

**BEFORE THE  
AIR RESOURCES BOARD  
OF THE  
STATE OF CALIFORNIA**

**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY  
COMMENT ON THE JANUARY 2013 PROPOSED CHANGES TO THE  
CAP AND TRADE REGULATION TO LINK WITH QUEBEC**

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# **SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON THE MAY 2012 PROPOSED CHANGES TO THE CAP AND TRADE REGULATION TO LINK WITH QUEBEC**

## **I. INTRODUCTION AND SUMMARY.**

The Southern California Public Power Authority (“SCPPA”)<sup>1</sup> 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 (“CA Regulation”), providing for linking with Quebec, released by the California Air Resources Board (“ARB”) for public comment on January 8, 2013.

In summary, SCPPA considers that:

- The prices of allowances in the allowance price containment reserves should be harmonized.
- Linking should not result in an increase to the auction reserve price. The auction reserve price should be the lower of the Quebec and California prices, not the higher.
- Offset supply issues and increased demand should be addressed by harmonizing offset protocols and approving additional protocols.
- California should adopt Quebec’s approach to the replacement of invalidated offsets.
- The ARB should track market performance and flows of compliance instruments between jurisdictions, for early warning of issues caused by linking. A process for delinking

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<sup>1</sup> 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.

should also be included in the regulation to enable a quick response to any severe issues that occur and to mitigate the damage caused by improperly functioning markets.

- To simplify and clarify the linking provisions, two new terms “Linked Program” and “Linked Jurisdiction” should be defined in section 95802(a) and used throughout the CA Regulation where appropriate.
- Section 95910 should be revised to more clearly explain when the auctions will be held. The new amendments proposed on January 8, 2013 are unclear.

These issues are discussed in more detail below.

## **II. PRICES OF ALLOWANCES IN THE ALLOWANCE PRICE CONTAINMENT RESERVES SHOULD BE HARMONIZED.**

The ARB staff has indicated that it was not considered crucial to harmonize the prices of allowances in California’s and Quebec’s cost containment reserves, as each jurisdiction is independently establishing a reserve and entities will only be able to access the reserve in their own jurisdiction.<sup>2</sup> However, reserve prices function as a soft cap on the price of allowances. Thus, differences between the reserve prices in each jurisdiction are likely to affect the unified allowance market. If the administratively established prices for allowances in Quebec’s cost containment reserve escalate more rapidly than the administratively established prices for allowances in California’s allowance price containment reserve, Quebec could put pressure on prices in the unified allowance market, forcing more reliance by California covered entities on the California allowance price containment reserve than would occur otherwise. This could occur despite the fact that entities registered in Quebec will be unable to access California’s

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<sup>2</sup> CA Reg § 95913(i) provides that entities registered in an external emission trading program to which California has linked will not be eligible to purchase from the California allowance reserve. Quebec regulation § 56 has a similar effect in relation to the Quebec reserve.

reserve directly. Thus, the rate of escalation of the prices for reserve allowances should be harmonized.

Section 95913(e)(3) of the CA Regulation and section 58 of Quebec's regulation set the same initial prices for allowances in the allowance reserves (although in different currencies): \$40 per allowance for allowances from the first tier, \$45 per allowance for allowances from the second tier, and \$50 per allowance for allowances from the third tier. The rate of escalation of allowance prices is set at five percent annually plus the rate of inflation.<sup>3</sup> However, the currencies will fluctuate, and the rates of inflation will differ in California and Quebec. If currency and inflation fluctuations cause Quebec reserve allowances to become more expensive than California's, there may be less demand for allowances from Quebec's reserve and greater demand for California allowances which are likely to remain capped at the California reserve prices (at least until the California reserve becomes depleted).

SCPPA suggests that the prices of allowances from the California and Quebec reserves be harmonized by providing that the prices be the lower of the prices that would otherwise apply under the California and Quebec regulations. This approach would be consistent with the calculation of the auction reserve price in section 95911(c)(3) with the change suggested in section III below.

### **III. LINKING SHOULD NOT RESULT IN AN INCREASE TO THE AUCTION RESERVE PRICE.**

One of the key purposes of linking to other cap-and-trade programs is to reduce the cost of compliance. However, one of the changes in the CA Regulation that was included to facilitate linking may instead increase the floor price of allowances at auction ("auction reserve price").

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<sup>3</sup> CA Reg § 95913(e)(4); Quebec regulation §58.

