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E-Filing
ARB's Cap-and-Trade Website

Steven Cliff, Ph.D.
Chief - Climate Change Market Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

**Re: Pacific Gas and Electric Company's Comments on the Air Resources Board 15-day
Language: Linkage with Québec**

Dear Dr. Cliff:

Pacific Gas and Electric Company (PG&E) welcomes the opportunity to submit these comments on the Air Resources Board's (ARB) 15-day language package. PG&E views successful linkage with Québec as a critical first step in broadening California's cap-and-trade market through linking with other jurisdictions. Larger more diverse markets enhance the prospects for efficient market outcomes, eventually leading to lower-cost emission reduction opportunities.

However, due to the complexity of linking these two programs, PG&E believes that both the scope of the review and the 15-day comment period are inadequate to address potential issues associated with a joint auction. PG&E urges ARB to use a more robust stakeholder review process to identify and remedy potential issues rather than immediately moving a Board vote, in the event these issues cannot be addressed before the February meeting. PG&E outlines several unresolved issues in its comments below to help ensure successful linkage with Québec. In addition, several recommendations to prevent linkage from adversely affecting covered entities in California offered in previous comments (see attached) were not incorporated into the 15-day language. Stakeholders' concerns should be addressed before the Board moves forward and requests the Governor make findings pursuant to Senate Bill (SB) 1018.

I. INTRODUCTION

PG&E's detailed comments on the 15-day language and additional documents added to the record are set forth below. The following summarizes the key issues:

- **A Joint Practice Auction Should Be Held**
- **A Contingency Plan is Needed to Respond to Instances of Market Stress/Failure**

- **The Exchange Rate and Auction Reserve Price Should be Posted Prior to the Day of the Auction (Section 95911(c))**
- **Québec’s Regulation Unnecessarily Limits Offset Credit Supply**
- **Information Sharing Guidelines Should Be Harmonized**
- **Clarify Procedure for Sale of Consigned Allowances In The Event of An Undersubscribed Auction (Section 95911(f))**

II. DISCUSSION.

A. Joint Practice Auction Should Be Held

Alain Olivier, director of the Québec Government Office in Washington, D.C., has indicated that Québec is planning on holding a Québec-only “practice auction” prior to a joint auction in August 2013. PG&E strongly supports his decision, particularly given the value ARB’s August 2012 practice auction offered to California stakeholders. Given the additional steps and concerns with joint auction mechanics, PG&E proposes that at least one practice joint auction also be held with sufficient lead time to allow any issues with exchange rates, reserve prices, auction mechanics, and bidder confusion to be resolved prior to the first real joint auction. This will afford participants the opportunity to gain familiarity with the auction systems and seek clarity on any questions before the linked auction is held. Following the practice joint auction, ARB and the Minister should provide detailed feedback on any problems with bids, bid formats, or currency exchange issues, prior to any linked auctions.

B. Contingency Plan is Needed to Respond to Instances of Market Stress/Failure

In September 2012, the Emissions Market Assessment Committee (EMAC) advised ARB to resolve five issues prior to linkage. Those included:

- Coordinating legal and regulatory frameworks;
- Consistency in transparency about market mechanisms;
- Consistency of definitions and market rules for the use of compliance instruments;
- Consistency in the enforcement of market rules; and
- Ability to respond quickly to unforeseen contingencies.

ARB and Québec have made significant strides in several of these areas over the last year, but significant progress towards developing a joint response to unforeseen contingencies is needed before successful linkage can occur. As the EMAC suggested during its September workshop,

the integration of multiple jurisdictions introduces challenges in assessing the cause of market stress or failure and implementing regulatory remedies. A process for coordinating between jurisdictions to recognize and effectively address market stress conditions, including the increased potential for market manipulation under a linked auction, should be established in Québec and California regulation prior to a joint auction. Linkage should not preclude California from making necessary adjustments to its program in market stress situations.

C. The Exchange Rate and Auction Reserve Price Should be Posted Prior to the Day of the Auction (Section 95911(c))

According to ARB's 15-day language (Section 95911(c)(3)(C)), the exchange rate for the Auction Reserve Price will be set "as the most recently available noon daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada." The auction administrator will then "use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated in U.S. and Canadian dollars." Section 49(2) of the Québec regulation specifies that the joint minimum price of emission units is defined in terms of "the official conversion rate of the Bank of Canada at noon on the date of the auction or, when that rate is not available, the most recent rate published in its Daily Memorandum of Exchange Rates."

As the exchange rate is set at 9:30AM PST by the Bank of Canada, entities will learn the effective exchange rate and the Auction Reserve Price at most 30 minutes before the auction window opens. This small window of opportunity to make modifications to bids based on an updated Auction Reserve Price could result in potential data entry errors, which is particularly troubling given that bids one cent below the Auction Reserve Price will be rejected. This last-minute modification could also impact the bid guarantee posted by stakeholders at least 12 days before the auction. PG&E strongly encourages the two jurisdictions to work together to remedy this issue before proceeding with a linked auction, rather than unnecessarily complicating the bidding process.

To avoid last-minute errors, the exchange rate and the Auction Reserve Price should both be calculated and announced on the last day prior to the auction that is a business day in both California and any linked jurisdictions. This will afford entities enough time to alter their bids, if needed, while maintaining the accuracy of the calculated exchange rate. PG&E recommends the following modifications:

95911(c)(3)(C): The auction administrator shall set the exchange rate as the ~~most recently available~~ noon daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada on the last day prior to the auction that is a business day in both California and in any jurisdiction operating an External GHG ETS to which California has linked pursuant to subarticle 12, and shall announce the exchange rate prior to ~~the opening of the auction window~~ 10 a.m. Pacific Prevailing Time on the day the exchange rate is set.

95911(c)(4): The Auction Reserve Price will be announced prior to ~~the opening of the auction window at 10 a.m. Pacific Prevailing Time Pacific Standard Time (or Pacific Daylight Time when in effect)~~ on the day the exchange rate is set per Section 95911(c)(3)(C) of auction, and will be in effect until the window closes at 1 p.m. Pacific Prevailing Time on the day of the auction. Standard Time (or Pacific Daylight Time when in effect).

PG&E would also like to reiterate its April 13, 2012 comments regarding the determination of the Auction Reserve Price. Rather than using the maximum of the two separate prices which will provide an upward bias on the reserve price, PG&E recommends using the average of the two prices. PG&E suggests the following change to section 95911(c)(3)(D):

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

D. Québec's Regulation Unnecessarily Limits Offset Credit Supply

The use of high quality offsets is an effective cost containment tool and an essential component of a successful cap-and-trade program. However, as stated in PG&E's February 17 and April 13, 2012 comments, without adequate supply and adjustment to the implementation of the quantitative usage limit, the cost containment objectives of providing offsets will not be realized. Québec's cap-and-trade regulation, which includes three existing offset project protocols, limits the volume of offsets that could be generated in Canada and provided for sale to California entities under a linked program, making linkage less advantageous for California. If Québec is a net buyer of AB 32 offset credits, the already low predicted supply of AB 32 offsets for covered entities in California entities will be even lower, reducing the value of this critical cost-containment feature.

For example, Québec's protocols limit offset credit volume by restricting project development to Québec (Covered Manure Storage Facilities - CH₄ Destruction, Landfill Sites - CH₄ Destruction), whereas the AB 32 protocols can be used to develop projects in most US states. Similarly, "promoters" in Québec (the rough equivalent of Offset Project Operators) must be emitters or people domiciled in Québec, or have an establishment in Québec, whereas ARB's protocols have no such geographic restriction.

