for public comment on May 11, 2012 ("Regulation"). This comment does not address the amendments relating to linking California's cap and trade program with Quebec's; SCPPA will submit a separate comment on linking issues.

SCPPA approves of many of the changes proposed in the Regulation, particularly new section 95833(a)(5), which allows publicly-owned utilities ("POUs") to have a corporate association with their electricity generating facilities in California and their electricity imports and to consolidate their accounts. However, certain issues should be addressed before the Regulation is finalized in order to reduce the administrative burden of the cap and trade program on market participants as well as the ARB. In summary, SCPPA considers that:

- The ARB should dedicate all necessary resources to ensure the cap and trade transfer system and auction platform are fully developed and thoroughly tested by stakeholders, and that stakeholders have received adequate training on using the system, before the first auction in November 2012.

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

- The registration information requirements should be revised to reflect the fact that not all entities applying for registration are companies.
- Circumstances in which applicants may be denied registration should be clarified.
- The provisions on protection of confidential information must be strengthened.
- The provision allowing for the ARB to create new types of accounts raises concerns about the impact such new accounts may have on the market. Changes to the structure of accounts should be reviewed through a public rulemaking process.
- The procedures for designation and delegation relating to account viewing agents appear to overlap and should be clarified.
- If the accounts of entities in a corporate association are consolidated, emissions liability should also be consolidated across the corporate association. There should not be a separate emissions liability for each entity in the association. Similarly, there should be no separate purchase limit for each entity.
- The Know-Your-Customer requirements are intrusive and will cause difficulties in practice. The type of information required should be less sensitive. Alternatively, the ARB should rely on employee screening procedures used by registered entities. Stringent Know-Your-Customer requirements should not be imposed for account viewing agents.
- The basis for setting the auction reserve price (floor price) at $10 should be explained.
- The additional personal information that is required to be provided to the financial services administrator is problematic.
- If utilities consign allowances to auction and bid in the same auction, they should be allowed to provide reduced bid guarantees.

- The period from the auction to notification of auction results and invoicing should be short, to reduce the risk of auction information leaking out and having adverse impacts on the secondary market.
- Winning bidders should have seven business days to pay for allowances after invoicing.
- Utilities that consigned allowances to auction should be able to net the payment to be received for allowances they sold against the payment to be made for allowances they purchased.
- Payments to utilities for allowances sold at auction should be made on the day after the due date for payment for allowances purchased at auction.
- The holding limit provisions should be amended. Penalties for breaching the holding limit should only be imposed after notice and a cure period. The limited exemption to the holding limit in 2012 should be calculated after 2011 emission reports have been verified.
- The provisions on compliance instrument transfers should be amended. Business day time periods for the allowance transfer process should be used instead of calendar days. The transfer process should be made as simple and flexible as possible. The references to "settlement" of transaction agreements are not relevant and should be removed. No penalties should be imposed if the seller's transfer request and confirmation and the buyer's confirmation are not received within the required timeframes. Information requirements for transfer requests should be clarified.
- The ARB should approve additional offset protocols this year to help ensure an adequate supply of offsets in the first compliance period.

These issues are discussed in more detail below, in the order in which they arise in the Regulation.

II. FOCUS ON SYSTEM DEVELOPMENT, TESTING, TRAINING AND IMPLEMENTATION TO ENSURE READINESS FOR FIRST AUCTION.

SCPPA is concerned that there remains much work to be done before the cap and trade allowance transfer system and auction platform will be ready for a successful auction in November 2012. In particular, concerns have arisen regarding software development, the ability to undertake thorough testing of the systems and user training, and ensuring the market is secure. ARB staff have been unable to state whether the software will be able to support certain desirable features such as 24/7 access to the tracking system and instant updating of holding limits. Dates for stakeholder testing of, and training on, elements of the tracking and transfer system have been delayed repeatedly, and it is unclear whether the practice auction scheduled for August 2012 will provide a thorough test of all elements of the auction, including the consignment of allowances.

SCPPA welcomes the establishment of the Market Simulation Group with the University of California Energy Institute. However, statements made at the first meeting of that group on June 7, 2012, indicate that results from its modeling and simulation work will not be available until just prior to the first auction in November 2012. This may be too late to correct any issues that are identified through this process.

Unless rigorous testing is undertaken, and time is allowed to correct the system if any weaknesses are identified and to properly train users of the system, there is a risk that market participants will find a way to manipulate the transfer system or the auctions to their advantage.

To ensure a successful start to this ambitious program, the ARB should allocate all necessary resources to ensure that these tasks are completed before the first auction later this year.

III. SECTION 95830: CLARIFY REGISTRATION REQUIREMENTS AND CIRCUMSTANCES IN WHICH REGISTRATION MAY BE DENIED, AND IMPROVE PROTECTION OF CONFIDENTIAL INFORMATION.

A. Clarify registration information requirements as they apply to POUs.

Section 95830(c)(1) of the Regulation sets out a list of information that an entity must provide in order to register with the ARB, including the following new requirements:

- Date and place of incorporation;
- Names and addresses of the entity's directors and officers; and
- Contact information for persons controlling over 10 percent of the voting rights attached to all the outstanding voting securities of the entity.

POUs such as the members of SCPPA are not incorporated entities; rather, they are municipal entities. As such, they do not have a date and place of incorporation, they do not necessarily have people with the job titles "directors" and "officers", which have specific meanings for incorporated entities, and they do not have voting securities.

Sections 95830(c)(1)(A)-(C) of the Regulation should be revised as follows to reflect the fact that not all entities applying for registration are companies:

> (A) Name, physical and mailing addresses, ~~and~~ contact information, type of organization, and if incorporated, the date and place of incorporation;
>
> (B) Names and addresses of the entity's directors and officers, or (for entities that do not have directors and officers) the entity's top-level managers;
>
> (C) If the entity is a corporation, ~~N~~names and contact information for persons controlling over 10 percent of the voting rights attached to all the outstanding voting securities of the entity;

B. The ARB should not be able to deny registration based on information provided.

Section 95830(c)(1)(I) of the Regulation provides that:

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

Given the importance of registration for participating in the emissions market and complying with the cap-and-trade program, any circumstances in which an applicant may be denied registration should be clear. Subsection (i) of section 95830(c)(1)(I) is problematic in this regard. The Regulation does not specify what sort of information, if provided by an applicant, would result in registration being denied under this subsection. Nor does subsection (i) include a requirement for a determination by the Executive Officer, unlike subsections (ii) and (iii).

