BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON PROPOSED CHANGES TO CAP AND TRADE REGULATION RELEASED ON SEPTEMBER 4, 2013

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SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON PROPOSED CHANGES TO CAP AND TRADE REGULATION RELEASED ON SEPTEMBER 4, 2013

I. INTRODUCTION AND SUMMARY.

The Southern California Public Power Authority ("SCPPA")[1] respectfully submits this comment on the proposed changes to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms regulation ("Regulation") released for 45-day public comment on September 4, 2013, by the California Air Resources Board ("ARB").

SCPPA commends the ARB for the majority of the proposed changes to the Regulation. In particular, SCPPA supports the changes to the Resource Shuffling provisions, the inclusion of the new Coal Mine Methane offset protocol, which will assist with offset supply and hence cost containment, the deletion of the requirement to retire renewable energy credits ("RECs") for specified source electricity, and the change from retiring compliance instruments on the annual deadlines to counting the number of compliance instruments.

However, revisions to some of the proposed changes are required. In summary, SCPPA considers that:

- Changes to the following definitions are required for clarity: "Execution Date", "Imported Electricity", "Over-the-Counter", "Public Service Facility", "Qualified Positive Offset Verification Statement", and "Resource Shuffling."
- Sections 95812(f) and (g), on retirement of allowances upon facility closure, should be revised to clarify that they apply only to industrial entities.

[1] 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.

- The ARB should reconsider the new requirement for covered entities to provide details about their employees with access to cap-and-trade information. These provisions should be either removed or limited.
- Section 95830(f)(1) should be revised to clarify that the timeframes to update information apply to the date the information was submitted.
- The "Know Your Customer" re-verification requirements should be revised to allow entities to attest that certain information remains unchanged.
- The new resource shuffling provisions are welcome, but a minor revision to safe harbor five is required.
- The proposed changes to the provisions on REC retirement for specified source electricity and the RPS Adjustment are welcome. However, the RPS Adjustment provision should be revised to avoid some unintended negative consequences.
- The change from retirement of compliance instruments on the annual deadlines to counting the number of compliance instruments is welcome. However, as a result of this change various additional drafting changes should be made to section 95856.
- Section 95892 should be revised to specify that the application of the set retirement order will not result in utilities inadvertently breaching section 95892(d)(5).
- The cost containment mechanism proposed in the Regulation would help contain prices if there is a short-term price spike, but the mechanism would not be sufficient to contain prices if there were a long-term supply/demand imbalance. Thus, the proposed mechanism would not satisfy the Board's resolution, which requires a mechanism to ensure that allowance prices will not exceed the highest price of the Allowance Price

Containment Reserve ("Reserve"). The ARB should adopt a suite of cost containment measures.

- Section 95912(d)(4)(E) should be revised to allow entities to list relevant investigations and still participate in the auctions.
- The entity information that must not change in the 45 days surrounding an auction, and the 35 days surrounding a Reserve sale, should be limited to key information that is likely to remain relatively stable.
- If a bidding advisor fails to provide information to ARB, the entity engaging the bidding advisor should not be penalized.
- The deadlines to complete compliance instrument transfer requests in section 95921(a) should be reconsidered.
- The additional data required to be reported on compliance instrument transactions in section 95921(b) should be minimized and the ARB should clarify how it will use this data and keep it confidential.
- Section 95923 on consultant and advisor disclosure requirements should be revised to exclude attorneys.

These issues are discussed in more detail below in the order in which these issues arise in the Regulation.

II. REVISIONS TO CERTAIN DEFINITIONS ARE NEEDED FOR ACCURACY AND TO AVOID CONFUSION.

A. Defined term "Execution Date" should be changed to avoid confusion.

Proposed new section 95802(a)(130) of the Regulation defines the term "Execution Date" as "a provision of a transaction agreement that requires the transfer of compliance instruments on or before a date specified in the agreement." The term appears to have been defined for proposed

new section 95921(a)(3)(B), which sets out the timeframe within which compliance instrument transfers must take place. As discussed in section XV below, SCPPA considers that there is no need for the Regulation to contain any restrictions on transfer timelines that refer to transaction agreements, as transaction agreements will contain penalties for late transfers. Therefore, section 95921(a)(3)(B) should be deleted, and in which case there would be no need to define "execution date."

However, if section 95921(a)(3)(B) is retained, the term "execution date" should be changed. This term is also used in section 95852.1.1(a)(1)(A), in relation to contracts for purchasing biomass-derived fuel. In this context the definition is inappropriate, as agreements for biomass-derived fuel won't necessarily require the transfer of any compliance instruments. This indicates a key problem with the defined term. The term "execution date," in relation to an agreement, is commonly understood to mean the date on which the agreement is executed, i.e. signed by the parties to the agreement. This is very different from the meaning assigned to the term by the definition in section 95802(a)(130). To avoid confusion, if the definition is not deleted, the defined term should be changed from "Execution Date" to something more accurate such as "Agreement Transfer Date."

