TURLOCK IRRIGATION DISTRICT

October 23, 2013

Dr. Steve Cliff
Assistant Division Chief – Climate Program
California Air Resources Board
1001 "I" Street
Sacramento CA, 95814

Filed Electronically

RE: TID Comments on September 4, 2013 Proposed Amendments to the California Cap-and-Trade Program

Dear Dr. Cliff:

Turlock Irrigation District ("TID") submits the following comments regarding the California Air Resources Board ("ARB") September 4th, 2013 *Proposed Amendments to the California Cap-and-Trade Program* ("September 4th Amendments"). In these comments, TID expresses concerns with the expanded informational requirements proposed in the September 4th Amendments. As discussed below, TID provides the following comments:

(1) It is not clear how the collection of additional allowance transfer information and new restrictions on allowance transfers aids the ARB in implementing and enforcing the Cap-and-Trade regulation;
(2) The cost containment mechanism should be revisited in subsequent rulemaking documents to include additional provisions that will remove restrictions on offset usage and not draw on future vintage allowances;
(3) The ARB should send market signals to encourage a robust offset market by allowing regulated entities to bank any unused portion of their offset limitations and trade that right with other regulated entities;
(4) Regulated entities should have the flexibility to determine their own retirement order for the triennial compliance obligation.

In addition to TID's detailed comments below, TID provides recommended language changes in Attachment A to these Comments. TID appreciates the opportunity to provide these comments and looks forward to working with the ARB and staff as the Cap-and-Trade Regulation continues to be refined.

DISCUSSION

1) The Collection Of Pricing And Contract Information In CITSS Is Beyond The Scope Of ARB's Market Monitoring Responsibilities.

The September 4th Amendments would revise Section 95921(b) of the Cap-and-Trade regulation to require the submission of detailed information about an allowance transfer before the ARB will approve a transfer. The information requested includes, among other things, detailed transaction-specific information and copies of contracts. These new informational requirements combined with other new informational requirements (e.g., employee and contractor information) go beyond the scope of information that was originally intended to be collected by the ARB.

The reporting and Cap-and-Trade programs should be designed to minimize the administrative burdens and transactional costs of regulated entities. The new informational requirements under Section 95921(b) would include: the type of transfer, dates for execution of the transfer agreement and settlement, price of the compliance instruments, and exchange information (among many other information requirements). In addition, the ARB regularly collects contracts for allowance transfers. The ARB has not specified why this information is needed or how the information furthers the ARB's Market Monitoring responsibilities.

According to the ARB, "the market monitor will monitor allowance holding and transfer activity to detect design flaws in the market operating rules, standards, procedures or practices, or to detect structural problems in the market."[1] The systematic collection of detailed transaction-specific information (in particular, copies of contracts) does not further the function of detecting design flaws in the Cap-and-Trade market. The existing reporting requirements (e.g., reporting on transfer prices and ensuring that transfers do not violate the holding limitations) provide more than enough information for the ARB to detect design flaws.

TID is particularly concerned with new restrictions on allowance transfers, which are specified in the proposed amendments to Section 95921(b)(3). These amendments would impose penalties on parties if the actual transfer of compliance instruments occurs after the three day period for review and approval by the Executive Officer. Section 95921(b)(3) would also penalize transfers of consideration that occur before the three day review and approval process by the Executive Officer. These amendments to Section 95921(b)(3) would unreasonably prohibit a broad array of commercial structures. Consideration is a legal term that can include any exchange of value and can be in the form of money, goods, services, commodities or other promises or forbearances. As amended Section 95921(b)(3) would restrict parties from structuring transactions to include provisions including advance payments, letters of credit, guarantees, and other forms of consideration. This amendment would increase the cost and the complexity of compliance with the Cap-and-Trade program and will not provide for additional transparency or market monitoring.

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[1] See *Facts About Cap and Trade: Market Oversight and Enforcement,* available at: http://www.arb.ca.gov/cc/capandtrade/market_oversight.pdf

For these reasons, the ARB should not place new restrictions on allowances transfers or require additional reporting requirements under Section 95921(b). Section 95921(b) should not be amended as proposed in the September 4th Amendments.

