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Clerk of the Board
Air Resources Board
1001 I Street
Sacramento, CA 95814

Submitted via web: <http://www.arb.ca.gov/lispub/comm/bclist.php>

RE: Comments on the Air Resources Board September 4, 2013 Proposed Regulation Order

Dear Sir or Madam:

Chevron has been a California company for more than 130 years and is the largest Fortune 500 corporation based in the state. We have participated in stakeholder meetings, broad-based industry and environmental group meetings, and discussions with ARB and its staff in order to make the program and this proposed rule workable for California, while meeting the goals of AB 32. We support the substantial progress being made on industry assistance and cost containment both through future offset protocol development and limited borrowing. As ARB has noted in meetings and workshops, additional work remains before 2015 to develop a refinery benchmark that will fairly allocate refinery allowances, complete trade exposure analysis, ensure expansion of offset supply, add cost containment measures and address market design elements and administrative concerns. We sincerely appreciate the opportunity to work with ARB staff and leadership and submit these comments on the September 4, 2013 Proposed Regulation Order for consideration.

Introduction

Chevron is pleased that ARB is considering adoption of the following policies which represent improvements in the cap and trade program:

- **Industry Assistance** – Chevron supports the proposed change in the application of the industry assistance factor that recognizes the competitive environment in the refining sector and other energy intensive trade exposed industries which if left unchanged, could lead to leakage and loss of California jobs.
- **Mine Methane Capture Protocol and Offsets** – Offsets afford California a critical opportunity to meet the AB 32 environmental goals in the most efficient and low cost

means possible in sectors that are not regulated. The Mine Methane Capture Protocol targets a sector that can contribute a significant US supply of greenhouse gas (GHG) reductions that would otherwise not be controlled. Offset protocols provide the business community and the agency with the assurance that there is a sound technical basis used to create real and permanent emission reductions. Chevron supports the Mine Methane Capture Protocol as a substantial step towards increasing the supply of offsets.

- **Cost Containment** – Board resolution 12-51 recognized the need for a clear and transparent approach to address the potential for unnecessarily high allowance prices. Chevron supports the current proposal for cost containment as a first step. It is important that the changes made by staff fulfill the requirements under the resolution.

We are concerned, however, that some proposed changes add market and administrative challenges to a program that is already complex. The changes in information submittal, instrument trading, and offset liability are excessively broad and could be better tailored to meet ARB's needs. These complex provisions create administrative burden, and have potential unintended market and enforcement consequences.

Chevron Supports ARB's Proposal on Industry Assistance

Chevron strongly supports ARB's proposed amendment to extend the first and second compliance period industry assistance factor into the second and third compliance periods as it will create a more measured start to the program. This change will help to maintain the environmental integrity of the cap-and-trade program by limiting leakage and protecting jobs in California. Allocation decisions do not directly impact the environmental effectiveness of the program since aggregate emissions remain limited by the cap regardless of how the allowances are distributed.

Emissions leakage can occur when California's consumers and carbon-intensive trade-exposed industries face carbon costs not borne by competitors outside the state. This leads to consumer purchases and production as well as its associated emissions shifting from California to other unregulated regions. Since California's market is essentially isolated from other markets where more cost effective reductions exist, the proposal to provide increased industry assistance through the second and third compliance periods is a critical policy element to both meet the programs goals and address competitive disadvantages to industry that could lead to job loss.

Industry assistance allows California to implement cap and trade more efficiently by enabling facilities to focus on the cost of reducing emissions rather than purchasing the initial allowances to start the program. We understand that ARB plans to continue its evaluation of industry assistance next year. We are concerned that refining may not be well represented in the study design. Given our significant operating presence in the state and extensive knowledge of refining economics and operations, we welcome the opportunity to work with ARB in this regard.

Chevron Supports the Mine Methane Capture Offset Protocol

Chevron supports efforts to increase the availability of offsets. An adequate supply of offsets plays a significant role in containing program costs. Geographic limitations on offset projects, such as those limiting projects to within the US and its territories, substantially increase program costs and may ultimately result in businesses and jobs leaving the state.

Carbon offset project types are limited to those that the California Air Resource Board approves through adoption of protocols. Industry analysts expect the program to need as many as 220 million compliance-eligible offsets. The four protocols that have been approved by ARB will not produce the needed supply for cost-effective compliance options under AB 32's requirements. Recent analysis by the American Climate Registry finds that there will be a significant shortage of offset supply by 29 percent in the first compliance period and up to 67 percent by the third compliance period.