In addition, future protocols, such as those based on forestry, could be precluded from adoption in Québec's system due to the regulatory requirement that GHG reductions be irreversible. Some projects, by nature, may be reversible due to unforeseen events such as forest fires, etc. The ARB's forestry protocol effectively manages this potential by adding the concepts of intentional and unintentional reversal. To avoid precluding the adoption of certain future

protocols, Québec should eliminate the term “irreversible” in the offset rules, or alternatively develop “buffer pools” to insure against risk of reversals.

Finally, if Québec cannot generate sufficient offset credits and becomes a net buyer, fewer offset credits will be available for California entities to fully utilize their 8% quantitative usage limit. Therefore, PG&E also supports changing the ARB’s quantitative usage limit described in Section 95854 to include a new Section 95854(c) that would allow an entity to bank any unexhausted portion of its limit from one compliance period for use in subsequent compliance periods. This language change will improve the potential for successful linkage with Québec. This new Section 95854(c) could read:

If O_O/S is less than L_O for any one compliance period, the number of compliance instruments identified in section 95854(a) that are between O_O/S and the number of compliance instruments identified in section 95854(a) where O_O/S is equal to L_O can be added to the quantitative usage limit of the subsequent compliance period.

E. Information Sharing Guidelines Should Be Harmonized

ARB is in the process of determining what auction information will be shared publicly, with a workshop on that topic scheduled for January 25, 2013. While there is some description of information sharing in the respective regulations, both jurisdictions need to be aligned on what information will be shared, for all types of data. PG&E recommends in particular that section 95921(e) be clarified to state that the section applies both to accounts registered to entities in California and in any linked jurisdictions.

F. Clarify Procedure for Sale of Consigned Allowances In The Event of An Undersubscribed Auction (Section 95911(f))

Section 95911(f) specifies (1) an order of sale if the auction is undersubscribed, with consigned allowances sold first, and (2) that when there are insufficient winning bids to exhaust the allowances from a consignment source in section 956911(f)(1), the auction operator will sell an equal proportion of allowances from each consigning entity in that source. The situation becomes more complex if linkage occurs because the amended Québec regulation Section 54 merely states, “Emission units of the vintage of the current year or of previous years that remain unsold after an auction are put up for sale at a later date...” PG&E requests ARB to clarify that section 95911(f)(1) applies to the proportion of total bids coming from California. PG&E proposes the following modification:

(f) Allowances will be sold from California sources (including consigned allowances) and from each jurisdiction to which California has linked pursuant to subarticle 12 in the same proportion as allowances were provided to the auction, rounded to the nearest 1000 allowances.

(f) (g) If the quantity of bids accepted by the Auction Administrator is less than the number of allowances offered for sale then some allowances will remain unsold.

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

(A) Allowances consigned to auction pursuant to section 95910(d)(2);

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

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

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

(2) When there are insufficient winning bids to exhaust the allowances from a consignment source in section 95911(f)(1), the auction operator will sell ~~an equal proportion of~~ allowances in equal proportion to the number of allowances consigned from each consigning entity in that source, rounded down. If, as a result of rounding down, not all California-sourced allowances specified in section 95911(f) are sold, the auction operator will assign a random number to each unsold bundle of 1,000 metric tons of CO₂e from that source. Beginning with the lowest random number assigned and working in increasing order, the auction operator shall sell allowances assigned the random number until all California-sourced allowances specified in section 95911(f) are sold.

III. CONCLUSION

Thank you for the opportunity to submit these comments. PG&E urges ARB to carefully review these suggestions and make the recommended changes before pursuing further action. We look forward to continuing our work with ARB and other stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

Judi K Mosley

cc: Rajinder Sahota, via email

February 17, 2012

***E-Filing
ARB's Cap-and-Trade Website***

Mr. Steven Cliff
Chief - Climate Change Markets Branch
CALIFORNIA AIR RESOURCES BOARD
1001 "I" Street
Sacramento, CA 95812-2828

Re: Pacific Gas and Electric Company's Comments on the Air Resources Board's Proposal to Link California and Quebec's Greenhouse Gas Cap-and-Trade Programs

Dear Mr. Cliff:

Pacific Gas and Electric Company ("PG&E") is pleased to submit these comments on the Air Resources Board's ("ARB") proposal to link the California and Quebec Greenhouse Gas ("GHG") cap-and-trade programs. PG&E believes a well-designed, multi-sector cap-and-trade program linked with other jurisdictions is critical to ensuring a robust and liquid market. We view linkage with Quebec as an important first step. We look to the ARB and California to continue to move quickly toward additional linkage opportunities, while also ensuring that linkage occurs in a manner that recognizes California's decades-long effort to increase energy efficiency and secure renewable energy resources. We also encourage ARB to continue to ensure that linkage and cross-market rules are coordinated so as not to limit compliance flexibility and cost-containment measures ARB has included as part of its program.

I. INTRODUCTION.

PG&E's detailed comments on the proposed linkage between California's and Quebec's cap-and-trade programs are set forth in Section II below. At the outset, however, the following summarizes the issues we believe to be of critical importance in assuring that the California and Quebec programs are harmonized and linked effectively:

- **PG&E Supports ARB Staff's Proposal to Limit Access to California's Allowance Price Containment Reserve to Entities with a Compliance Obligation under California's Cap-and-Trade Program.**
- **Market Simulations During 2012 are Essential and Will Help Ensure That the California and Quebec Programs are Properly Harmonized.**



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- **Beneficial Holding Requirements, Holding Limits, and Account Management Restrictions Should Be Modified to Put California Complying Entities on a Level Playing Field with Their Quebec Counterparts.**
- **Allowances Purchased from a Linked Jurisdiction Should Remain Fully Fungible for Compliance Purposes.**
- **Without the Timely Adoption of Additional Offset Protocols and Added Compliance Flexibility, Linkage with Quebec May Put a Strain on the Already Limited Supply of Offsets Available in the First Compliance Period.**

II. DISCUSSION.

A. PG&E Supports ARB Staff's Proposal to Limit Access to California's Allowance Price Containment Reserve to Entities with a Compliance Obligation under California's Cap-and-Trade Program.

PG&E supports ARB staff's recommendation to prohibit Quebec entities from purchasing from California's allowance price containment reserve. The allowance price containment reserve is an essential mechanism in the cap-and-trade program to reduce the likelihood of high and volatile allowance prices. As we have noted in prior comments on the cap-and-trade regulation, allowing entities without a cap-and-trade compliance obligation in California to purchase from the reserve may accelerate depletion of the reserve and compromise the price protection that the reserve provides.

B. Market Simulations During 2012 are Essential and Will Help Ensure That the California and Quebec Programs Are Properly Harmonized.

PG&E supports ARB's intent to conduct market simulations prior to the start of the program as expressed in resolution 11-32.^{1/} As we have noted in our prior comments on the cap-and-trade regulation, we see significant value in testing and better understanding potential market outcomes under different conditions. Specifically, simulations could allow for an assessment of how the

^{1/} ARB Resolution 11-32 directs "the Executive Officer to contract with an external entity and work closely with regulated entities and other stakeholders to evaluate potential market conditions, trading dynamics, the Allowance Price Containment Reserve, and other key design features of the program prior to the beginning of the compliance obligation on January 1, 2013" (ARB Resolution 11-32, October 20, 2011).



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market functions in response to the behavior of market participants and identify a range of expected market outcomes. Through such testing, ARB will be able to gain valuable insights with respect to market design and pursue any necessary modifications, if possible, prior to commercial and financial commitments being made in the first two auctions in 2012.

The linkage of the California program to Quebec only adds to the importance of timely simulations that can help inform and shape the specific contingency measures included in the regulation. Sophisticated market simulations will help ARB determine which provisions of the regulation need to be harmonized with the Quebec regulation based on the potential for market gaming or other unintended consequences. Market simulations can assess potential outcomes under base case scenarios, or alternative scenarios of high growth and/or shortcomings of program measures, under which the California and Quebec economies may generate more emissions than in the base case modeled by WCI and in which the Allowance Price Containment Reserve has a significant probability of being depleted.