Section 95911(c)(1) of the CA Regulation sets the auction reserve price at \$10 per metric ton for allowances auctioned in 2012. In subsequent years, the auction reserve price will be the higher of the prices established under the Quebec and California programs.<sup>4</sup> The Quebec and California prices may differ due to differences in inflation rates and currency fluctuations.

Rather than choosing the higher of the two prices, which may result in increasing the floor price above what it would be in the absence of linking, the auction reserve price should be the lower of the two prices. Section 95911(c)(3)(E) of the CA Regulation should be revised as follows:

(E) 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 ~~lower~~higher of the two values.

#### **IV. ADDRESS OFFSET SUPPLY AND OFFSET INVALIDATION ISSUES.**

##### **A. Harmonize and Increase the Number of Approved Offset Protocols in each Program.**

In addition to allowing the use of offsets from the linked jurisdiction, offset supply should be increased as part of the linking arrangements, to address the increased demand for offsets. This is particularly important given that the full cost containment potential of offsets will not be realized unless each covered entity is able to, and does, acquire offsets up to the eight percent limit, and that several studies (for example by Thompson Reuters Point Carbon) have indicated that there is likely to be a shortage of offsets in the California program compared to the demand from California covered entities. This shortage will be exacerbated by linking to

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<sup>4</sup> CA Reg § 95911(c)(3)(E); Quebec regulation § 49 paragraph 3, subsection (2).

Quebec, which will have a strong demand for compliance instruments (including offsets) due to its stringent cap, broad coverage and high penalties.<sup>5</sup>

The California and Quebec regulations approve the following divergent sets of offset protocols:<sup>6</sup>

<b>California</b>	<b>Quebec</b>
<ul style="list-style-type: none"><li>• Livestock methane destruction</li></ul>	<ul style="list-style-type: none"><li>• Livestock methane destruction</li></ul>
<ul style="list-style-type: none"><li>• Destruction of ozone depleting substances</li></ul>	<ul style="list-style-type: none"><li>• Destruction of ozone depleting substances</li></ul>
<ul style="list-style-type: none"><li>• Forestry and urban forestry</li></ul>	<ul style="list-style-type: none"><li>• Landfill methane destruction</li></ul>

It is unclear why California has not approved a landfill methane destruction protocol for small landfills and why Quebec has not approved forestry and urban forestry protocols. Nor is it clear whether the currently-approved California and Quebec offset protocols will together produce sufficient offsets to meet the joint demand from the two jurisdictions. To increase the supply of offsets, SCPPA urges California to adopt an offset protocol similar to Quebec’s landfill methane destruction protocol, Quebec to adopt protocols similar to California’s two forestry protocols, and both jurisdictions to put a high priority on investigating and adopting additional protocols.

**B. Adopt Quebec’s Approach to Offset Invalidation.**

To avoid asymmetrical demand for Quebec offsets and differential pricing due to differences in the risk profiles of Quebec and California offsets, California should adopt Quebec’s rule regarding the replacement of invalid offsets: Invalid offsets should be replaced by

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<sup>5</sup> The ARB paper *Discussion of Findings Required by Government Code section 12894* issued January 8, 2013 (“Discussion of Findings”), notes that “overall the Quebec emissions reduction goal is equivalent to or stricter than California’s goal” (page 3), “Quebec’s Cap-and-Trade program is stricter insofar as it reaches sources that no California regulation yet reaches (page 6), and “Quebec’s regulation allows for penalties higher than California law” (page 10).

<sup>6</sup> CA Reg Subarticle 13; Quebec regulation Appendix D.

the entity that generated them, not the entity that purchased or surrendered them as in the CA Regulation. Failing that, invalid offsets should be replaced from an offset buffer account maintained by the regulator.<sup>7</sup> This approach will provide greater certainty in the offset market than the approach in the CA Regulation, and therefore will strengthen the offset program as a whole. The linking rulemaking offers a good opportunity to adopt provisions in the linked program that are superior to those in the CA Regulation.

**V. PROVIDE PROCESSES FOR TRACKING ALLOWANCE FLOWS AND MARKET PERFORMANCE, AND DELINKING IN SPECIFIED CIRCUMSTANCES.**

Linking increases the complexity of the cap-and-trade program. Issues with one or both programs may arise. If so, prompt action will be required to identify and address the issues to avoid negative impacts on the markets, including related markets such as the electricity market. For this reason, the CA Regulation must contain procedures for tracking the performance of each program and for monitoring and reporting on California's and Quebec's markets. The flows of compliance instruments between the two jurisdictions and the trading activities of covered entities and (separately) non-covered entities should be monitored.