In the proposed rulemaking, ARB would add a protocol that has the potential to substantially help meet these goals. The Mine Methane Capture Protocol targets reductions that are measurable based on sound technology, and result in a significant potential US supply of GHG reductions that would not otherwise occur under business as usual. Through strict technical guidelines, offset protocols provide the business community and the agency with the assurance that there is a sound technical basis to help create real and permanent emissions reductions. Chevron supports the Mine Methane Capture Protocol as an important step towards increasing the supply of offsets.

We urge ARB to continue to both develop additional protocols and explore options to streamline its adoption and offset review process. This is particularly important because under the six protocols, adopted and in process, several experts have predicted offset supply shortages.¹ Any ARB efforts to reduce future uncertainty regarding the role of offsets in the program will help boost offset supply, as current uncertainty is holding back offset project investment. Additional specific comments are included in the attachment to this letter.

We support ARB's existing rule that places responsibility for the invalidation of surrendered forestry offsets on forest owners. This policy is sound because forest owners, not the offset purchasers, are in the best position to assess and manage the three grounds for invalidation: (1) non-compliance with environmental laws; (2) overstatement of the GHG removals; and (3) double registration of the removals.

We appreciate ARB's revised Proposed Regulation Order to apply the new liability regime to offsets issued on or after January 1, 2014. While this change is a significant improvement over

¹ Bloomberg Jul 2013: <http://bnef.com/Insight/8132> ; Point Carbon Apr 2013: <http://eikon.pointcarbon.com/research/northamerica/wci/analystupdates/1.2325891> ; American Carbon Registry 2012: <http://americancarbonregistry.org/acr-compliance-offset-supply-forecast-for-the-ca-cap-and-trade-program>

the original July proposal, it would leave covered entities vulnerable to administrative delay in ARB's issuance process. This is a risk that cannot be controlled in any way by covered entities.

In order to protect the good faith commercial interest of parties enabling offset projects through early stage offtake and financing arrangements (which are desirable to jump start supply), ARB should also protect covered entities that have already entered into contractual arrangements to purchase forestry offsets based on the invalidation parameters in the existing rule. Accordingly, we suggest that ARB apply the new rules to any offset project listed after adoption of the draft regulatory changes.

Finally, Chevron is also concerned that ARB continues to introduce additional administrative requirements in the offset program. Chevron supports high quality offsets. We urge ARB to streamline the administrative process and would be happy to work with staff to identify specific opportunities.

ARB Should Develop a Robust Cost Containment Mechanism

In order for the cap and trade program to meet AB 32's legislative mandate, it must be implemented in a cost effective manner. Board Resolution 12-51 recognized the potential for prices to rise to an unacceptably high level and instructs staff to develop a mechanism to ensure that prices do not rise above the third tier of the allowance price containment reserve (APCR). While Chevron supports borrowing as a mechanism to reduce price volatility, the borrowing mechanism in the proposed amendments does not ensure that prices will not rise above the APCR price. As a result, the borrowing approach may not fully satisfy the Board Resolution.

Chevron supports the cost containment approach presented by the Joint Utilities Group at the July 18, 2013 workshop which proposed, among other things, expanding offsets, changing holding limits, and limited borrowing. Further, to send a clear signal and offer the greatest impact on cost containment, the offset trigger measures in the second element of the Joint Utilities Group proposal should be implemented immediately, rather than require a trigger event before being implemented.² We are convinced that actions taken today to limit costs will benefit the environmental goals of the program by reducing the chance of leakage and protecting jobs and the California economy.

ARB Participant Registration and Information Requirements Are Needlessly Broad

An efficient, liquid market facilitates the most cost effective emission reductions. Rules must enable a level playing field between allowance market participants. To this point, entity specific, market sensitive data must be protected to avoid unfairly exposing sensitive position information for compliance entities which could lead to a less competitive market.

ARB requests all possible information with the apparent intent to use it to look for some type of unspecified irregularities. The overwhelming majority of the information gathered will never be

² <http://www.arb.ca.gov/cc/capandtrade/meetings/062513/industry-present.pdf>

useful and represents a waste of resources. Chevron recommends that ARB take a “for cause” or “as needed” approach for anything beyond the current regulatory language. We believe that giving the ARB leeway to ask for additional information when the need arises can accomplish ARB’s need to investigate unusual situations without burdening every compliance entity with reporting data that will never be the subject of concern. This type of conditional data request provides the ARB an efficient and effective means to gather data when needed.