C. Beneficial Holding Requirements, Holding Limits, and Account Management Restrictions Should Be Modified to Put California Complying Entities on a Level Playing Field with Their Quebec Counterparts.

PG&E is concerned that the current proposed beneficial holding requirements do not provide sufficient flexibility to electrical distribution utilities to procure compliance instruments on behalf of certain counterparties with which it has contracts for the delivery of electricity. PG&E is also concerned that the holding limit will not enable it to procure sufficient compliance instruments on behalf of certain counterparties with which it has contracts. Further, the proposed holding limit prevents entities with a large compliance obligation from being able to sufficiently hedge future obligations. PG&E believes that both the beneficial holdings and holding limit sections of the regulation should be amended to resolve these concerns. Further detail is provided below.

1. Beneficial Holdings.

PG&E appreciates that ARB has recognized the need to allow electrical distribution utilities to claim a beneficial holding relationship under certain circumstances to enable them to procure allowances on behalf of certain counterparties. While the beneficial holdings language of Section 95834 allows for the compliance instruments held by an agent to count against the holding limit of the principal, the requirements in Section 95834(b)(2) may result in an agent having to acquire compliance instruments before it has knowledge of the principal's actual annual compliance obligation. There are several factors beyond our control regarding whether a given facility will be dispatched (and therefore emit) making it impossible to accurately forecast a given facility's emissions and, therefore, procure on a per facility basis. For example, factors such as weather,



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seasonal and daily demand fluctuations, hydro availability, and plant outages impact the operation of a facility. For these reasons, it is not unusual for a facility's output to vary by roughly a factor of three from one year to the next.

Given the variability in dispatch, timing requirements related to beneficial holdings are of significant concern. The allowance auctions occur in advance of the reporting by facilities of emissions at a time when a facility's generation is unknown. Electrical distribution utilities will forecast compliance obligations on a portfolio basis. However, parsing out the exact production on a facility level cannot be done until after emissions are reported and verified which will occur well after compliance instruments for the current vintage are sold through the auction. Providing ARB with notification of how to parse out auction purchases in advance of these calculated emissions could result in stranded allowances. Under the current approach, it is possible that an agent could be obliged to transfer more compliance instruments to the principle than its contract for the delivery of electricity requires.

As ARB works to link with Quebec and harmonize the two programs' regulations, we recommend changes to ARB's regulations to resolve the aforementioned concerns and allow California entities flexibility to comply with the holding limit requirements. We propose the following changes and clarifications to the current ARB regulations:

- (1) To satisfy the "prior to purchase" disclosure requirements detailed in Section 95834(a)(3) of the regulations, entities should simply provide a list to ARB of potential entities for whom we may purchase and hold compliance instruments ("Disclosure List") without having to disclose specific quantities to be purchased. The Disclosure List would establish the beneficial holdings relationship for purposes of compliance with the regulations and would be provided prior to submitting any transfer requests for beneficial holdings. The Disclosure List would be updated as needed to add additional entities with which there is a beneficial holding relationship, as well as remove entities where the relationship is no longer in effect;
- (2) Upon initiating a transfer request to ARB, the agent will designate a quantity of compliance instruments as beneficial holdings to be transferred within one year. The quantity of compliance instruments included in the transfer request will not count toward the agent's holding limit. Within one year of initiating the transfer request, the transfer request will be completed by the agent with serial number specification and quantity to be



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completed by the agent with serial number specification and quantity to be transferred to each specific principal. After confirmation by each principal, the compliance instruments will be transferred to the principal's account. Once the transfer is complete and compliance instruments have been transferred, they will count toward the principal's holding limit; and

- (3) To ensure that the holding limit flexibility recommended above is only used to support entities with a physical compliance obligation, transfer requests for compliance instruments designated as beneficial holdings must be transferred to the compliance account of the principal in the beneficial holdings relationship.

This simple process provides ARB with information on beneficial holding relationships and transfers of compliance instruments while providing the intended and necessary relief to a complying entity's holding limit so they may comply without being disadvantaged as compared to entities in linked jurisdictions.

2. Holding Limits.

During the February 3rd workshop on linkage, ARB proposed that the holding limit calculation established in the regulation use an annual allowance budget equivalent to the total number of allowances issued in the linked programs or an aggregate "base" value. While an aggregate "base" value would modestly increase the holding limit in California by a few hundred thousand tons (~320,000 mtCO₂e), Quebec's holding limit would increase from about 1 million to about 2.7 million. This would provide Quebec entities disproportionate flexibility in holding compliance instruments as compared to California entities, which raises concerns regarding the ability of Quebec entities to procure and hold large volumes of compliance instruments relative to their obligation.

When harmonizing the two programs, we recommend the holding limits be adjusted proportionally, per the two jurisdictions' cap-and-trade programs, to ensure that modifications to the holding limits do not disproportionately benefit one jurisdiction over the other. Alternatively, if ARB is not able to modify the beneficial holdings section as described above, PG&E recommends that ARB revisit the holding limit established in Section 95920 to provide the necessary flexibility to procure compliance instruments on behalf of its utility-owned and contractual obligations.

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3. Flexibility in Managing Compliance Accounts.

Several parties attending the linkage workshop noted that ARB's plan to create separate accounts for each separate covered facility makes it difficult to comply with the holding limit, as well as use the limited exemption to the holding limit to its full benefit. Given these concerns and those expressed above with respect to beneficial holdings and holding limit, we also recommend that the cap-and-trade regulation be modified to allow complying entities to move compliance instruments between all compliance accounts over which they have control. Alternatively, ARB could allow entities to use one set of accounts to pertain to the entity's total compliance obligation and total compliance instrument inventory.

D. Allowances Purchased from a Linked Jurisdiction Should Remain Fully Fungible for Compliance Purposes.

PG&E recommends that ARB amend the cap-and-trade regulation to specify that compliance instruments purchased from a linked jurisdiction are fully fungible for compliance purposes even if a linked jurisdiction subsequently modifies its program or ceases to be linked with California. Market participants need assurance that compliance instruments will be given "full faith and credit" by California provided that the issuing jurisdiction was linked with California when the instrument was originally issued.

E. Without the Timely Adoption of Additional Offset Protocols and Added Compliance Flexibility, Linkage with Quebec May Put a Strain on the Already Limited Supply of Offsets Available in the First Compliance Period.

PG&E believes that the use of high quality offsets is an effective cost containment tool and an essential part of a successful cap-and-trade program. Multiple studies have shown that the costs of the cap-and-trade program are much higher without a robust supply of high quality offsets.

PG&E supports the addition of Quebec to the cap-and-trade market. However, we believe linkage puts a strain on an already limited supply of offsets in the first compliance period. This is due to the lack of current offset protocols and the lead time to develop offset projects once the protocols are approved. Assuming that all offset projects in the first compliance period are verified and issued tons under the current ARB protocols or early action offset protocols, PG&E's model forecasts about 26 million metric tons ("MMT") of offsets that will be available in the cap-and-trade market. The Quantitative Usage Limit in the first compliance period in California is approximately 28 MMT, and Barclay's Bank estimates that the inclusion of Quebec increases the limit to around



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31 MMT.² Without the approval of additional protocols, the supply of offsets will not be able to meet the demand, and the cost containment objectives of offsets will not be realized.

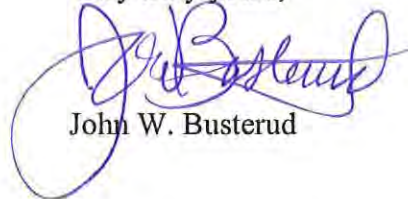
Unfortunately the approval of additional protocols may not be sufficient because the lead time to develop a new offset project is significant. Based on information from the Climate Action Reserve, it takes an average of between 121 and 717 days to go from project listing to first issuance. The first project for a new protocol typically takes even longer to go from listing to first issuance. Even if the ARB or Quebec approves additional protocols, there may not be sufficient time for those projects to enter the market in time for the first compliance period.