Subject to our comment in section III.A above, the information that must be provided under sections 95830(c)(1)(A)-(H) is relatively straightforward and, so long as it is accurate and complete, would not appear to provide any reasonable basis for denying registration. Subsections (ii) and (iii) of section 95830(c)(1)(I) address accuracy and completeness. The ARB should not have the broad ability to deny an application for registration "based on information provided" if that information is complete and accurate.

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

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

C. Strengthen protection of confidential information.

Section 95830(g) provides that information about individuals collected under certain sections of the Regulation "will be treated as confidential by the Executive Officer and the

accounts administrator to the extent possible, and except as needed in the course of oversight, investigation, enforcement and prosecution." Given the significant volume and sensitivity of the information about individuals collected under the relevant sections of the Regulation – including personal bank account details – it is very important to strengthen this information protection provision.

As the information collected is of similar sensitivity to that collected for taxes, the confidentiality provision in the California Revenue and Taxation Code may serve as a guide. Section 14251 of that code provides as follows:

> All information and records acquired by the Controller or any of his or her employees are confidential in nature, and except insofar as may be necessary for the enforcement of this part or as may be permitted by this article, shall not be disclosed by any of them.
>
> Except insofar as may be necessary for the enforcement of this part or as may be permitted by this article, any former or incumbent Controller or employee of the Controller who discloses any information acquired by any inspection or examination made pursuant to this article is guilty of a felony, and upon conviction shall be imprisoned pursuant to subdivision (h) of Section 1170 of the Penal Code.

Certain concepts in this provision, particularly the consequences for breaching the confidentiality requirement, should be incorporated into the confidentiality provision in the Regulation to ensure that appropriate weight is given to this requirement.

In addition, the confidentiality provision in the Regulation should not be limited to information collected during the registration process. Confidential information may also be collected under the relevant sections of the Regulation at any time after registration, if a new or replacement primary account representative, alternate account representative, or account viewing agent is appointed.

This provision should clarify that only the Executive Officer, the accounts administrator and their employees will have access to this information, except in the defined circumstances. The reference to "the extent possible" should be deleted – the confidentiality obligation should be absolute, other than in the defined circumstances. The information management systems used by the entities with access to this information should ensure its confidentiality.

Finally, the defined exceptions – oversight, investigation, enforcement and prosecution – should be limited to those actions taken by the ARB pursuant to this Regulation. Confidential information provided under this Regulation should not be available for enforcement of another ARB regulation or for unrelated programs of the accounts administrator.

Section 95830(g) of the Regulation should therefore be amended as follows:

> (g) Information Confidentiality. The following information collected about individuals ~~during the registration process~~ will be held only by, and will be treated as confidential by, the Executive Officer, ~~and~~ the accounts administrator ~~to the extent possible~~, and their employees, except to the extent~~as~~ needed in the course of ~~oversight,~~ investigation, enforcement and prosecution by the Executive Officer under this article. Except as permitted by this article, any former or incumbent Executive Officer, accounts administrator, or any of their employees who discloses any such information is guilty of a felony.~~:~~ ...

IV. SECTION 95831: CLARIFY WHY ADDITIONAL ACCOUNTS MAY BE CREATED AND HOW THEY WILL BE FILLED.

Sections 95831(a) and (b) set out each type of account to be created under the cap and trade program, and specify which compliance instruments may be deposited into each type of account, and by which entity. New section 95831(d) provides that "Additional accounts may be created by the Executive Officer to implement the Cap-and-Trade Program."

Section 95831(d) appears to be designed to give the Executive Officer the flexibility to create new accounts if the Executive Officer deems it necessary. However, if new accounts are created, it would presumably be for the purpose of undertaking transactions with compliance

instruments that are not currently provided for under the system of accounts and transfer rules established under sections 95831(a) and (b). Compliance instruments deposited in such new accounts would need to be taken from one of the accounts established under sections 95831(a) and (b). This could have significant – and perhaps unintended – impacts on the flow of compliance instruments between accounts and hence the functioning of the carbon market. Before being implemented, any such new treatment of compliance instruments should be subject to public review and comment by means of a new rulemaking process, rather than being able to be undertaken at the Executive Officer's complete discretion.

Therefore, section 95831(d) of the Regulation should be deleted. If new accounts are needed in the future a new provision can be inserted through a rulemaking process. Alternatively, section 95831(d) should be amended to provide limits on the ability of the Executive Officer to change the flow of compliance instruments, for example by setting out specific circumstances in which new accounts would be created and specifying where the compliance instruments in those new accounts would come from.

V. SECTION 95832: ATTESTATION REQUIREMENTS AND THE DESIGNATION AND DELEGATION PROCEDURES FOR ACCOUNT VIEWING AGENTS SHOULD BE REVISED.

A. Attestations should be "to the best of my knowledge and belief."

Sections 95832(a)(6) and 95832(d) of the Regulation set out attestation requirements of the primary account representative, alternate account representative and officers of an entity. The changes to the Regulation proposed for 15-day comment in July 2011 deleted the phrase "to the best of my knowledge and belief" from section 95832(d) and inserted section 95832(a)(6) without including this phrase. In the Final Statement of Reasons ("FSOR") issued as part of the Final Rulemaking Package for the Regulation, which was filed with the Office of Administrative Law in October 2011, the ARB responded to comments regarding these changes as follows:

> …it appears that "to the best of my knowledge and belief" was inadvertently deleted. Unfortunately, we cannot fix this at this time. However, the intent is to hold the Authorized Account Representative to the "best of my knowledge and belief" standard. We will correct this omission when the regulation is amended in the future.[2]

In accordance with this statement, the ARB should take this opportunity to amend the Regulation to include the phrase "to the best of my knowledge and belief" in the attestations to be provided under sections 95832(a)(6) and 95832(d).

Section 95832(a)(6) should be amended as follows:

> (6) An attestation as follows: "I certify that I have personally examined, and am familiar with, the statements and information submitted in this document and all its attachments. I also certify under penalty of perjury of the laws of the State of California that to the best of my knowledge and belief all information required to be submitted to ARB is true, accurate, and complete."