The requirement to report complete contact information for any employee who has access to or knowledge of allowance holding or procurement strategy is unreasonable and unenforceable. The proposed rule does not provide sufficient clarity regarding access and information. As written, regulated parties will be compelled to submit excessively large amounts of employee information in order to avoid a potential enforcement risk. Because of the vague nature of this rule the bulk of this information will likely be of no use to ARB and may actually make ARB’s tracking and enforcement activities more difficult.

Chevron understands that the purpose of this rule is to monitor employees that also act as voluntary associated entities (VAE) so that employees who operate as voluntary participants do not exploit information. Chevron supports efforts to maintain the integrity of the cap and trade market but believes as written this proposed rule could actually work counter to this effort. Chevron has internal governance processes to manage market sensitive information. Chevron suggests that ARB require VAEs to attest if they are employees of regulated entities. Chevron looks forward to working with ARB to identify the appropriate and useful level of participant information to be provided.

The Regulation Order requires entities to disclose all corporate associates, regardless of whether they are registered in the cap-and-trade program. Although ARB is characterizing the proposed change as a clarification of an existing requirement, existing Section 95830(c) (1) (H) clearly limits the scope of the disclosure requirement to “entities registered pursuant to this article”. Although the proposed changes may be important to monitor affiliations that may be used in violation of the regulations, the Proposed Regulation Order is simply unworkable and overreaching for large public companies that may have thousands of affiliates in more than 100 countries. Accordingly, Chevron proposes an exemption from this disclosure requirement for publicly traded companies.

When registering for the auction, entities must now attest that they have not been subject to any previous or pending investigation related to securities, commodities or financial markets. This proposal is unworkable because it would exclude entities from participating in an auction merely for having been investigated, even if no wrongdoing is ever uncovered. Chevron believes the current requirement – disclosure of such investigations – is sufficient to ensure appropriate market monitoring.

ARB Market Design Needlessly Prohibits Robust Transaction Processes

The proposed amendments provide relief in some areas, such as true up allowances and the treatment of future vintage allowances under the holding limit rule. However, Chevron continues

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to be challenged by holding limits that impact our ability to operate efficiently in the market. To that end, Chevron supports the Joint Utilities Proposal changing the requirement for the limited exemption. Enabling allowances corresponding to the limited exemption to be placed in the compliance entity's holding account will allow compliance entities the flexibility to efficiently manage their compliance instrument portfolio within the confines of a quantitative holding limit. Because the holding limit does not account for the size of a compliance obligation, this change is particularly important for large compliance entities.

Chevron is concerned with the trade restrictions and market complexity introduced in the proposed amendments. These proposed restrictions will eliminate critical transactions such as options, futures, forwards, right of first refusal contracts. These promote a robust and efficient market structure. Chevron understands the agency's need to identify bad actors, but rules must be designed so that honest parties are able to avoid inadvertent missteps.

ARB should provide guidance similar to guidance issued for resource shuffling that explains specific safe harbors or specific examples of bad behavior. This is needed in the rulemaking to provide some measure of definition to allow regulated parties to understand the limits or boundaries that ARB means to enforce.

Prohibitions on trading are generally overbroad and should be curtailed to permit legitimate transactions that support program objectives and create liquidity. For example, requiring that "an entity cannot acquire allowances and hold them in its own holding account on behalf of another entity" could be interpreted to interfere with the ability of entities to purchase allowances from market makers at auction prices.

The Proposed Regulation Order includes additional language that deviates materially from the guidance provided by ARB in December 2012 (which Chevron supports). The new language uses very broad language that could be read to prohibit legitimate transactions discussed above. This language needs to be scaled back to be consistent with the December 2012 guidance – or at the very least, ARB needs to explain why it is making changes to its December 2012 position.

Additionally the prohibition on beneficial holding does not allow escrow arrangements, because by definition, such arrangements involve a holding on behalf of another. Escrow is a fundamental component of corporate transactions and this could create unnecessary obstacles to numerous corporate transactions involving covered entities. We support the addition of a safe harbor for escrow accounts, in addition to the safe harbor for forward contracts and for direct corporate associations.