Because there will be an insufficient supply of offsets at the outset of the program, PG&E requests that the Quantitative Usage Limit apply to a complying entity's total compliance obligation from January 1, 2013 through the current compliance period. This will allow time for the offset market to develop projects while maintaining the current cap on the use of offsets. Even if projects will not be able to deliver offsets within the first compliance period, PG&E strongly urges both the ARB and Quebec to quickly adopt additional protocols. PG&E also encourages Quebec to quickly adopt the ARB protocols as written.

Finally, PG&E recommends the ARB and Quebec adopt the Climate Action Reserve's Nitric Acid Production and Coal Mine Methane protocols, as well as the American Carbon Registry's Protocol for Conversion of High-Bleed Pneumatic Controllers in Oil & Natural Gas Systems. These protocols show the greatest potential of quickly delivering high quality reductions.

Thank you for the opportunity to submit these comments. We look forward to continuing our work with the ARB and all concerned stakeholders to ensure the successful implementation of AB 32.

Very truly yours,



John W. Busterud

JWB:kp:bd

cc: Mr. Rajinder Sahota, Manager – Market Monitoring Group, *via e-mail rsahota@arb.ca.gov*
Mr. Ray Olsson, Air Pollution Specialist/Lead Staff, *via e-mail rolsson@arb.ca.gov*

² "Carbon Flash – Due North, Quebec Cap and Trade", Barclays Bank Commodities Research, February 9, 2012.



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Re: Pacific Gas and Electric Company's Comments on the Proposed Amendments to the California Cap-and-Trade Regulations to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

Dear Dr. Cliff:

Pacific Gas and Electric Company ("PG&E") welcomes the opportunity to submit these comments on the Air Resources Board's ("ARB") proposed amendments to the California Greenhouse Gas ("GHG") cap-and-trade regulations. PG&E supports ARB's efforts to link its cap-and-trade program with other jurisdictions, and we appreciate ARB's efforts to ensure that linkage occurs in a manner that does not adversely affect covered entities in California. We encourage ARB to continue to coordinate cross-market rules and assess the impact of linkage on California entities so as not to limit compliance flexibility and cost-containment measures ARB has included as part of its program.

I. INTRODUCTION

PG&E continues to have concerns regarding the holding limit and conduct of trade provisions. We suggest several modifications to address these concerns. PG&E also offers comments on the Know-Your-Customer requirements and other amendments to aid in implementation of the regulation. Finally, we recommend a number of modifications to ensure that linkage does not adversely affect covered entities in California. PG&E's detailed comments on the proposed amendments are set forth in Section II below. The following summarizes the key issues:

A. Modify Several Provisions Related to the Holding Limit and Conduct of Trade

- A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))**
- A2. Modify Provisions Relating to Conduct of Trade (Section 95921)**
- A3. Clarify Limited Exemption Petition (Section 95920(d)(3))**
- A4. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))**
- A5. Modify Time Requirements Associated with Transfers Between Accounts (Section 95921(a)(1))**

B. Know-Your-Customer Requirements (Section 95834 And Appendix A)

C. Additional Comments On Amendments To Aid In Implementation Of Regulation

- C1. Modify Auction Administration to Return Unsold Allowances to Their Respective Source Accounts (Sections 95911(f))**
- C2. Additional Recommended Changes and Clarifications for Registration Requirements (Sections 95830, 95832, and 95833)**
- C3. Clarify Definition of Serial Number**

D. Ensure Linkage Does Not Adversely Affect Covered Entities in California

- D1. Ensure Permanence of Compliance Instruments Issued from Linked Jurisdictions**
- D2. Approve Additional Offset Protocols and Adjust Quantitative Usage Limit**
- D3. Make Other Changes Necessary to Harmonize California and Quebec Cap-and-Trade Programs**

II. DISCUSSION

A. Modify Several Provisions Related To The Holding Limit And Conduct Of Trade

PG&E recognizes that the cap-and-trade regulation adopted in 2011 included regulatory language regarding Beneficial Holdings that contained challenging information disclosure and trade conduct requirements. As such, PG&E supports the deletion of this regulatory language and the associated requirements.

However, the current Holding Limit calculation continues to unfairly constrain PG&E and other entities with a large GHG exposure due to the nature of our electric portfolio, which includes both utility owned generation and contracted electric generation with third parties through “Tolling Agreements.” Therefore, PG&E recommends changes to the Holding Limit and Limited Exemption as described below.

A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))

PG&E remains concerned that the current holding limit unfairly disadvantages entities with a large compliance obligation in their ability to procure sufficient compliance instruments on behalf of certain counterparties with which they have contracts for the delivery of electricity. PG&E believes there are several potential solutions that could address our concerns and would like to work with staff and others concerned about the holding limit provisions to discuss potential options.

As mentioned in PG&E’s April 13, 2012, comments on the discussion draft (see Attachment A, p. 3), one potential solution is to (1) apply the limited exemption to allowances in both the holding account and compliance accounts, and (2) calculate the limited exemption based on the greater of the amount permitted in the current regulation section 95920(d)(2) (i.e., the most recent emissions data report that has received a positive or qualified positive emissions data verification statement) or a percentage of the entity’s annual allowance allocation from ARB, since the allocation correctly contemplates that GHG exposure for some entities may extend beyond their compliance obligation.

A2. Modify Provisions Relating to Conduct of Trade (Section 95921)

PG&E requests modification to, or clarification of, the regulatory language in section 95921(f)(1): “An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity.” This language appears to prohibit electrical distribution utilities from procuring allowances pursuant to their transaction agreements. PG&E suggests the following modification:

(f) General Prohibitions on Trading.

(1) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity, except an entity may acquire and hold allowances and transfer them to another entity to address related obligations in electricity transaction agreements.

Alternatively, PG&E recommends that ARB clarify the intent of the “Prohibitions on Trading” language in its forthcoming Guidance Document. PG&E believes that the regulatory language that prohibits an entity from acquiring and holding allowances “on behalf of another entity” is not intended to apply to GHG obligations in contracts for electricity because the counterparties to these contracts do not have an interest in the allowances until they are transferred. PG&E also recommends that ARB clarify in the Guidance Document that a purchase of allowances matched with a transfer request is exempt from the prohibition on trading.

Additionally, it has been PG&E’s understanding that transfer request deficiencies would result in ARB simply not approving the request and resultant transfer of compliance instruments. PG&E is concerned that Section 95921(a)(3) indicates that if either party fails to successfully approve the transaction within the limited time frame prescribed by the regulation, both parties would be in violation and that penalties may apply. PG&E recommends transfer request deficiencies resulting from both incomplete information or approvals occurring outside of the required time frame result in ARB declining the request and requiring that entities submit a new transfer request.

A3. Clarify Limited Exemption Petition (Section 95920(d)(3))

PG&E supports the process that permits entities to petition to adjust the limited exemption. However, PG&E requests clarification to the timing implied by the regulations.

(3) Petition to Adjust the Limited Exemption

(A) Prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating an increase in emissions for that year over the previous year and request a temporary increase in the limited exemption until verified data for that year are available.

PG&E would like to confirm that the petition process will enable entities to update the limited exemption for 2011 verified emissions regardless of when the regulation becomes effective. The current language is unclear in that the regulation states that “prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating an increase in emissions for that year...” (Section 95920(d)(3)(a).) The original version of the regulations initially set the limited exemption based on 2010 emissions (i.e., the most recent verified emissions as of June 1, 2010) and then maintained this exemption until an update on October 1,

2013 with 2012 emissions. Therefore, it is extremely important that the new petition process allow for an update in the interim to account for 2011 verified emissions reports. Without this opportunity to update, the limited exemption would not be adjusted to account for emissions associated with new facilities that came online in 2011 that have a significant compliance obligation. PG&E would like to request that the Guidance Document allow for the petitioning and inclusion of verified 2011 emissions for facilities in the limited exemption category.