Section 95832(d) should be amended as follows:

> (d) ... Each such submission shall include the following attestation statement by the primary account representative or any alternate account representative: "…Based on my inquiry of those individuals with primary responsibility for obtaining the information, I certify under penalty of perjury under the laws of the State of California that to the best of my knowledge and belief the statements and information submitted to ARB are true, accurate, and complete. ..."

B. The designation and delegation procedures for account viewing agents appear to overlap and should be clarified.

Under section 95832(a) of the Regulation, an application for registration must include information on the primary account representative and any alternate account representatives and account viewing agents, including an attestation from an officer of the relevant entity verifying the selection of those representatives (sections 95832(a)(1) and (4)). Separately, section 95832(h) of the Regulation sets out a procedure for a primary account representative or alternate account

[2] FSOR at 1679.

representative to delegate authority to account viewing agents via a notice of delegation, also including an attestation from an officer of the relevant entity (section 95832(h)(2)(C)).

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

Furthermore, as the term "account viewing agent" is defined in section 95802(a)(1), this term should be used throughout section 95832(h) rather than re-defining the term in section 95832(h). For completeness, the definition in section 95802(a)(1) should be revised to include the additional information about the role of the account viewing agent that is provided in section 95832(h).

SCPPA proposes the following changes to clarify and streamline the provisions on account viewing agents in sections 95802(a)(1), 95832(a) and 95832(h):

Section 95802(a)(1):

> "Account Viewing Agent" means an individual authorized by a registered entity to view all the information on the entity's accounts and transfer records contained in the tracking system. The account viewing agent shall not have authority to take any other action with respect to an account on the tracking system.

Section 95832(a):

> (a) An application for registration into the California Cap-and-Trade Program for an account must designate a single primary account representative and at least one but no more than four alternate account representatives, and may designate up to five account viewing agents. ...

Section 95832(h):

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

~~(1) A primary account representative or an alternate account representative for a registered entity may authorize up to five natural persons per account that may view all information contained in the tracking system involving the entity's accounts, information, and transfer records (account viewing authority). The persons delegate shall not have authority to take any other action with respect to an account on the tracking system.~~

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

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

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

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

VI. SECTION 95833: ACCOUNT CONSOLIDATION PROCEDURES SHOULD BE STREAMLINED.

A. SCPPA welcomes the option for POUs to consolidate their accounts.

SCPPA greatly appreciates the inclusion of new section 95833(a)(5) of the Regulation, which allows POUs to claim a "corporate association" with their electricity generating facilities in California and their electricity imports. A POU can then consolidate its accounts for those facilities into one set of accounts under section 95833(f), avoiding the risk of having allowances stranded in the compliance account of any one facility. This significantly improves the operation of the cap and trade program for POUs.

B. Entities should be able to request or refuse consolidation of accounts during registration.

Section 95833(f) of the Regulation sets out a process for the consolidation of the accounts of entities in a corporate association. An entity must submit a notice by October 1, 2012, if it wishes to have its accounts consolidated (section 95833(f)(2)). An entity must also submit a notice if it wishes to opt out of consolidation (section 95833(f)(3)). This process requires an unnecessary number of notices. It would be more efficient if the registration forms to be completed by each entity under section 95830 included, in the section on corporate associations, a section where the entity can specify whether it wants the accounts of its corporate association to be consolidated.

If this streamlined approach is followed, sections 95833(f)(2) and (3) could then be deleted. Section 95833(f)(1) should be amended as follows, to reflect the fact that not all corporate associations may wish to consolidate their accounts:

> (1) By January 1, 2013, the Executive Officer will consolidate the accounts held by entities registered into the California Cap-and-Trade Program pursuant to section 95830 that are part of a direct corporate association into a consolidated set of accounts, if the entities have so requested in the registration forms submitted pursuant to section 95830.

C. If accounts are consolidated, liability should also be consolidated.

If entities forming part of a corporate association have their accounts consolidated pursuant to section 95833(f), the Regulation should clarify that the compliance obligations of the entities in that association are also consolidated, for the purposes of the surrender of allowances and the determination as to whether sufficient allowances have been surrendered. There should be one total emissions liability figure for all entities forming part of the corporate association, rather than a separate liability for each entity.

The simplest way to make this clarification may be to include it in section 95833(f)(1), as follows:

> (1) By January 1, 2013, the Executive Officer will consolidate the accounts held by entities registered into the California Cap-and-Trade Program pursuant to section 95830 that are part of a direct corporate association into a consolidated set of accounts, if the entities have so requested in the registration forms submitted pursuant to section 95830. If a group of covered entities with a direct corporate association have consolidated accounts under this section, references to a "covered entity" in Subarticle 7 and to an "entity" in section 96014 are taken to be references to that group as a whole, and separate compliance obligations will not apply to each member of that group.

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

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

Section 95834 requires all individuals seeking access to the tracking system, which would include primary account representatives, alternate account representatives, and account viewing agents, to provide extensive personal information (including passport numbers and personal bank account details) to the Executive Officer.

SCPPA understands that the ARB wishes to be able to confirm the identity of individuals to avoid the problems with fraud and market manipulation that have occurred in the European emissions trading system. However, the proposed Know-Your-Customer requirements are intrusive. It would be difficult for an entity to require up to 10 of its staff to provide this personal information to the ARB. If it obtains all this personal information, the ARB should recognize the potential for significant liability if there is a breach of the security of the ARB's records. (See SCPPA's comments in section III.C above on strengthening the protection of confidential information.)

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

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

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

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

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

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

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

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

D. Quebec's approach to personal bank account details should be adopted.

If none of the above methods are adopted, at a minimum section 95834(b)(6) requiring disclosure of personal bank accounts should be revised to follow the approach taken in Quebec's revised cap and trade regulation. The Quebec regulation requires:

> confirmation from a financial institution located in Canada that the natural person has an account with the institution and that an identity check was carried out when the account was opened.

This provision fulfils the objective given by ARB staff when asked why bank account details are required – to allow the ARB to rely on the fact that a bank has undertaken an identity check on the relevant individual – while avoiding disclosure of actual bank account details, one of the most objectionable parts of the Know-Your-Customer requirements.