Chevron believes that market makers have an important role to assist entities that need to participate in the market but do not have internal resources devoted to learning all the detailed rules. ARB should support this role. We support workable rules for market makers that do not increase their market power.

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Conclusion

Chevron appreciates the opportunity to comment on the proposed draft regulation. We have included in Exhibit 1 a summary of our proposed changes to the Proposed Regulation Order. Chevron urges the ARB to make changes to the regulation in accordance with the suggestions contained herein.

Sincerely,

(original signed by)

Lloyd Avram
State Government Affairs

Enclosures

Attachment 1
Summary of Chevron Proposed Changes to Regulations

1. Forestry Offsets

- Issue: changing liability for the invalidation of forestry offsets would leave covered entities vulnerable to administrative delay in ARB's issuance process and will impact transactions already signed in reliance of the current rule.
- Proposed Change: apply new invalidation rule only to forestry projects listed after the date of adoption of the amendments to the regulations.

2. Employee Disclosure Requirements

- Issue: requiring market participants to disclose all employees involved with the program is difficult to implement and administratively burdensome.
- Proposed Change: remove new requirement in Section 95830(c)(1)(I) and, instead, require individuals registering as voluntarily associated entities to attest that they are not employees of a covered entity with access to cap-and-trade information.

3. Corporate Associations Disclosure

- Issue: requiring registrants to disclose all of their affiliated entities regardless of whether they are registered in the program.
- Proposed Change: create exemption in Section 95833(a)(1) for publicly traded companies.

4. Market Prohibitions

- Issue: the proposed language deviates materially from the guidance provided by ARB in December 2012 because it could be read to prohibit transactions such as options and right to match terms.
- Proposed Change: clarify the prohibition by adding new safe harbors in Section 95921(f) for certain transaction types.

5. Auction Participation Information

- Issue: the current prohibition on auction information disclosure prohibit certain transactions that would help small and medium size covered entities procure allowances.
- Proposed Change: modify Section 95914(c)(1) to permit limited exchange of information in certain transactions that are disclosed to ARB.

6. Holding Limit

- Issue: the holding limit is too small for covered entities with large compliance obligations.
- Proposed Change: amend Section 95920(d)(2)(A) to make the limited exemption to the holding limit apply to an entity's allowances in both the holding and compliance account.

Attachment 2
Proposed Revisions to the Cap-and-Trade Regulation Amendment Proposal

The following text shows Chevron's proposed revisions to the ARB September 4, 2013 proposed regulation. Text in plain type is included in ARB's proposal. Text in **bold** shows proposed additions to the September 4 proposal. Text in ~~bold and strikethrough~~ shows deletions to the September 4 proposal. Underlined text shows text that has been moved within the September 4 proposal.

1. FORESTRY OFFSETS

§ 95985. Invalidation of ARB Offset Credits

...

(h) Requirements for Replacement of ARB Offset Credits

- (1) If an ARB offset credit that is issued to a non-sequestration offset project or an urban forest offset project, or a U.S. forest offset project **that has been listed prior to issued on or after January 1, 2014, or** the effective date of this regulation, and is in the Retirement Account, and it is determined to be invalid pursuant to section 95985(f) for only the circumstance listed in section 95985(c)(1), then...

2. EMPLOYEE DISCLOSURE REQUIREMENTS

§ 95830. Registration with ARB.

...

(c) Requirements for Registration.

- (1) An entity must complete an application to register with ARB for an account in the tracking system that contains the following information:

...

~~(I) Names and contact information for all persons employed by the entity in a capacity giving them access to information on compliance instrument transactions or holdings, or involving them in decisions on compliance instrument transactions or holdings.~~

...

3. CORPORATE ASSOCIATION DISCLOSURE

§ 95830. Registration with ARB.

...

(c) Requirements for Registration.

- (1) An entity must complete an application to register with ARB for an account in the tracking system that contains the following information:

...

(H) Identification of all other entities with whom the entity has a corporate association, direct corporate association, or indirect corporate association pursuant to section 95833, and a brief description of the association, **unless the entity completing an application to register with ARB is a publicly traded company, in which case such entity need only**

identify such associated entities that are registered in the cap-and-trade program or are registering in the cap-and-trade program. An entity completing an application to register with ARB and for an account in the tracking system must provide all applicable information required by section 95833.

