

**Comments of the Western Power Trading Forum
To the California Air Resources Board
on Changes to the Cap and Trade Program
Related to Compliance, Information Requirements and Cost-
Containment**

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The Western Power Trading Forum¹ (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (CARB) on its proposed changes to the compliance and information requirements under the cap and trade program and options to contain allowance costs, as presented at the workshop on June 25th.

Order of compliance instrument retirement

At the June 25th workshop, CARB staff presented their proposal to changes to the regulation to delineate the order in which compliance instruments will be removed from each entity's compliance account and into the central Retirement account administered by CARB. Our understanding of this proposal is that for both the annual and triennial surrender, instruments will be removed in the following order, up to the level of the entity's surrender obligation: 1) offsets, starting from oldest, 2) any allowances purchased from the price containment reserve, and 3) allowances, earlier vintages first. The only difference between the annual and triennial surrender would be that the 8% limit on use of offsets would be binding only for the triennial surrender.

WPTF has two concerns with this proposal. First, WPTF has previously advocated for functionality that would enable an entity to choose unit types and vintages for retirement in CITSS and to allow early retirement, rather than having the order of retirements of compliance instruments imposed by CARB. The reason for allowing entities to retire compliance instruments early is a CITSS account holder bears the replacement risk for invalidated forestry offsets held in its compliance or holding account only until the offsets have been moved to the retirement account. An entity should be allowed to retire these offsets at anytime after purchase in order to shift this risk to the producer of the offset.

Second, under CARB's proposed approach, the quantity of offsets moved from an entity's compliance account to the retirement account could exceed the 8% limit at the end of a compliance interval, due to the accidental 'over-surrender' by an entity for its annual compliance obligation. Rather than return these offsets to the entity's compliance account, CARB has proposed to retire those offsets permanently without compensation to the entity. WPTF strongly oppose CARB proposal that 'over-surrendered' offsets be lost. Essentially, CARB is on the one hand, preventing entities from managing the retirement of their compliance instruments, while on the other imposing a financial consequence (loss of valid offset credits) for failing to manage those compliance instruments.

WPTF urges CARB to forego this approach, and instead implement functionality in CITSS that would enable each compliance entity to designate the compliance instruments and types to be moved from its compliance account to the retirement account for each surrender obligation. We also recommend that CITSS 'flag' any designation of offsets for retirement that would result in

¹ WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within California, western states, as well as other markets across the United States.

surrender in excess of the 8% limit. If any offsets have inadvertently been surrendered in excess of the 8% limit, these should be returned by CARB to an entity's compliance account. Finally, if CARB proceeds with the regulation as proposed, it must modify the regulation to allow a return of excess offsets to the account holder's active account.

Changes in the Compliance Timeline

CARB has proposed moving up the deadline for verification of emissions data reports to mid-August (instead of early September) to allow for more time for CARB to hold the Price Containment Reserve (PCR) sale in advance of the annual surrender deadline on November 1st. Presumably this would also entail a corresponding move in the deadline for submitting emission reports.

Electric Power entities already find it challenging to procure the services of verification bodies in the short window of time between the deadline for submission of emission reports on June 1 and the deadline for verification statements on September 1st. Moving the deadlines for submission of emissions reports will exacerbate the problem by reducing the amount of time available to entities to prepare reports. A shortened report preparation time would be particularly problematic for electric power entities because input data (e.g. emission factors) and the reporting format for electric power entities isn't available until relatively close to the June 1 emissions report due date.²

The impetus for this proposed change appears to be to give CARB staff more time to perform the end of year PCR sales prior to the compliance instrument surrender deadline. If so, WPTF would propose that CARB move the deadline for the November surrender obligation to December 1 instead, rather than reduce the time available for covered entities to comply with program requirements.

Publicly available information

Staff presented a detailed proposal at the June 25th workshop for public release of information related to entity compliance under the cap and trade program. While WPTF generally supports publication of most of the information in the proposal and the timeline for its release, WPTF remains strongly opposed to publication of information on compliance account holdings of individual covered entities.