2) The ARB Should Continue To Evaluate Provisions For A More Robust Cost Containment Proposal.

The September 4th Amendments would revise Section 95913(f)(5) to create a new cost-containment mechanism, wherein the ARB would draw on the latest vintage of allowances in the event that the highest price tier of the Allowance Price Containment Reserve (APCR) is exhausted. While TID supports the integration of new cost-containment mechanisms, we do not believe that the proposed revisions to Section 95913(f)(5) satisfy the Board's directive in Resolution 12-51. TID encourages the ARB to continue to evaluate additional cost-containment mechanisms through 15 day language amendments.

Resolution 12-51 requires staff to develop a cost containment proposal that meets all of the following objectives: (1) The proposal must achieve the policy objective of ensuring that allowance prices will not exceed the highest price tier of the APCR; (2) the proposal must minimize the impact on existing allowances; (3) the proposal must maintain the environmental objectives of the program; and (4) the proposal must demonstrate that the proposed mechanisms are effective in a reasonable range of plausible combinations of conditions as needed to assure their effectiveness during the period of 2013 to 2020.[2]

The proposal does not meet all of the requirements in Resolution 12-51. Specifically, the proposed changes do not account for the conditions where the mechanism in Section 95913(f)(5) is needed in more than one year. If prices get to $50, they will likely remain at that level for a sustained period. The September 4th Amendments recommend that if the highest price tier is depleted in more than one year, then the ARB would pull allowances from the previous compliance period (i.e., 2020 allowances would be used first, then 2019, and finally 2018). Consequently, the mechanism in Section 95913(f)(5) could not be used for more than three years during any triennial Compliance Period because in 2018 there would be no future compliance period from which the ARB could borrow allowances. This mechanism clearly does not "minimize the impact on existing allowances" because future allowances would be depleted, which would in turn put further upward pressure on allowance prices. The proposed mechanism addresses the need for price containment for a limited period, but exacerbates the price conditions in the later years of the program.

In addition, TID is concerned that if the ARB borrows allowances from the future to keep the prices down, then in the future, we will have higher prices. Anyone can buy allowances in the forward market for future vintage allowances. If the ARB pulls allowances from the future, that will immediately drive up the prices for future vintage allowances. If such a mechanism were used, then the ARB would penalize an entity that seeks to plan ahead. Utilities routinely hedge risks by transacting in forward markets, and shortening the forward market limits that ability.

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[2] See Air Resources Board Resolution 12-51, available at: http://www.arb.ca.gov/cc/capandtrade/final-resolution-october-2012.pdf

In order to best satisfy the direction of Resolution 12-51, TID believes that staff should continue to evaluate cost containment mechanisms through further amendments to the Cap-and-Trade Regulation. For example, the ARB could simply create an unlimited number of allowances at the $50 price, which would be available only through the Allowance Price Containment Reserve. The policy argument against this approach in the past is that it sacrifices the environmental integrity of the cap, so called "printing" of allowances. Access to the APCR is limited to compliance entities, so while there are more allowances are in play, none of the allowances made available under this scenario would be in circulation. The measure would simply serve as a safety valve, and would not increase the number of allowances in circulation and available to the market, therby retaining the integrity of the cap. The ARB should also evaluate liberalization of offset rules as discussed in the next section of these comments.

3) **The ARB Should Encourage A Robust Offset Market By Allowing Regulated Entities To Bank Any Unused Portion Of Their Offset Limitations And Trade That Right With Other Regulated Entities.**

TID supports the changes to the offset provisions to include two new offset protocols and streamlining of the offset project review process. The Coal Mine Methane Capture Protocol (MMC), in particular, represents a major supply of emissions reductions that are sorely needed. A recent analysis by Ruby Canyon Engineering estimates that MMC project have the potential to provide 28 million tons of carbon reductions.[3] Existing offset supply is woefully short of demand and is lacking liquidity, which is diminishing the cost containment effectiveness of the offsets market in general. Compliance entities like TID have been hesitant to enter in to the offsets markets as the risks are outweighing the reward. TID believes that more should be done to increase demand for offset projects. Reducing offset use restrictions will not only help contain costs consistent with Resolution 12-51, but also drive more robust offset market with greater opportunities for new, economic growth. As noted in Dr. Brian Murray's presentation at the June 25th workshop, the ARB should take into account both time and space considerations of GHG emissions when evaluating the environmental integrity objectives in Board Resolution 12-51. Dr. Murray asserts that for GHG emissions, time (when the emissions occur) matters, but not that much within a ten year period.[4] Dr. Murray also asserts that space does not matter because GHG emissions produced in California have the same impact on the overall concentration of GHG emissions as the same amount of emissions produced elsewhere in the world.[5]