Therefore, unless section 95834(b)(6) of the Regulation is deleted altogether under one of the approaches outlined in section VII.B or section VII.C, above, section 95834(b)(6) should be amended as follows:

> (6) ~~An open bank account in the United States~~ confirmation from a financial institution located in the United States that the individual has an account with the institution and that an identity check was carried out when the account was opened;

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

While it is important that the identity of primary account representatives and alternate account representatives be verified in a reasonable manner as discussed above, there does not

appear to be a need for account viewing agents to be subject to the same requirements. These agents cannot undertake any transactions on the tracking system – they can only view it (section 95832(h)(1)). They cannot commit fraud involving compliance instrument transfers. SCPPA considers that extensive Know-Your-Customer requirements should not apply to account viewing agents.

F. The process for submitting information should be clarified.

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

VIII. SECTION 95911: EXPLAIN THE BASIS FOR SETTING THE AUCTION RESERVE PRICE AT $10 AND CLARIFY TREATMENT OF UNSOLD CONSIGNED ALLOWANCES.

A. The basis for setting the Auction Reserve Price at $10 should be explained and tested.

Section 95911(c)(1) provides that the floor price or Auction Reserve Price ("ARP") for vintage 2013 and vintage 2015 allowances auctioned in 2012 will be $10. SCPPA requests the ARB to provide reasons for setting the ARP at this level.

The FSOR states that:

> We chose the $10 reserve price for two reasons. First, we are concerned that through recessionary economic conditions or forecasting error the cap-setting procedure may accidently lead to the creation of excess allowances. Throughout the regulatory process, we heard concerns from environmental groups that the cap would be unintentionally set too lax—a condition sometimes referred to as "oversupply" or "over-allocation." The over-allocation condition occurs if too many allowances are supplied to covered entities relative to expected business-as-usual emissions levels. If the cap is set too loose, prices will be lower than expected, and a weakened incentive to reduce emissions will be created. The reserve price mechanism would correct this condition

> by transferring excess allowances to future auctions. Second, staff is adapting the approach used in the federal Waxman-Markey proposal (HR 2454), which proposed a reserve price of $10 with an inflator mechanism of 5 percent per year plus inflation.
>
> Finally, ARB does not consider the prices observed in markets, such as RGGI, as representative of the marginal cost of abatement or production of offsets. These prices are instead the result of the over allocation problem that ARB is determined to prevent in California.[3]

The FSOR also states that:

> The auction reserve price starts at $10, which is high enough to support the initial expected offset credits price.[4]

It appears that the $10 floor price in the Waxman-Markey cap and trade bill was adopted without further research and was assumed to be appropriate in the context of the California cap and trade program, even though the California program is quite different from a national cap and trade program of the kind that the Waxman-Markey bill would have established. Furthermore, we are not aware of the original basis for setting this floor price in the Waxman-Markey bill.

SCPPA would appreciate it if the ARB could provide any research indicating that an ARP starting at $10 and increasing at five percent per year plus inflation is necessary in order to alleviate any over-allocation and to support the generation of offsets or covered-sector emissions reductions in California. Is it the case that a $10 floor price would achieve these objectives (listed in the above extracts from the FSOR) but that a lower floor price, or one increasing only with inflation, would not? This issue is significant because a floor price that is higher than necessary is likely to increase the overall cost of compliance with the cap and trade program.

This issue should be tested in the market simulation exercises that will be undertaken this year.

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[3] FSOR at 366.

[4] FSOR at 364.

B. Clarify the sale order of allowances consigned to auction by utilities that were unsold and then redesignated to auction.

Sections 95911(f)(4)(A) and (B) state that unsold allowances that were consigned to auction from limited use holding accounts and from closed accounts will be held in the Auction Holding Account until the next auction. Section 95911(f)(1) sets out the order in which allowances will be sold at auction, including allowances that were previously consigned to auction by the ARB and remained unsold. However, section 95911(f)(1) does not specify the sale priority of allowances that are redesignated to auction from the Auction Holding Account under section 95911(f)(4).

Utilities that consign allowances to auction will have a keen interest in knowing when those allowances are likely to be sold, as they need to track and account for all revenue from the auction of their allowances. This interest extends to the sale of allowances that were initially unsold and then returned to auction. SCPPA suggests that the unsold allowances from limited use holding accounts and closed accounts be used to fulfill winning bids prior to the allowances consigned to the current auction for the first time.

Section 95911(f)(1) of the Regulation should therefore be amended as follows:

(1) If allowances remain unsold at auction, the auction administrator will fulfill winning bids with allowances from consignment sources in the following order:

(A) Allowances consigned to auction pursuant to sections 95910(d)(2) and 95911(f)(4)(B);

(B) Allowances redesignated to the auction pursuant to section 95911(f)(4)(A);

(~~B~~C) Allowances consigned from limited use holding accounts pursuant to section 95910(d)(1);

(~~C~~D) Allowances redesignated to the auction pursuant to section 95911(f)(3); and

(~~D~~E) Allowances designated by ARB for auction pursuant to section 95910(c)(1)(B) and (c)(2)(B) and (C).

IX. SECTION 95912: CHANGES TO THE AUCTION PROCEDURES ARE REQUIRED.

SCPPA considers that certain changes to the allowance auction procedures set out in section 95912 of the Regulation should be implemented for a smoother and more efficient auction and settlement process.

A. The additional information required to be provided to the financial services administrator is problematic.

Section 95912(d)(5) requires account representatives to provide certain information before they are able to participate in an allowance auction, including the Know-Your-Customer requirements and additional information to be provided to the financial services administrator ("FSA"). See section VII above for SCPPA's concerns regarding the Know-Your-Customer requirements. For the same reasons, SCPPA is also concerned about the information listed in Appendix A to the Regulation, which must be provided to the FSA under section 95912(d)(5)(B). The information required is similar to, but goes further than, the Know-Your-Customer requirements.

This is a new requirement which has not previously been part of the Regulation. The need for this information must be clearly explained and justified. One key concern is that there are no provisions in the Regulation to safeguard the confidentiality of the Appendix A information. Section 95912(g) on confidentiality does not apply to this information, only to information provided as part of the auction application. Before account representatives provide the Appendix A information, the FSA should be required to provide guarantees of confidentiality to the account representatives, with details of the way in which the information will be used, who will have access to it, and the steps to be taken to limit unauthorized access to the information.