A4. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))

PG&E acknowledges the need to address Holding Limit violations not discovered until after a transfer request is recorded, or if the Holding Limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage Holding Limit. However, the 5 business day cure period is too stringent and may be unworkable for some entities with internal governance processes and/or additional regulatory oversight. Also, the compliance instrument transfer process outlined in 95921(a) could take up to three days, which allows very little time to find an appropriate counterparty. Given the possibility of an illiquid market where it may be difficult to sell large volumes of compliance instruments, additional time may be needed to find a buyer.

A5. Modify Time Requirements Associated with Transfers Between Accounts (Section 95921(a)(1))

PG&E recommends that ARB consider translating the time requirements in the regulations from days to business days, to reflect any potential timing conflicts with holidays and weekends. PG&E also recommends that ARB develop a master calendar for stakeholders that marks all holidays that ARB and linked jurisdictions plan to observe.

B. Know-Your-Customer Requirements (Section 95834 and Appendix A)

PG&E has serious concerns regarding the Know-Your-Customer provisions of the regulations that would require the collection and submission to ARB of extensive personal data of PG&E employees. Neither the Regional Greenhouse Gas Initiative (RGGI) program nor the Western Renewable Energy Generation Information System (WREGIS) tracking systems require this level of information of participants. It is unclear why the ARB needs this extensive personal information in order to prove identity, and PG&E has concerns about the security of such private data being provided to ARB. PG&E would like to recommend that ARB remove the Know-Your-Customer Requirements of the registration process and follow registration requirements similar to WREGIS and RGGI.

Additionally, PG&E is concerned about the additional requirements in section 95912(d)(5), which states that any primary or alternate representative submitting bids for Reserve Sales must

also submit additional information required by the financial services administrator contained in Appendix A. Not only is much of the information required similar to the Know-Your-Customer Requirements, but it is also more concerning as it requires additional personal information such as social security numbers, copies of identity cards issued by a state, government-issued identity documents, and a copies of passports. Again, these requirements are neither consistent with RGGI nor WREGIS, and require a level of information that raise security and privacy concerns for our employees.

C. Additional Comments On Amendments To Aid In Implementation Of Regulation

C1. Modify Auction Administration to Return Unsold Allowances to Their Respective Source Accounts (Sections 95892(c)(1) and 95911(f))

The proposed language in this section provides that unsold allowances consigned to the auction from Limited Use Holding Accounts are kept in the Auction Holding Account until the next auction. After December 31, 2012, consigning entities have the flexibility to determine the quantity of allowances to be consigned in each particular auction, as long as all total annual allocated allowances are consigned within the applicable year. Adding the provision that unsold allowances remain in the Auction Holding Account restrains the flexibility of consigning entities to determine the quantity of allowances to be consigned in each auction. PG&E recommends, as was the case prior to the current draft amendments to the regulation, that any unsold consigned allowances be returned to their respective Limited Use Holding Accounts in order to support the management and timing of revenues returned to our customers.

In addition, the proposed language in section 95892(c)(1) requires that each IOU consign one-third of its 2013 allowances to the November auction. These allowances, combined with the 2015 allowances that will be auctioned in the Advance Auction, would create an outsized supply of allowances in the first auction. PG&E suggests instead that IOUs be required to consign *one-fifth* of their allocated 2013 allowances to auction, since there will now be five auctions for 2013 allowances.

C2. Additional Recommended Changes and Clarifications for Registration Requirements (Sections 95830, 95832, and 95833)

Section 95830(c)(1)(H) – Clarification on Identification of Direct and Indirect Corporate Associations. Section 95830(c)(1)(H) requires the identification of corporate associations, direct corporate associations, and indirect corporate associations, which are defined in section 95833. We recommend clarifying that the definitions of corporate association and direct corporate association in sections 95833 (a)(1)-(3) require connection through only one entity, and do not include entities that are connected indirectly through one or more intermediate entities. We also note that, as defined, “corporate association” does not include “indirect corporate associations.” Finally, we note that registrants may not have enough information to identify all indirect

corporate associations because they may need to obtain detailed information regarding third-parties' corporate structure, which is typically considered confidential business information. We recommend that ARB revise this section to permit registrants to rely on internally-available information and corporate structure information set forth in publicly-available annual filings made with the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the California Public Utilities Commission.

Section 95832 – Attestations. PG&E supports the change in 95832(a) of additional alternate authorized account representatives and the addition of account viewing agents. However, with respect to the attestations in the registration section, PG&E requests that ARB revise the attestations language with the “to the best of my knowledge and belief” standard as indicated in last year’s Final Statement of Reasons (FSOR), which stated: “[I]t 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.” (FSOR, p. 1679, Oct. 2011.) PG&E asks that this language be added back into the regulations in sections 95832(a)(3), 95832(a)(6), and 95832(d).

Section 95833(c) – Disclosure of Information. Sections 95912(f) and 95914(c) both place limits on an entity’s ability to disclose information on auction participation. PG&E is concerned that these provisions could conflict with a utility’s obligations to provide information to the California Public Utilities Commission. PG&E appreciates the addition of section 95833(c), to address this concern, but suggests that it be modified as follows:

(c) Any registered entity subject to ~~affiliate compliance rules promulgated by jurisdiction of~~ state or federal agencies shall not be required to disclose information or take other action that violates the requirements of those agencies or any law, rule or regulation to which the registered entity is subject ~~rules~~.

Section 95833(f) – Consolidation of Accounts for Direct Corporate Associations. PG&E supports the new approach to enable entities to consolidate accounts that are part of a direct corporate association. This approach will reduce complexity and simplify the compliance process. PG&E seeks clarification as to whether entities that are part of a direct corporate association could opt-in and then at a later point opt-out of having a consolidated account. Additionally, PG&E would like to request that entities that have direct corporate associations have the ability to group accounts that they would like to have consolidated to account for different lines of business that exist at large companies. PG&E also recommends amending the titles of section 95914(d) and section 95920(f) to replace “corporate associations” with “direct corporation associations,” to reflect the new approach to consolidation of accounts.

C3. Clarify Definition of Serial Number

Section 95802(258) – Definition of Serial Number. PG&E requests that ARB clarify in its Guidance Document that the definition for “Serial Number” should be broadly interpreted and that entities registered in the tracking system will only be able to view attributes of the serial numbers and not unique numbers associated with the compliance instruments.

D. Ensure Linkage Does Not Adversely Affect Covered Entities In California

D1. Ensure Permanence of Compliance Instruments Issued from Linked Jurisdictions

PG&E appreciates that, as indicated in the Initial Statement of Reasons, ARB is committed to working closely with Quebec staff to resolve any potential issues so as to ensure that delinking is not necessary. However, if such efforts fail, staff would have to propose regulatory action to the Board with no certainty that Quebec compliance instruments would continue to be eligible for use in California. Given that compliant entities do not know the issuing jurisdiction of allowances in their holdings, this would create great uncertainty in the markets. PG&E recommends that ARB establish the continuing fungibility of Quebec-issued instruments before the fact so as to avoid the possibility of such uncertainty.

D2. Approve Additional Offset Protocols and Adjust Quantitative Usage Limit

PG&E believes that the use of high-quality offsets is an effective cost containment tool and an essential part of a successful cap-and-trade program. In fact, ARB’s May 2012 economic analysis forecasts an increase of 14 percent in allowance prices if offset volume falls below 80 percent of that allowed in the regulation. PG&E’s economic analysis forecasts allowance prices to more than double without the use of offsets. As stated in PG&E’s February 17, 2012, comments, without the approval of additional protocols and adjustment to the implementation of the quantitative usage limit, the cost containment objectives with respect to the use of offsets in the cap-and-trade program will not be realized.