When evaluating cost-containment mechanisms, the Cap-and-Trade Regulations should reduce time and space restrictions related to the use of offsets. Such time and space restrictions do not further the environmental objectives of the program. However, removing offset use restrictions will bolster the existing cost containment mechanisms and also further the policy goals of AB 32. One of the legislature's findings in adopting AB 32 was that:

> investing in the development of innovative and pioneering technologies will assist California in achieving the 2020 statewide limit on emission of greenhouse gases established by this division

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[3] http://www.arb.ca.gov/cc/capandtrade/protocols/mmc/rce_amm_protocol.pdf

[4] See Dr. Murray's June 25th presentation, at Slide 2, available at: http://www.arb.ca.gov/cc/capandtrade/meetings/062513/brian-murray-presentation.pdf.

[5] *Id.*

> and will provide an opportunity for the state to take a global economic and technological leadership role in reducing emissions of greenhouse gases.[6]

AB 32 goes on to direct the State Air Resources Board to:

> design emissions reduction measures to meet the statewide emissions limits for greenhouse gases . . . in a manner that . . . maximizes additional environmental and economic co-benefits for California . . ..[7]

The development of a more robust offset market will further these AB 32 objectives. Specifically, the ARB should adopt JUG's 2013 revisions to offset rules, which include: (1) allowing the regulated entities to carry over all of the unused portion of the 8% offset restriction on an annual, quantitative basis; (2) exempting California-originated offset projects from the 8% limit; (3) allowing compliance grade offsets to be sourced from anywhere in North America; and (4) moving the offset project commencement to an earlier date. Specific language revisions to implement these objectives are attached hereto as "Attachment A."

In addition, regulated entities should be allowed to trade any unused portion of their offset limitations with other regulated entities. The ARB should incorporate these mechanisms into the Cap-and-Trade program as set forth in Attachment A. Offset projects can take years to develop and sending signals now that there will be higher demand for offset credits in the future will encourage near term investment in new offset projects.

4) <u>Regulated Entities Should Have The Flexibility To Determine The Order That Their Compliance Instruments Are To Be Retired.</u>

The September 4th Amendments would revise Section 95856 of the Cap-and-Trade regulation to provide that allowances would not actually be retired from the compliance account at the annual surrender obligation. TID Supports this change. However, under Section 95856(h)(2), the ARB will retire allowances under the triennial compliance obligation based on a mandated and pre-determined retirement order. TID is concerned that a mandated retirement order for the triennial compliance obligation will tend to result in higher compliance costs for regulated entities. Regulated entities are in the best position to determine how to meet their compliance obligation in the most cost effective manner.

Moreover, the use and recognition of serial numbers in the existing CITSS software should allow for sufficient functionality to ensure that regulated entities do not violate any of the allowance usage restrictions, while at the same time, the use of serial numbers would preclude the need for a predetermined retirement order. At most, the ARB should allow regulated entities to choose a pre-determined retirement order. TID's proposed revisions to Section 95856(h)(2) in Attachment A would provide regulated entities with greater flexibility and would reduce compliance costs.

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[6] See, Cal. Health and Safety Code Sec. 38501(e).
[7] See, Cal. Health and Safety Code Sec. 38501(h).

Conclusion

TID appreciates your consideration of our comments on the September 4th Amendments. TID is concerned with the expanded informational requirements proposed in the September 4th Amendments. It is not clear how the collection of additional allowance transfer information and new restrictions on allowance transfers aids the ARB in implementing and enforcing the Cap-and-Trade regulation. TID also believes that the cost containment provisions should be revisited to include additional cost containment provisions that will remove restrictions on offset usage and not draw on future vintage allowances. ARB should also send a market signals to encourage a robust offset market by allowing regulated entities to bank any unused portion of their offset limitations and trade that right with other regulated entities. Finally, regulated entities should have greater flexibility in determining the retirement order of their compliance instruments.