Among other items, Appendix A requires account representatives to provide copies of a valid identity card issued by a state or province, a government-issued identity document, and a passport. However, a person may not have three separate documents matching these descriptions. The Know-Your-Customer requirements, by contrast, require only one of a passport or a driver's license or identity card, not all three (section 95834(b)(8)). Appendix A should be modified to require only one of these three documents.

Furthermore, the Regulation should provide details on the process for providing the Appendix A information. This information is not required to be provided as part of the auction participant application under section 95912(d)(4), so it appears that it will be submitted separately. Currently, there are no instructions on how, when or where to submit this information, beyond the fact that it must be submitted before participating in an auction.

Finally, section 95912(d)(5) refers initially to participation in an auction, and it is part of the section on auction administration, but it also refers to "entities eligible to participate in Reserve sales." Presumably the reference to Reserve sales should instead be a reference to auctions. This should be corrected.

B. Utilities consigning allowances to auction should be able to provide reduced bid guarantees.

Section 95912(i) requires auction participants to provide bid guarantees covering the maximum potential value of the submitted bids. The value of the allowances that utilities consign to auction should be recognized when bid guarantees are calculated. The financial risk that the bid guarantee is designed to address – a winning bidder not being able to pay for its allowances – is reduced in the case of utilities that stand to receive payments for the allowances they consigned to auction. The bid guarantee for utilities that consign allowances and bid at the same auction should be reduced accordingly.

If an auction clears above the ARP established under section 95911(c), all of the allowances a utility consigns to auction will be sold. The only circumstance in which all of a utility's consigned allowances will not be sold is if there is insufficient demand at the auction for allowances at the ARP, in which case unsold consigned allowances will be returned to the Auction Holding Account under section 95911(f)(4) of the Regulation.

Therefore, if a utility consigns allowances to auction and submits bids for a number of allowances less than or equal to the number of allowances it consigned ("Consigned Allowances"), the bid guarantee should be calculated as the ARP multiplied by the total number of allowances in the utility's bid. If the utility submits bids for a number of allowances in excess of its Consigned Allowances, the bid guarantee should be calculated as the ARP multiplied by its Consigned Allowances, plus the maximum value of its bid for allowances in excess of the Consigned Allowances (calculated in accordance with section 95912(i)(2) of the Regulation).

Changing the bid guarantee requirements in this way will reduce transaction costs for utilities – specifically the cost of obtaining large bid guarantees, which is a particular concern for the smaller POUs that are interconnected with the California Independent System Operator ("CAISO") and are thus required to auction their allowances under section 95892(d)(5) of the Regulation. It will also reduce the unnecessary flows of money that the FSA must handle, making the guarantee and settlement process quicker and more efficient for all parties.

For these reasons, section 95912(i)(2) of the Regulation should be revised, and a new section 95912(i)(3) should be included, as follows:

> (2) The amount of the bid guarantee must be greater than or equal to the maximum value of the bids to be submitted, subject to section 95912(i)(3) below. ...
>
> (3) If an auction participant has consigned allowances to the auction pursuant to section 95910(d)(1), the amount of the bid guarantee must be calculated as follows:

(A) If the number of allowances in the bids to be submitted by the auction participant for that auction is less than or equal to the number of allowances the auction participant has consigned to that auction: the Auction Reserve Price multiplied by the number of allowances in the bids to be submitted by the auction participant; or

(B) If the number of allowances in the bids to be submitted by the auction participant for that auction exceeds the number of allowances the auction participant has consigned to that auction: the sum of (i) the Auction Reserve Price multiplied by the number of consigned allowances; plus (ii) the maximum value of the bids in excess of the consigned allowances, calculated in accordance with section 95912(i)(2).

C. The period from the auction to notification of auction results and invoicing should be short.

Section 95912(j) lists the steps that will be taken after each allowance auction. The only specified time period is the period of seven days for winning bidders to pay. (See SCPPA's comments on this period in section IX.D below.) No other time periods are specified.

ARB staff indicated at a meeting on May 14, 2012, that, at least for the first auction in November 2012, it will take a week after the auction to notify bidders of auction results, and a further five days will pass before invoices would be sent to successful bidders, with payments due two days later.

A period of one week from the auction to the notification of results is too long. Having such a long period before the results are available increases the risk of information leaks resulting in detrimental impacts on the secondary market for allowances (which will remain active throughout this period). It would be desirable, and should be possible, for results to be published electronically and invoices to be transmitted sooner after the auction.

SCPPA understands that the auction results must be reviewed and certified. However, this can be done relatively quickly as many of the steps can be automated. The auction administrator should provide its initial report on the auction on the same day as the auction, as auction results can be collated by the auction software. The market monitor's report can then be

submitted on the following day, and the ARB should immediately consider this report. Before the first auction, the ARB should establish criteria for auction certification. If the criteria are satisfied, certification should be automatic.

As soon as the auction results are certified, they should be made available on the auction platform, and invoices should be prepared and sent by email immediately. Much of this process should be automated. Sending invoices five days after notification of results and only two days before the due date for payments is not very helpful, as invoices are crucial components of most organizations' payment processes.

With these changes, notification of auction results and invoicing should be able to be completed within three days after the auction. After the first few auctions have taken place and the procedures become settled, notification and invoicing should be able to be completed even more quickly. As an example of an efficient auction process, the complex electricity auctions held by the CAISO clear on the same day the auction is held.

D. Winning bidders should have seven business days to pay for allowances.

Under section 95912(j)(2)(B) of the Regulation, winning bidders must pay for the allowances they purchased at auction seven calendar days after notification of auction results. This could be only three business days after notification, assuming an extended Thanksgiving holiday. Furthermore, as noted above, payments are due only two days after invoices are released, and most entities will need to receive a formal invoice before payment can be authorized.

Bidders should be given a longer period to pay for their allowances. Few bidders are likely to provide bid guarantees in the form of cash (as this would constitute an uncompensated loan to the FSA), so they will need to arrange for a separate payment after the auction. A period

of two or three business days is not sufficient to prepare and authorize a payment which may be a significant amount, often millions of dollars.