PG&E is encouraged that Western Climate Initiative Partner Jurisdictions “will begin the review and evaluation” of four new protocols, two of which are new for the ARB – Coal Mine Methane and Small Landfills. Unfortunately, these protocols will not produce sufficient volume of offsets for cost containment. PG&E recommends that the ARB and Quebec adopt the Climate Action Reserve’s Nitric Acid Production and Coal Mine Methane protocols, as well as the American Carbon Registry’s Protocol for Conversion of High-Bleed Pneumatic Controllers in Oil & Natural Gas Systems. These two protocols show the greatest potential of quickly delivering high quality reductions.

Given the time required to approve additional protocols, the current limited supply of offsets, and the uncertainty surrounding the outcome of the Citizens Climate Lobby lawsuit, PG&E also

Steven Cliff, Ph.D.

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requests that the quantitative usage limit apply to a complying entity's total compliance obligation from January 1, 2013, through the current compliance period. This will allow time for the offset market to develop projects while maintaining the current cap on the use of offset credits.

D3. Make Other Changes Necessary to Harmonize California and Quebec Cap-and-Trade Programs

PG&E appreciates ARB's efforts to ensure that linkage occurs in a manner that does not adversely affect covered entities in California. On April 13, 2012, PG&E submitted comments on the draft amendments, which provided a number of other recommendations to refine the regulation in this regard. (See Attachment A, pp. 5-7.) PG&E recognizes that there is insufficient time to make all of these changes in time to allow the first auction to occur this year. However, PG&E urges ARB to carefully review these suggestions and make these changes in the next set of amendments.

Thank you for the opportunity to submit these comments. We look forward to continuing our work with the ARB and all concerned stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

Judi K Mosley

JKM:kp

cc: Ray Olsson, via email
Edie Chang, via email
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Attachment



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April 13, 2012

***E-Filing
ARB's Cap-and-Trade Website***

Mr. Steven Cliff
Chief - Climate Change Markets Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

Re: Pacific Gas and Electric Company's Comments on the Draft Amendments to the California Cap-and-Trade Regulations to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

Dear Mr. Cliff:

Pacific Gas and Electric Company ("PG&E") welcomes the opportunity to submit these comments on the Air Resources Board's ("ARB") draft amendments to the California Greenhouse Gas ("GHG") cap-and-trade regulations. PG&E supports ARB's efforts to link its cap-and-trade program with other jurisdictions, and we view linkage with Quebec as an important first step. We appreciate ARB's efforts to ensure that linkage occurs in a manner that does not adversely affect covered entities in California. We encourage ARB to continue to coordinate cross-market rules so as not to limit compliance flexibility and cost-containment measures ARB has included as part of its program.

I. INTRODUCTION

PG&E's detailed comments on the proposed amendments are set forth in Section II below. The following summarizes the key issues:

A. Modify Several Holding Limit Provisions

A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))

A2. Clarify Intent in Conduct of Trade (Section 95921(f))

A3. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))

A4. Clarify Intent and Language for Holding Limit for Future Vintage Allowances (Section 95920(e))

A5. Clarify Implementation Timeline for Limited Exemption Petition (Section 95920(d)(3))

B. Ensure Linkage Does Not Adversely Affect Covered Entities in California

B1. Ensure Permanence of Compliance Instruments Purchased from Linked Jurisdiction

B2. Approve Additional Offset Protocols and Adjust to Quantitative Usage Limit

B3. Modify Determination of Auction Reserve Prices (Section 95911(c)(3)(D))

B4. Make Bid Guarantees for Linked Jurisdiction Equivalent to Those Required for California Auction Participants (Section 95912(i)(1)(D))

B5. Compute Common APCR Tier Prices in the Same Manner as the Auction Reserve Price (Section 95913(e))

B6. Harmonize Annual Compliance Showings Across Linked Jurisdictions (Section 95855)

C. Revise and Refine Provisions Regarding Auction and the Allowance Price Containment Reserve (APCR), the Registration Process, and Conduct of Trade

C1. Clarify Calculation of Bid Guarantee for Auction (Section 95912)

C2. Modify Auction Administration to Ensure that All Potential Bid Scenarios are Appropriately Addressed, Revise Process to Sell Consigned Allowances, and Return Unsold Allowances to their Respective Source Account (Section 95911 (e) & Section 95911 (f))

C3. Modify APCR Sale Administration to Clarify Calculation of Bid Guarantee and Ensure Sale is Conducted in Line with Market Efficiency Principles (Section 95913)

C4. Other Recommended Changes and Clarifications for Attestations, Corporate Association Requirements, and Conduct of Trade. (Sections 95830, 95832, 95921)

D. Modify the Know-Your-Customer Requirements (Section 95834)

II. DISCUSSION.

A. Modify Several Holding Limit Provisions

PG&E recognizes that the Cap-and-Trade Regulation adopted in 2011 included regulatory language regarding Beneficial Holdings that contained challenging information disclosure and trade conduct requirements. As such, PG&E supports the deletion of this regulatory language and the associated requirements.

However, the current Holding Limit calculation continues to unfairly constrain PG&E and other entities with a large portfolio due to the nature of our electric portfolio, which includes both utility owned generation and contracted electric generation with third parties through "Tolling Agreements." As such, PG&E recommends the changes to the Holding Limit and Limited Exemption described in A1 below.

A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))

The current Holding Limit unfairly disadvantages both large entities and entities such as PG&E with an electric portfolio of both owned and contracted resources through "Tolling Agreements". To address this, PG&E recommends modifications to the regulatory language pertaining to the limited exemption, which would provide greater flexibility to large compliance entities who are constrained by the current Holding Limit calculation.

The current limited exemption contemplates that entities only buy allowances equivalent to the emissions from their owned generating units or from electricity imports. The determination of the ARB annual allowance allocation, however, correctly contemplated that GHG exposure for some entities may extend beyond an entity's direct compliance obligations. With this in mind, PG&E proposes the following modifications to the Holding Limit calculation:

- 1) Currently, the limited exemption only applies to credits in an entity's Compliance Account. However, PG&E requests further flexibility to allow the limited exemption to apply to credits in both the Holding Account and Compliance Account.
- 2) The limited exemption equals the greater of, the amount permitted in the current regulation section 95920(d)(2) (i.e. the most recent emissions data report that has received a positive or qualified positive emissions data verification statement), or a percentage of the entity's annual allowance allocation from ARB for the prompt year. Specific percentage of the entity's annual allowance allocation to be applicable for limited exemption should be determined through more discussion on this topic with stakeholders and ARB.

A2. Clarify Application and Intent of General Prohibitions on Trading Provision (Section 95921 (f))

PG&E requests clarification on ARB's intent with respect to section 95921(f)(1): "An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." PG&E seeks clarity on whether this statement precludes PG&E (and other utilities) from purchasing allowances as part of contractual arrangements with counterparties with which we have tolling agreements.

A3. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))

PG&E acknowledges the need to address Holding Limit violations not discovered until after a transfer request is recorded; or if the Holding Limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage Holding Limit. However, the 5 business day cure period is too stringent and may be unworkable for some entities with internal governance processes and/or additional regulatory oversight.

If a Holding Limit violation occurs, one method to cure could be via sale of allowances. Currently, the California Public Utilities Commission's ("CPUC") Proposed Decision on Tracks I and III of the 2010 Long Term Procurement Plan states that utilities may only resell greenhouse gas Compliance Instruments with prior Commission approval via a Tier 2 advice letter, and after consultation with their Procurement Review Group (Proposed Decision Before The California Public Utilities Commission, Rulemaking 10-05-006, February 21, 2012). Given this constraint, PG&E and other Investor Owned Utilities would not be able to obtain the CPUC authority to sell allowances within 5 business days. Even if PG&E were allowed to sell Compliance Instruments without an advice letter, the process to cure a violation within a large entity like PG&E requires more time due to the need to obtain approvals, execute sales, conduct transfers, etc. As such, PG&E requests that the entity in violation have 30 business days to cure.