As WPTF has previously commented, we recognize that the public has a legitimate interest in the compliance of covered entities with the cap and trade program. However, we believe that this interest can be met through publication of information on units retired by compliance entities, which we support. In contrast, we do not see a legitimate public interest in publication of units in individual entity holding accounts, because there is no correspondence between the quantity of units held in an entity's compliance account (which are units available for future compliance obligations) and whether an entity is currently in compliance with the program. Further, as WPTF and others have noted, publication of information on the quantity of units held by an entity in compliance accounts could convey commercial advantage to other market participants. WPTF

² The reporting spreadsheet for electric power entities was published by CARB on April 1st this year.

supports publication of information of aggregated quantities of compliance instruments in all entity compliance accounts, but opposes publication of information on individual compliance accounts.

With respect to the option of publishing aggregate compliance instruments by sector, WPTF would recommend instead that CARB publish aggregated emissions data by sector (in addition to emissions data for covered entities.) Changes in emissions will give a better indication to the market of changes in demand for compliance instruments by a sector, than information on compliance holdings of that sector would.

Information reporting in CITSS

WPTF is troubled by CARB's proposal to require entities to provide more information in CITSS about the contractual arrangements underlying transfers of compliance instruments, and for 'customized bilateral' contracts, to break down price by base and margin components.

WPTF acknowledges CARB's legitimate interest in tracking prices and volumes in the secondary and derivative markets, because movements in those markets may signal changes in supply and demand for compliance instruments and auction prices. However, we consider that the better data on the secondary carbon market will be available through exchanges. This is due to the fact that price information collected via CITSS is likely to be inaccurate and incomplete. As WPTF has noted in previous submissions, the physical transfer of compliance instruments that is reflected in CITSS may be the final outcome of multiple forward buy and sell transactions. In these cases, the price reported by the entity may reflect the final transaction, an average of all transactions price, or some other representative value.

Further, CARB's proposal to collection of information on base and margin prices in bilateral contracts, and its potential verification of the underlying contractual agreements, suggests that CARB is asserting authority over areas that would appear to fall under the jurisdiction of the Commodity Futures Trading Commission. While it is appropriate for the Market Monitor to monitor activity and behavior of the secondary and derivatives market through publicly available information, CARB should leave monitoring of individual transactions to the CFTC.

WPTF considers that information currently provided when transfers are initiated in CITSS, combined with price and volume information publicly available from exchanges, provides sufficient information for CARB to monitor and enforce compliance with program rules. We oppose further expansion of information requirements for CITSS transfer.

Cost-Containment

WPTF applauds CARB's effort's to contain program costs, while ensuring attainment of the environmental goals of the cap and trade program. In this regard, we believe that it is important to not only put in place provisions that would trigger price containment mechanisms at a pre-determined allowance price, but also to modify program rules to reduce the likelihood of attaining that allowance price in the first place.

To this end, WPTF support the proposals of the Joint Utilities Group (JUG) for program modifications to be put in place now to reduce the likelihood of allowance prices reaching the level of the lowest tier of the PCR. Specifically, we support carry-over by covered entities of any unused portion of the 8% offset limit, exemption of offset projects located within California from the 8% limit; removal of allowance holding limits and the addition of one more auction annually.

WPTF also recommends that the regulation be modified to allow entities to use allowance vintages from the current and subsequent year towards their compliance obligations. The additional flexibility provided by this one-year 'borrowing' would enhance the ability of covered entities to manage compliance, and will thus help constrain GHG costs. The program's three-year discrete compliance periods provide entities with flexibility to use future year allowance budgets in the early years of the compliance period, but no flexibility in the final year. If the final year turned out to be anomalous due to weather and economic conditions, then capped entities could have difficulty acquiring sufficient allowances for compliance, which will in-turn drive up allowance costs. Simply allowing limited borrowing would mitigate price effects from short-term demand spikes.

WPTF also supports additional cost-containment if the PCR is depleted. The JUG proposal for CARB to make additional allowances available to the market at the highest tier reserve price and to use the revenue to buy and retire compliance instruments outside the program, or to invest in additional GHG reductions in state would seem to be the most effective means of capping allowances prices, while still maintaining the environmental integrity of the cap.

Finally, WPTF considers that the ability of entities to use low-cost offsets for compliance is CARB's most effective tool for constraining allowance prices. CARB should take additional steps now to improve the availability of offsets, through approval of additional offset protocols and expansion of the geographic scope of projects, and ensure that they can be used by covered entities. We do not support an approach that will increase the offset limit only after a price trigger has been crossed, because measures to increase the supply of offsets would need to be taken well in advance of any adverse price event in order to be effective.