Instead, payments should be due no sooner than seven business days after invoices are sent. (As noted above, invoices should be able to be sent much earlier in the process.) This is the minimum period within which an organization could arrange for a large payment. Indeed, it is still much shorter than the typical commercial payment period of 30 days after invoicing.

For these reasons, sections 95912(j)(2)(B) and (C) of the Regulation should be revised as follows:

> (B) Collect cash payments from winning bidders within seven business days of notifying them of the auction results pursuant to section 95912(j)(2)(A);
>
> (C) Use the bid guarantee to cover payment for allowance purchases by any entity that fails to make cash payment within seven business days after bidders are notified of results pursuant to section 95912(j)(2)(A), and place the proceeds into the Air Pollution Control Fund.

E. Utilities consigning allowances to auction should be allowed to net the payment to be received for allowances they sold against the payment to be made for allowances they purchased.

Section 95912(j)(2) should allow netting in respect of payments for allowances purchased at auction. A utility that consigned allowances to auction will receive, after financial settlement, an amount equal to the number of its allowances that were purchased at the auction times the settlement price ("Sale Amount"). If that same utility also purchased allowances at the auction, it should be allowed to deduct the Sale Amount from the amount it must pay the FSA for the allowances it purchased ("Purchase Amount"). This should be reflected in the invoice from the FSA to the utility. If the Sale Amount is larger than the Purchase Amount, the utility should not be required to make any payment to the FSA, and the FSA should refund the difference to the utility after financial settlement.

As with the changes to the bid guarantee calculation discussed above, this netting procedure would reduce transaction costs for utilities as well as making the financial settlement process more efficient.

For these reasons, a new section 95912(j)(2)(B) should be added to the Regulation as follows:

> (A) Notify each winning bidder of the auction settlement price, the number of allowances purchased, the total purchase cost, and the deadline and method for submitting payment;
>
> (B) For winning bidders that consigned allowances to the auction pursuant to section 95910(d)(1), calculate the amount owing for purchased allowances by deducting the number of allowances sold by the winning bidder from the number of allowances purchased by the winning bidder, and multiplying the result by the auction settlement price;

F. The Regulation should specify that utilities will receive payment for allowances consigned to auction the day after payment by winning bidders.

Section 95912(j)(2)(E) provides that auction proceeds will be distributed to entities that consigned allowances for auction. However, there is no indication as to when this distribution will take place. As this distribution will involve a significant amount of money, it is important for the relevant utilities to know when it will be received. This distribution should be made on the day following the deadline for winning bidders to pay for their allowances. If bidders have not paid on time, section 95912(j)(2)(C) allows for the use of their bid guarantees to cover their payments, so the FSA will have access to sufficient funds to make the distribution.

Section 95912(j)(2)(E) should be revised as follows:

> (E) Distribute auction proceeds to entities that consigned allowances for auction pursuant to section 95910(d) the day following the due date for payments from winning bidders; and

X. SECTION 95914: THERE SHOULD BE NO SEPARATE PURCHASE LIMITS FOR ENTITIES WITH CONSOLIDATED ACCOUNTS.

Section 95914(d) addresses the allocation of shares of the auction purchase limit among entities with a direct corporate association. This section does not recognize that entities with a direct corporate association may choose to have their accounts consolidated under section 95833, effectively becoming one entity for the purposes of the Regulation. Entities with a direct corporate association with consolidated accounts should not be required to allocate shares of the auction purchase limit among themselves. The auction purchase limit applies to the 'consolidated' entity as a whole, and there is no need to divide it between members of the corporate association, since all allowances purchased by the consolidated entity will be delivered into one account.

This is recognized in section 95920(f)(3) in relation to the holding limit. Only entities that are part of a direct corporate association that opt out of account consolidation are required to allocate shares of the holding limit among themselves. The same approach should be taken in relation to the auction purchase limit.

Sections 95914(d)(2) and (6) should be amended as follows:

> (2) Entities that are part of a direct corporate association that opt out of account consolidation pursuant to section 95833 may allocate shares of the purchase limit amongst themselves. ...
>
> (6) If entities with a direct corporate association that opt out of account consolidation pursuant to section 95833 do not allocate shares of the purchase limit among themselves, then the auction administrator will apply the purchase limit to the entities as follows: ...

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

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

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

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

[5] See section 95921(a), setting time limits of two days for actions by the seller and three days for actions by the buyer. If both buyer and seller in a particular transaction act more quickly, the transaction may be concluded in a shorter period.

At a minimum, notice and a cure period should be provided before any penalties are imposed if a transfer would result in a buyer exceeding its holding limit only by a small amount (for example, a few percent over the limit). Penalties should only be imposed without a cure period for transfers that would result in the buyer exceeding its holding limit by a considerable amount.

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

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

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

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

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

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

As of June 1, 2012, the most recent verified emissions report will be for 2010, as the verification statement for the 2011 report is not due until September 1, 2012.[6] The 2010 electricity transactions report does not include emissions, only megawatt hours of electricity imported, exported, wheeled, and purchased or sold within California. Therefore, it is not appropriate to use the 2010 reports to establish the limited exemption, as the 2010 reports lack emissions data for imported electricity.

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

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

C. The cross-reference in section 95920(f)(3) should be corrected.

Section 95920(f)(3) refers to entities that are part of a direct corporate association that choose to opt out of account consolidation pursuant to section 95833(e)(3). The provision on opting out of account consolidation is section 95833(f)(3), not (e)(3). This cross-reference should

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

be corrected. (Note however SCPPA's comments on section 95833(f) of the Regulation, in section VI.B above, which if adopted would result in a change to the numbering of section 95833.)

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

A. Business day time periods should be adopted for the allowance transfer process.

Sections 95921(a)(1)(B) and (C) of the Regulation set calendar day time periods for the allowance transfer process: two days for the seller to confirm the transfer request, and three days for the buyer to confirm the transfer request. Using business days for transfer time periods is preferable to calendar days given the short number of days in question, which may easily be exceeded over a weekend or holiday period such as Thanksgiving. If calendar days are used, this will tend to discourage transactions towards the end of the week where the time periods would end over the weekend. Trades would be concentrated in the first half of the week, which may be more difficult for the transfer system to handle as well as making the work flows of traders and the administrative personnel working on transfers more uneven. Business days are used elsewhere in the Regulation (e.g. section 95870(d)) as well as in Quebec's cap and trade regulation,[7] and should also be used in section 95921 of the Regulation.