We look forward to continuing to work with staff in this year's rulemaking.

Sincerely,

Dan B. Severson

Turlock Irrigation District

ATTACHMENT A

TURLOCK IRRIGATION DISTRICT PROPOSED REVISIONS
TO SEPTEMBER 4, 2013 CAP-AND-TRADE REGULATION
(Revisions are noted in Strikethrough and Underline)

1. *Do not revise Section 95921(b).*

2. *Amend Section 95854 to allow regulated entities to bank and transfer offset usage limits with other regulated entities:*

§ 95854. Quantitative Usage Limit on Designated Compliance Instruments--Including Offset Credits

(a) Compliance instruments identified in section 95820(b) and sections 95821(b), (c), and (d) are subject to a quantitative usage limit when used to meet a compliance obligation.

(b) The total number of compliance instruments identified in section 95854(a) that each covered entity may surrender to fulfill the entity's compliance obligation for a compliance period must conform to the following limit:

O[o]/S must be less than or equal to Lo

In which:

O[o] = Total number of compliance instruments identified in section 95854(a) submitted to fulfill the entity's compliance obligation for the compliance period.

S = Covered entity's compliance obligation.

L[o] = Quantitative usage limit on compliance instruments identified in section 95854(a), set at 0.08.

(c) The number of sector-based offset credits that each covered entity may surrender to meet the entity's compliance obligation for a compliance period must not be greater than 0.25 of the L[o] for the first and second compliance periods and not more than 0.50 of the L[o] for subsequent compliance periods.

(d) A covered entity may apply to the Executive Officer for an increase in the Quantitative usage limit if it did not use a portion of its allowable offset usage limit in a previous triennial compliance period or another covered entity has agreed to transfer its offset usage limit from a previous or current compliance period. If approved by the Executive Officer, the covered entity's compliance instruments identified in section 95854(a) that each covered entity may surrender to fulfill the entity's compliance obligation for a compliance period must conform to the following limit:

O[o]/S must be less than or equal to Lo

In which:

O[o] = Total number of compliance instruments identified in section 95854(a) submitted to fulfill the entity's compliance obligation for the compliance period.

S = Covered entity's compliance obligation.

L[o] = Quantitative usage limit on compliance instruments identified in section 95854(d), set at 0.08 + L[o](unused) + L[o](transferred)

L[o](unused) = The unused portion of the entity's quantitative usage limit from a previous compliance period. L[o](unused) may not exceed .08% in the second compliance period, and .16% in the third compliance period.

L[o](transferred) = The unused portion of another entity's quantitative usage limit, expressed as a percentage, and that has been approved for transfer by the Executive Officer. The transferring entity must have a total compliance obligation that is greater or equal to the transferee's compliance obligation.

3. *Revise Proposed Section 95856(h)(2) to provide greater flexibility for Regulated Entities in determining the order of retirement for their compliance instruments.*

(2) When a covered entity or opt in covered entity surrenders compliance instruments to meet its triennial compliance obligation pursuant to section 95856(f) and the entity has not specified its desired retirement order by October 1st, the Executive Officer will retire them from the Compliance Account in the following order:

(A) Offset credits specified in section 95820(b) and sections 95821(b) through (d) with oldest credits retired first and subject to the quantitative usage limit set forth in section 95854:
(B) Allowances purchased from an Allowance Price Containment Reserve sale or compliance instruments pursuant to section 95821(f)(1);
(C) Allowances specified in section 95820(a) and 95821(a) with earlier vintage allowances retired first; and
(D) The current calendar year's vintage allowances and allowances allocated just before the triennial surrender deadline up to the true-up allowance amount as determined in section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), or 95894(d)(1) if an entity was eligible to receive true up allowances pursuant to section 95891(b), 95891(c)(3)(B), 95891(d)(1)(B), 95891(d)(2)(B), 95891(d)(2)(C), 95891(e)(1), or 95894(d)(1).