4. MARKET PROHIBITIONS

§ 95921. Conduct of Trade.

...

(b) Information Requirements for Transfer Requests. Parties to the transfer request agree to provide documentation about the transaction agreement for which the transfer request was submitted upon the request of the Executive Officer. The following information must be reported to the accounts administrator as part of a transfer request before any transfer of allowances can be recorded on the tracking system:

...

(6) If the transaction agreements do not contain a price for compliance instruments, entities may enter a price of zero into the transfer request if the transfer request is submitted to fulfill one of the following transaction agreement types and the entity discloses the agreement type in the transfer request.

...

(G) The proposed transfer is from an entity that is a party to an escrow agreement to an entity designated as escrow agent pursuant to the same escrow agreement.

(H) The proposed transfer is from a borrower to a secured party.

...

(f) General Prohibitions on Trading.

(5) An entity cannot acquire allowances and/or hold them in its own holding account on behalf of another entity, ~~including the following restrictions:~~

(A) An entity may not hold allowances in which a second entity has any ownership ~~or financial~~ interest.

(B) An entity may not hold allowances pursuant to an agreement that gives a second entity control over the holding or planned disposition of allowances while the instruments reside in the first entity's accounts, ~~or control over the acquisition of allowances by the first entity. These prohibitions do not apply to agreements that only specify a date to deliver a specified quantity of allowances and that include no terms applying to allowances residing in another entity's account~~

(C) **Notwithstanding the prohibitions in section 95921(f)(1)(A)-(B), the following transactions are permitted:**

(i) An entity may ~~purchase~~ **acquire** and/or hold allowances for ~~later transfer to~~ members of a direct corporate association.

(ii) **An entity may acquire and/or hold allowances subject to a purchase and sale agreement for future delivery to a purchaser, provided that the purchase and sale agreement does not allow the purchaser to gain an ownership interest in allowances until they are transferred to the purchaser's account.**

(iii) **An entity acting as escrow agent pursuant to an escrow agreement may acquire and hold allowances on behalf of the party or parties to the transaction subject to the escrow agreement.**

(iv) **An entity may hold allowances in which another entity has an ownership interest as a pledge or as collateral pursuant to a secured transaction,**

provided that the holding entity may not sell, transfer, retire or otherwise use the allowances unless such action is in accordance with the secured transaction. Upon a default in the secured obligations, the secured party may take ownership of the allowances and/or transfer them to a third party in connection with its exercised remedies against the collateral.

- (v) **An entity may acquire and/or hold put, call or right of first refusal options to purchase or sell allowances that reside in another entity's account.**

5. AUCTION PARTICIPATION INFORMATION

§ 95914. Auction Participation and Limitations.

...

(c) Non-disclosure of Bidding Information.

...

(2) Auction participation information listed in section 95914(c)(1) may be released under the following conditions:

...

(E) When an entity is participating in an auction pursuant to conditions defined in a purchase and sale agreement with a third party, auction participation information may be disclosed by such auction participant to the third party if:

- 1. The auction participant and the third party contractually ensure against either party transferring information to any other party, or coordinating the bidding strategy among other participants;**
- 2. The third party neither participates in the auction, nor enters into a similar purchase and sale agreement for the same auction with any other market participant;**
- 3. The auction participant informs ARB of the existence of the contract, identifies the third party and the auction to which the agreement applies, provides the third party's contact information, and provides an attestation by the Primary Account Representative of the entity of the completeness of the disclosure; and**
- 4. The auction participant must provide to the Executive Officer in writing at least 15 days prior to an auction, the following information:**
 - a. Names of all of the third parties participating in the Cap-and-Trade Program with which the auction participant has contracted to purchase allowances in the auction;**
 - b. Description of the agreements pursuant to which the auction participant is purchasing allowances at auction for future delivery to other third parties; and**
 - c. Confirmation that the auction participant is not transferring to or otherwise sharing auction participation information with other auction participants.**

6. HOLDING LIMIT

§ 95920. Trading.

...

(d)

...
(2) Limited Exemption from the Holding Limit.

(A) The limited exemption from the holding limit (limited exemption) is the maximum number of allowances which can be held in an entity's **holding account or** compliance account that will not be included in the holding limit calculated pursuant to section 95920(c)(1). To qualify for inclusion within the limited exemption, allowances must be placed in the entity's Compliance Account **or Holding Account**.