An account representative should, however, have the flexibility to enter a transfer request at any time, including on non-business days. If the transfer request was entered on a non-business day, the time period for the counterparty to respond should not be triggered until the

[7] Section 10.1 of the Quebec regulation, as revised by the amendments released on June 8, 2012 (available at http://www.arb.ca.gov/regact/2012/capandtrade12/qcaamendpt2.pdf) defines "business day" as follows: "any day other than a Saturday, Sunday or statutory holiday, including statutory holidays in the territory of a partner entity." California would be a partner entity if the two jurisdictions link their programs.

start of the next business day. This will avoid unintentional defaults by counterparties that are unaware of actions taken by another party on non-business days.

Sections 95921(a)(1)(B) and (C) of the Regulation should therefore be revised as follows:

> (B) The primary account representative or another alternate account representative for the same entity must confirm the transfer request within two business days of the initial submission of the transfer request.
>
> (C) The primary account representative or an alternate account representative for the destination account must confirm the transfer request to the accounts administrator within the time remaining in the three business days following the initial submission of the transfer request in section 95921(a)(1)(A).

B. Clarify the role of the primary account representative in the transfer process.

Section 95921(a)(1) of the Regulation requires an allowance seller to undertake two steps in order to transfer allowances to a buyer: submit and confirm a transfer request. The transfer request may be submitted by the seller's primary account representative or an alternate account representative (section 95921(a)(1)(A)), and the confirmation must be made by the primary account representative or another alternate account representative (section 95921(a)(1)(B)).

If the primary account representative makes the initial submission, it is not clear whether the primary account representative – the same person – can also confirm the transfer request. (It is clear that the same alternate account representative cannot undertake both steps.)

SCPPA suggests, for greater flexibility, that the seller's primary account representative should be able to undertake both steps. If an entity wishes to have a second person involved, the entity is free to adopt that policy, but this should not be mandated by the ARB. If the ARB does not intend to allow the primary account representative to undertake both steps, section 95921(a)(1)(B) should be revised to clarify this.

C. Clarify that the buyer can confirm the transfer request at any time in the three-day period.

Section 95921(a)(1)(C) requires allowance buyers to confirm a transfer request "within the time remaining in the three days following the initial submission of the transfer request." This phrasing indicates, without specifying, that the buyer can only make this confirmation after the confirmation by the seller under section 95921(a)(1)(B), and that the buyer cannot make its confirmation directly after the initial submission of the transfer request under section 95921(a)(1)(A).

SCPPA sees no need for this restriction. For greater flexibility, the buyer should be allowed to submit its confirmation at any time in the three-day period, whether before or after the seller's confirmation. Providing this flexibility may allow for quicker transfers, if desired by the parties, and would not detract from the security provided by the three-step process, as the three steps would still be required. After the first step has taken place, kicking off the three-day period, the order of the other two steps is not important.

Section 95921(a)(1)(C) should be revised as follows:

> (C) The primary account representative or an alternate account representative for the destination account must confirm the transfer request to the accounts administrator within ~~the time remaining in the~~ three business days following the initial submission of the transfer request in section 95921(a)(1)(A).

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

Sections 95921(a)(1)(E), (a)(3)(B) and (b)(5) refer to the date of "settlement" of an agreement to transfer compliance instruments. Of particular note, section 95921(a)(1)(E) requires the parties to such an agreement to complete the allowance transfer process within three days of the day of settlement of the agreement. However, not all agreements may specify settlement dates as such – they may instead refer to delivery dates, transaction dates or transfer dates.

Furthermore, the parties may intend the settlement or delivery date to be the date on which the transaction is to be completed, i.e. the instruments transferred to the buyer, rather than the date starting the process of requesting a transfer, which may be up to three days before the actual transfer. Therefore it may be difficult to determine the "settlement" day of each transfer agreement, making it hard to comply with the requirement in section 95921(a)(1)(E) to complete the three steps for transfers within three days of the day of settlement.

In addition to being impractical, there is no need to tie allowance transfers to a "settlement date." Each agreement to transfer compliance instruments will contain its own provisions to ensure the buyer and seller undertake the necessary steps to transfer the instruments at the agreed time. There is no need for the ARB to enforce the delivery provisions in each commercial allowance transfer agreement. This is a commercial matter and should be left to the relevant parties, who should be free to negotiate the provisions that suit them best and enforce them under the law of contract. For example, if the agreement does happen to specify a settlement date, it may excuse the seller from commencing the transfer process on the settlement date if certain conditions apply, such as the buyer failing to provide sufficient security. The ARB should not step in and require the seller to commence the transfer process regardless. The transfer provisions in the Regulation should be no more prescriptive than necessary, and should be limited to matters over which it is important, for the proper functioning of the carbon market, for the ARB to have control. Contractually-determined settlement dates are not one of those matters.

Therefore section 95921(a)(1)(E) should be deleted, and consequently sections 95921(a)(3)(B) and (b)(5) are no longer relevant and should also be deleted.

E. No penalties should be imposed if the transfer process is not completed within the required timeframes.

Section 95921(a)(3) imposes penalties if the seller and buyer do not complete the transfer process within three days of the initial transfer request and three days of the settlement day of the transfer agreement. SCPPA strongly opposes this section. The ARB should not impose penalties in these circumstances.

For the reasons discussed in section XII.D above, there should be no penalties for failing to complete the transfer process within a specified time of the settlement day.

It is also inappropriate, and unnecessary, to impose penalties for failing to complete the transfer process within three days after the initial transfer request. If the parties fail to comply with the timeframes set in sections 95921(a)(B) and (C), the only outcome the Regulation should specify is that the transfer will not be processed. If the parties wish to proceed with the transfer at a later date, they can restart the process of submitting the transfer request and two confirmations under section 95921(c)(1)(C). This is a sufficient incentive to ensure parties abide by these timeframes.

Furthermore, the agreement between buyer and seller to transfer compliance instruments will contain its own provisions to ensure each party completes the necessary steps at the appropriate times. If the parties do not comply with these timeframes, there may be a contractual reason for this. For example, the agreement may provide for the seller to halt the transaction (e.g. by not providing its confirmation of the initial transfer request) if it discovers that the buyer's security is inadequate. The ARB will not know of these circumstances and should not need to know them. Such matters will be resolved between the buyer and seller in accordance with their contract.