In addition, the CA Regulation should contain provision for delinking in specified circumstances. However, to provide certainty to the market, the delinking provisions must explicitly allow California entities, after delinking, to continue using Quebec allowances (which will not be identifiable as such by market participants) that have already been issued.

**VI. INCLUDE NEW DEFINED TERMS TO SIMPLIFY LINKING PROVISIONS.**

The linking amendments frequently use the cumbersome phrase "External Greenhouse Gas Emissions Trading System to which California has linked its Cap-and-Trade Program

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<sup>7</sup> Quebec regulation § 70.20. Compare CA Reg § 95985. The different approaches are noted in the Discussion of Findings, page 8.



pursuant to subarticle 12.” There are also some inconsistencies in the way this concept is described – for example, some sections used the term “approved External GHG ETS” instead. The linking provisions would be shorter and easier to read, with improved clarity and consistency, if the following two new defined terms were included in the definitions section of the CA Regulation, section 95802(a):

“Linked Program” means an External Greenhouse Gas Emissions Trading System to which California has linked its Cap-and-Trade Program pursuant to subarticle 12.

“Linked Jurisdiction” means a jurisdiction operating a Linked Program.

These defined terms could then be used to simplify the drafting on linking in the following sections of the CA Regulation:

- Sections 95802(a)(17), (53), and (129);
- Sections 95830(h)(1) and (3);
- Section 95833(f)(3)(D);
- Section 95910(a)(2) – see for example the redrafting in section VII below;
- Sections 95911(a)(5) and (c)(5);
- Section 95912(c)(8);
- Sections 95913(d)(4) and (i);
- Sections 95920(g) and (h);
- Sections 95942(d), (e), (f), (g) and (h);
- Section 96010(b); and
- Section 96022.

## VII. REVISE SECTION 95910 TO CLARIFY AUCTION DATES.

Section 95910(a)(2) of the CA Regulation was revised in the January 8, 2013 revisions as follows:

Beginning in 2013, auctions shall be conducted on the twelfth business day in California or a jurisdiction operating and External GHG ETS to which California has linked pursuant to subarticle 12 of the second month of each calendar quarter.

The notice of availability of the proposed changes to the CA Regulation states that this modification was “to recognize that auction dates must be business dates in California and any jurisdiction to which California has linked.”<sup>8</sup>

It appears that in fact there are two requirements that must be satisfied when calculating the auction dates: the auction date must be a business day in all linked jurisdictions; and the date must be at least 12 business days after the start of each calendar quarter in at least one of the linked jurisdictions. The second requirement may cause some confusion as the twelfth Quebec business day of the second month of each calendar quarter will not necessarily be the same date as the twelfth California business day of the second month of each calendar quarter. One jurisdiction may have a holiday in that period (the first few weeks of the second month of the quarter) whereas the other jurisdiction may not. Furthermore, the twelfth business day in one jurisdiction may not be a business day at all in the other jurisdiction.

The proposed change to section 95910(a)(2) of the CA Regulation does not sufficiently address these complexities. It could be interpreted in various different ways. The language should be clarified, or a simpler method of determining the auction dates should be used (for example, a method that does not require a period to be calculated in business days in multiple jurisdictions).

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<sup>8</sup> Second Notice of Public Availability of Modified Text and Availability of Additional Documents and Information, issued January 8, 2013, page 7.

SCPPA suggests the following revisions to section 95910(a)(2) of the CA Regulation to clarify what we understand to be the intended method to determine auction dates:

Beginning in 2013, auctions shall be conducted on the first date in each calendar quarter that is both (A) at least twelve business days after the start of the second month of the quarter ~~twelfth business day~~ in California or a jurisdiction operating an External GHG ETS to which California has linked pursuant to subarticle 12; ~~of the second month of each calendar quarter~~ and (B) a business day in California and in each jurisdiction operating an External GHG ETS to which California has linked pursuant to subarticle 12.

If the additional definitions proposed in section VI above are adopted, the revision to section 95910(a)(2) would be as follows:

Beginning in 2013, auctions shall be conducted on the first date in each calendar quarter that is both (A) at least twelve business days after the start of the second month of the quarter ~~twelfth business day~~ in California or a Linked Jurisdiction ~~operating and External GHG ETS to which California has linked pursuant to subarticle 12;~~ ~~of the second month of each calendar quarter~~ and (B) a business day in California and in each Linked Jurisdiction.

## VIII. CONCLUSION

SCPPA urges the ARB to consider these comments and appreciates the opportunity to submit these comments to the ARB.

Respectfully submitted,

*/s/ Lily M. Mitchell*

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