A4. Clarify Intent and Language for Holding Limit for Future Vintage Allowances (Section 95920(e))

PG&E believes the intent of the Holding Limit for Future Vintage allowances is to calculate the future vintage Holding Limit based on the annual allowance budget for the year in which the future allowances are issued. We suggest the following revision to confirm this is the case:

"Annual Allowance Budget" is the number of allowances issued for the current ~~budget~~ year. It is calculated as the sum for the ~~current~~ budget year of the compliance budgets of California and all ETS programs to which California has linked pursuant to section 95940.

A5. Clarify Implementation Timeline for Limited Exemption Petition (Section 95920(d)(3))

PG&E supports the process which permits entities to petition to adjust the limited exemption. However, PG&E requests that ARB define the time frame for the Executive Officer to approve or deny the limited exemption petition after being submitted. This clarification is needed as market participants need to have a clear understanding of their current and future applicable limited exemption in order to properly manage positions and Compliance Instrument procurement and avoid Holding Limit violations.

B. Ensure Linkage Does Not Adversely Affect Covered Entities in California

B1. Ensure Permanence of Compliance Instruments Issued from Linked Jurisdiction

PG&E recommends that ARB amend the Cap-and-Trade regulation to specify that Compliance Instruments purchased from a linked jurisdiction are fully fungible for compliance purposes even if a linked jurisdiction subsequently modifies its program or ceases to be linked with California. Market participants need assurance that Compliance Instruments will be given "full faith and credit" by California provided that the issuing jurisdiction was linked with California when the instrument was originally issued.

B2. Approve Additional Offset Protocols and Adjust Quantitative Usage Limit

PG&E believes that the use of high quality offsets is an effective cost containment tool and an essential part of a successful cap-and-trade program. However, as stated in PG&E's February 17, 2012 comments on linkage, without the approval of additional protocols and adjustment to the implementation of the quantitative usage limit, the cost containment objectives with respect to the use of offsets in the cap-and-trade program will not be realized.

PG&E recommends that the ARB and Quebec adopt the Climate Action Reserve's Nitric Acid Production and Coal Mine Methane protocols, as well as the American Carbon Registry's Protocol for Conversion of High-Bleed Pneumatic Controllers in Oil & Natural Gas Systems. These protocols show the greatest potential of quickly delivering high quality reductions. PG&E also encourages Quebec to quickly adopt the ARB protocols as written.

In addition, given the time required to approve additional protocols and the current limited supply of offsets, PG&E also requests that the quantitative usage limit apply to a complying entity's total compliance obligation from January 1, 2013 through the current compliance period. This will allow time for the offset market to develop projects while maintaining the current cap on the use of offset credits.

B3. Modify Determination of Auction Reserve Prices (Section 95911(c)(3)(D))

The auction administrator uses a specified exchange rate to convert the Auction Reserve Prices calculated separately in U.S. and Canadian dollars to a common currency, and then uses a formula to set a single Reserve Price to apply in both currencies and for both jurisdictions. While PG&E supports the use of a single Reserve Price that applies to both currencies for each auction, we do not support using the maximum of the two separate prices, as it will provide an upward bias on the reserve price for both jurisdictions, compared to the reserve price used in earlier versions. Instead, PG&E proposes using the average of these two prices, with the following proposed modification to section 95911(c)(3)(D):

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

B4. Make Bid Guarantees for Linked Jurisdiction Equivalent to Those Required for California Auction Participants (Section 95912(i)(1)(D))

In the event of a joint auction, section 95912(i)(1)(D) would allow entities from a linked jurisdiction to use “any financial instruments” accepted by that linked jurisdiction. We believe ARB should revise this section to require participants from linked jurisdictions to provide bid guarantees with an equivalent level of financial assurance to that provided in section 95912(i)(1). We therefore propose that the language proposed in section 95912(i)(1)(D) of the draft regulation be revised as follows:

If California participates in a joint auction with one or more external GHG ETS programs to which it has linked, and entities from all linked programs are eligible to purchase from the auction, then the auction administrator will accept any financial instruments accepted by any linked external GHG ETS for allowance purchases, provided such instruments are equivalent to the bid guarantees authorized in subsection 95912(i)(1).

B5. Compute Common APCR Tier Prices in the Same Manner as the Auction Reserve Price (Section 95913(e)(5))

While the Auction Reserve Price is set equal in the two working currencies, the California and Quebec Allowance Price Containment Reserve (APCR) tier prices are not and may diverge after 2013. This could lead to market distortions if the “marginal price” for the APCR in California (i.e. the price for the lowest tier with available credits) is less than an expected Auction price but the lowest reserve tier price in Quebec is greater than the expected Auction price. The reverse situation could likewise lead to market distortions. In the former case, entities in California may choose to purchase from their APCR while entities in Quebec would not, if all entities were

attempting to minimize their current compliance costs. This would lead to lower demand for auctioned allowances for all entities, potentially reducing the Auction price for both California and Quebec entities, while only the California APCR would be drawn down.

To maintain a level playing field between California and Quebec entities, PG&E recommends computing common Reserve Tier Prices for each tier in the same manner as the Auction Reserve Price in section 95911. PG&E proposes the following language for new subsection 95913(e)(5):

The auction administrator will calculate each Reserve Tier Price using the following procedure:

(A) The Reserve Tier Price in U.S. dollars shall be the U.S. dollar Reserve Tier Price for the previous calendar year increased annually by 5 percent plus the rate of inflation as measured by the most recently available twelve months of the Consumer Price Index for All Urban Consumers.

(B) The Reserve Tier Price in Canadian dollars shall be the Canadian dollar Reserve Tier Price for the previous calendar year increased annually by 5 percent plus adjusted in the manner provided for in section 83.3 of the Financial Administration Act (R.S.Q., c. A-6.001) of Quebec.

(C) At 0900 Pacific Standard Time on the day of the Reserve Sale, the Auction Administrator shall announce the exchange rate to be used to determine the Reserve Tier Prices. The exchange rate shall be the most recently available at 1200 Pacific Standard Time daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada.

(D) The auction administrator will use the announced exchange rate to convert to a common currency the Reserve Tier Price previously calculated separately in U.S. and Canadian dollars. The auction administrator will set each Reserve Tier Price equal to the average of the two values.

B6. Harmonize Annual Compliance Showings Across Linked Jurisdictions (Section 95855)

Under the ARB regulations, entities have an annual compliance obligation equal to 30% of the previous year's reported emissions; there is no such obligation under the rules published by Quebec's MDDEP. The annual compliance obligation is an important tool to reduce the likelihood of market volatility close to the triennial compliance deadlines. For these reasons, and to create a level playing field, PG&E urges ARB to work with MDDEP to harmonize the two regulations, particularly with respect to annual compliance limits.

C. Revise and Refine Provisions Regarding Sale of Allowances from Auction and the Allowance Price Containment Reserve (APCR), the Registration Process, and Conduct of Trade

C1. Clarify Calculation of Bid Guarantee for Auction (Section 95912)

PG&E appreciates ARB's revisions to the language in section 95912(i)(2) to clarify the bid guarantee calculation. PG&E suggests the following language modifications to further clarify this approach:

(2) The amount of the bid guarantee must be greater than or equal to the maximum value of the bids submitted from the set of notional values calculated.