Whether the transfer process is completed within three days, knowing that the transfer will not be processed if this timeframe is not met, primarily affects only the buyer and seller, and should be decided by them without penalty. There is no need for the ARB to impose penalties to protect against market uncertainty due to transactions being incomplete for long periods of time. To provide certainty, the ARB only needs to provide that if the transfer process is not completed within the time limits, the transfer will not be processed. It appears that section 95921(c)(1)(C) is intended to accomplish this – however, see SCPPA's comments on this provision in section XII.G below.

For these reasons, the ARB should not impose penalties if the parties do not comply with the timeframes in sections 95921(a)(1)(B) and (C). Section 95921(a)(3) should be deleted in its entirety.

(a) Transfers of Compliance Instruments Between Accounts. ...

~~(3) The parties to a transfer will be in violation and penalties may apply if the above process is completed:~~

~~(A) More than three days after the initial submission of the transfer request; or~~

~~(B) More than three days after the settlement day of the transaction for which the transfer request is submitted.~~ ...

F. Information requirements for transfer requests should be clarified.

Section 95921(b)(1)-(6) sets out a list of information requirements for transfer requests. Two of the listed items of information should not be required for any transfer requests, and amendments to other items on the list should be made to accommodate internal transfers from an entity's holding account to its own compliance account.

Section 95921(b)(4) requires the parties to report the date of the transaction agreement for which the transfer request is submitted. It is unclear why the ARB needs this information. A

single agreement may provide for a series of transfers to occur at intervals over a period of years, or for only one transfer to take place immediately. In either case, the date of the agreement does not appear to be relevant to the ARB. Parties should not be required to provide information under this section unless it is necessary for the transfer of compliance instruments.

Section 95921(b)(5) requires the parties to report the actual or expected settlement date of the agreement. For the reasons discussed in section XII.D above, all references to settlement dates should be deleted.

These two requirements are even more irrelevant in the case of internal transfers, where there will be no transaction agreement.

Additionally, for internal transfers there is no need to identify the destination account representative who will confirm the transfer request (section 95921(b)(2)), since section 95921(a)(2)(B) provides that this confirmation is not required for internal transfers. Section 95921(b)(2) also refers to the holding account number of the destination account, whereas the destination account is a compliance account in the case of internal transfers.

Section 95921(b) of the Regulation should be revised as follows to address these issues:

(b) Information Requirements for Transfer Requests. The following information must be reported to the accounts administrator as part of a transfer request before any transfer of compliance instruments~~allowances~~ can be recorded on the tracking system: ...

(2) ~~Holding a~~Account number of destination account and identification of a primary account representative or alternate account representative for the destination account confirming the transfer request. Identification of a representative of the destination account is not required for transfers from an entity's holding account to its compliance account. …

~~(4) Date of the transaction agreement for which the transfer request is submitted;~~

~~(5) Actual or expected settlement date, if not the same as the date of the transaction agreement;~~

G. Clarify that if the transfer process is not completed correctly, the transfer will not proceed.

Section 95921(c)(1)(C) provides that if an acceptable transfer request is not submitted within the time limit, the buyer and seller must either withdraw the transfer request or submit a new one, and penalties may still apply. SCPPA has three concerns with this provision.

Firstly, this provision requires the buyer and seller to undertake an unnecessary administrative task – withdrawing the transfer request (if they do not wish to submit a new one). If the transfer request was late or otherwise deficient, the consequence should be that the accounts administrator will not process the transfer. There is no need for a withdrawal process. The allowance transfer procedures should be made as clear and simple as possible to reduce the administrative burden on market participants, the accounts administrator and the ARB. The Regulation should only require notices to be submitted and other administrative procedures to be undertaken where necessary, and a withdrawal notice is not necessary.

Secondly, this provision does not clearly state that the accounts administrator will not process transfers if the transfer request is deficient and is not corrected. This consequence is important and should be made clear.

Thirdly, penalties should not be imposed for the reasons set out in section XII.E above.

To address these issues, section 95921(c)(1) should be revised as follows:

(c) Transfer Request Deficiencies:

(1) If the accounts administrator detects a deficiency in a transfer request before it is recorded into the tracking system: ...

(B) The entities submitting the transfer request may resubmit the request with the deficiency corrected within the time limit set pursuant to section~~s~~ 95921(a)(1)(C)~~ and (E)~~, in which case the accounts administrator will record the transfer into the tracking system; and

(C) If the entities fail to submit an acceptable transfer request within the time limit, then the accounts administrator will not record the

transfer into the tracking system. If the entities wish to proceed with the transfer they must ~~either withdraw the transfer request or~~ submit a new transfer request. ~~Penalties may still apply pursuant to section 95921(a)(3).~~

XIII. SECTION 95973: THE ARB SHOULD APPROVE ADDITIONAL OFFSET PROJECT TYPES IN 2012.

Section 95973(a)(2)(C) of the Regulation lists the four offset project types that are currently approved by the ARB as Compliance Offset Protocols. This limited range of offset project types will limit the number of offsets that are available to covered entities for compliance, particularly in the first compliance period. If less than the maximum allowed quantity of offsets is available,[8] the offsets program will not fulfill its cost containment potential and the costs of the cap and trade program as a whole will increase.

On May 17, 2012, the Western Climate Initiative ("WCI") announced that it will review and evaluate additional offset protocols, including protocols relating to coal mine methane and small landfills. The WCI may also consider reviewing additional protocols relating to municipal and industrial waste water treatment, fertilizer application N_2O emission reductions, rice cultivation, and enteric fermentation.

SCPPA recommends that the ARB works with the WCI to ensure the review and evaluation process is completed promptly, and that the ARB then proceed to a new rulemaking in 2012 to approve the additional offset protocols for compliance use. This prompt action will help ensure that sufficient offsets are available from the first compliance period onwards, maximizing the cost containment potential of the offsets program.

[8] Section 95854 sets the quantitative usage limit at eight percent of an entity's compliance obligation.

XIV. CONCLUSION

SCPPA urges the ARB to consider these comments in finalizing the Regulation. SCPPA appreciates the opportunity to submit these comments to the ARB.

Respectfully submitted,

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