(A) ~~The value of a set of bids, evaluated at any potential auction settlement price, equals the quantity of bids submitted at or above that price times the price.~~ To determine set of notional values, calculate the notional value of each bid point, where the notional value is the bid point price multiplied by the allowance quantity to be awarded at that bid point price.

~~(B) The maximum value of a set of bids is the highest value of a set of bids calculated at any potential auction settlement price.~~

C2. Modify Auction Administration to Ensure that All Potential Bid Scenarios are Appropriately Addressed, Revise Process to Sell Consigned Allowances, and Return Unsold Allowances to their Respective Source Account (Section 95911 (e) & Section 95911 (f))

Section 95911(e) - Ensure that All Potential Bid Scenarios are Appropriately Addressed

PG&E appreciates the added clarity on resolution of tie bids in the new draft language in 95911(e)(5). In addition, PG&E suggests the following modifications to Section 95911(e) to ensure that each potential bid situation is addressed:

(e)(3) Beginning with the highest bid price, bids from each bidder will be considered in declining order by price and entities submitting bids at that price will be sold allowances until either the auction operator shall reject a bid:

* * *

(e)(4)(A) The next lower bid price is less than the auction reserve price, or there are no additional bids, in which case the ~~current price~~ Auction Reserve Price becomes the auction settlement price; or

(e)(4)(B) The total quantity of allowances contained in the bids at the next lower bid price is greater than or equal to the number of

allowances yet to be sold, in which instance, the next lower bid price becomes the auction settlement price and the procedure for resolution of tie bids in section 95911(e)(5) shall apply.

Further, we note the need for two additional clarifications in section 95911(e)(5)(B). First, the cross reference to section 95912(e)(4)(A) needs to be corrected as 95912(e)(4)(A) does not exist. Second, the reference to “the number of allowances in the tier” appears to be incorrect. We expect the intent is to say “number of allowances at that price point” given this section refers to the auction and not the APCR.

Section 95911(f)(2) - Revise Process to Sell Consigned Allowances

The new draft language would require the auction operator to sell an “equal proportion” of allowances from each consigning entity when there are insufficient winning bids to exhaust the allowances. PG&E suggests the following changes to clarify that the proportion would be based on the quantity of allowances consigned by each entity. For example, suppose there are two entities consigning allowances in a given auction: Entity A consigns 10 MMT and Entity B consigns 5 MMT. A total of 12 MMT of consigned allowances are sold through this auction. Rather than each entity selling an “equal proportion” of 6 allowances each, Entity A should sell 8 Allowances and Entity B 4 Allowances, since Entity A consigned more allowances than Entity B:

When there are insufficient winning bids to exhaust the allowances from a consignment source in section 95911(b)(3)(A), the auction operator will sell allowances ~~an~~ in equal proportion to the number of allowances consigned from each consigning entity in that source rounded down. If, as a result of rounding down, there are fewer allowances sold than demanded, the auction operator will assign a random number to each unsold bundle of 1,000 metric tons of CO₂e from a consignment source in section 95911(b)(3)(A). Beginning with the lowest random number assigned and working in increasing order of the random numbers assigned, the auction operator shall sell allowances assigned the random number until the quantity of allowances sold equals the quantity of allowances demanded.

Section 95911(f)(4) - Return Unsold Allowances to their Respective Source Account

The proposed language in this section provides that unsold allowances consigned to the auction from Limited Use Holding Accounts are kept in the Auction Holding Account until the next auction. After December 31, 2012, consigning entities have the flexibility to determine quantity of allowances to be consigned in each particular auction, as long as all total annual allocated allowances are consigned within the applicable year. Adding the provision that unsold allowances remain in the Auction Holding Account restrains the flexibility of consigning entities to determine quantity of allowances to be consigned in each auction. PG&E recommends, as was the case prior to the current draft amendments to the regulation, that any unsold consigned

allowances are returned to their respective Limited Use Holding Accounts in order to support the management and timing of receiving revenues to be returned to our customers.

C3. Modify APCR Sale Administration to Clarify Calculation of Bid Guarantee and Ensure Sale is Conducted in Line with Market Efficiency Principles (Section 95913)

PG&E supports the proposal that only entities registered in the California GHG Cap-and-Trade program will be eligible to purchase allowances from the APCR. However, we recommend the following modifications.

Section 95913(f) - Clarify Calculation of Bid Guarantee

PG&E recommends the following modified language for section 95913(f) to clarify calculation of bid guarantee.

At least twelve days before the scheduled sale an entity intending to participate in a Reserve sale must submit to the financial services administrator a bid guarantee, payable to the financial services administrator, in an amount greater than or equal to the sum of the bid quantity at each tier multiplied by the tier price, summed across the three tiers

~~(1) The maximum value of a set of bids is the quantity bid at each tier times the tier price, summed across the three tiers~~

Section 95913(g) – Ensure Reserve Sale is Conducted in Line with Market Efficiency Principles

As PG&E has stated in earlier comments, PG&E requests that ARB revisit the Purchase Determination process to ensure that sale of allowances from the APCR is conducted in line with market efficiency principles. The current process makes it difficult for entities to bid into the Reserve in a manner that reflects their true willingness to pay. For a specific proposal on how Purchase Determinations could better allow participants to bid according to willingness to pay, see PG&E's August 11, 2011, comments, page 26.

C4. Other Recommended Changes and Clarifications for Attestation, Corporate Association Requirements, and Conduct of Trade. (Sections 95830, 95832, 95921)

Section 95832 - Attestations

PG&E supports the change in 95832(a) of additional alternate authorized account representatives and the addition of account viewing agents. However, with respect to the attestations in the registration section, we suggest the following modification.

In the Final Statement of Reasons posted in October 2011, ARB indicated that the “to the best of my knowledge and belief” language for the attestations associated with registration was inadvertently deleted and this omission would be corrected when the regulation is amended.

PG&E asks that this language be added back into the regulations in sections 959832(a)(3), 959832(a)(6), and 959832(d).

Section 95833(e) – Consolidation of Accounts for Corporate Associations

PG&E supports the new approach to enable entities to consolidate accounts that are part of a direct corporate association. This approach will reduce complexity and simplify the compliance process. PG&E seeks clarification as to whether entities that are part of a direct corporate association could opt-in and then at a later point opt-out of having a consolidated account.

95830(c)(1)(H) – Clarification on Identification of Direct and Indirect Corporate Associations

Section 95830(c)(1)(H) requires the identification of direct and indirect corporate associations, which is defined in section 95833(a)(5). It is possible that entities may not have enough information to identify all indirect corporate associations because they would need to obtain detailed information regarding third-parties' corporate structure, which is typically considered confidential business information. We recommend that ARB revise this section to require entities to disclose only those indirect associations that are set forth in public filings, such as those made with the Securities and Exchange Commission and other regulatory agencies.

Section 95921 – Conduct of Trade

For 95921(a)(1), we recommend that ARB consider translating the time requirements in the regulations from 24 hours or 48 hours to business days, to reflect any potential timing conflicts with holidays and weekends.

D. Modify the Know-Your-Customer Requirements (Section 95834)

PG&E recognizes that this section is still under development and appreciates the opportunity to provide ARB with feedback. On a general note, PG&E would like to ensure that if private personal information is collected by ARB, that the proper security measures are in place to ensure that this sensitive data remains private.

PG&E would like to point out that most companies already conduct background checks on their employees before they are hired. As such, PG&E recommends that ARB use the same criteria presently used by the federal government for proof of identity and eligibility to work to include: driver's license, valid passport, and social security number. In addition, while PG&E supports the criminal background check that Staff is considering, we understand that California law does not permit review of criminal history beyond seven years. PG&E recommends that the background check should be limited to that time frame.

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Thank you for the opportunity to submit these comments. We look forward to continuing our work with the ARB and all concerned stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

John W. Busterud

JWB:kp

cc: Ray Olsson, via email
Edie Chang, via email
Rajinder Sahota, via email