SCPPA's proposed change to section 95802(a)(130), absent deletion of the section together with deletion of section 95921(a)(3)(B), is set out below:

> (130) "Agreement Transfer~~Execution~~ Date" means a provision of a transaction agreement that requires the transfer of compliance instruments on or before a date specified in the agreement.

B. Revise the definition of "Imported Electricity" to refer to balancing authorities.

In section 95802(a)(179) of the Regulation, a new sentence has been added to the definition of "Imported Electricity" to exempt electricity imported by an "Independent System

Operator" to obtain or provide emergency assistance under applicable emergency preparedness and operations reliability standards of the North American Electric Reliability Corporation ("NERC") or Western Electricity Coordinating Council.

The Regulation does not define "Independent System Operator"; the term appears to refer to the California Independent System Operator ("CAISO"). However, the relevant NERC standard, Standard EOP-002 – Capacity and Energy Emergencies, applies not just to the CAISO but more generally to balancing authorities and reliability coordinators.[2] CAISO is an important, but not the only, balancing authority in California. Other balancing authorities (including some of the SCPPA members) that are not known as "Independent System Operators" may also be required to import electricity for reliability purposes under NERC Standard EOP-002 from time to time. Therefore, the definition of "Imported Electricity" should refer to balancing authorities rather than just "Independent System Operators" in the sentence on emergency assistance. Furthermore, the term "balancing authority" is defined in section 95802(a)(29).

To avoid inadvertently restricting the application of the first new sentence in the definition of "Imported Electricity" and to maintain consistency with existing defined terms, section 95802(a)(179) should be revised as set out below:

> (137) "Imported Electricity" means electricity generated outside the state of California and delivered to serve load located inside the state of California. ... Imported Electricity does not include electricity imported into California by a~~n~~ balancing authority~~Independent System Operator~~ to obtain or provide emergency assistance under applicable emergency preparedness and operations reliability standards of the North American Electric Reliability Corporation or Western Electricity Coordinating Council.

[2] See Standard EOP-002-3, available at: http://www.nerc.com/files/EOP-002-3.pdf.

C. The definition of "Over-the-Counter" should be revised for clarity.

Proposed new section 95802(a)(244) defines the term "Over-the-Counter" as "the trading of carbon compliance instruments, contracts, or other instruments not listed on any exchange."

This definition is useful, but certain changes would increase its clarity and reduce redundancy. First, the term "carbon compliance instrument" is not used elsewhere in the Regulation; it should be changed to the usual term "compliance instrument."

Second, the term "over-the-counter" is used only in section 95921 in relation to transactions involving compliance instruments other than on exchanges. Therefore, the reference to "contracts or other instruments" should be deleted as this term only refers to the trading of compliance instruments.

SCPPA's proposed changes to section 95802(a)(244) are set out below:

> (244) "Over-the-Counter" means the trading of ~~carbon~~ compliance instruments~~, contracts, or other instruments~~ not listed on any exchange.

D. The definition of "Public Service Facility" should be revised for clarity.

Proposed new section 95802(a)(284) defines "Public Service Facility" as:

> a facility that is a covered entity or opt-in covered entity (i) owned by a local government as defined in Government Code section 53720(a) or (ii) supplying steam under an existing agreement to a facility meeting the definition of an educational facility pursuant to Education Code section 94110(e) excluding facilities owned or operated by an electrical distribution utility, that provides steam and chilled water solely to buildings and facilities owned by the local government or to a publicly-owed [*sic*] education facility, and may also provide electricity to its own facilities or for sale to an electrical distribution utility.

Under proposed new section 95870(f), Public Service Facilities are to receive an allocation of allowances from the ARB. However, a facility (physical plant) cannot itself be a covered entity and receive allowances; the entity that operates the facility is the one that must register and open an account for the allowances. The Regulation should keep the distinction

between entities and facilities clear: an entity (a person, company or other organization) can take actions and will be liable for its actions; a facility cannot.

Therefore, the term “Public Service Facility” should be changed to “Public Service *Entity*” in the definitions and throughout the Regulation.

SCPPA’s proposed changes to section 95802(a)(284) are set out below:

> (284) “Public Service ~~Facility~~Entity” means ~~a facility that is~~ a covered entity or opt-in covered entity ~~(i) owned by a local government as defined in Government Code section 53720(a) or (ii) supplying steam under an existing agreement to a facility meeting the definition of an educational facility pursuant to Education Code section 94110(e) excluding facilities owned or operated by~~ (other than an electrical distribution utility)~~,~~ that operates a facility that provides steam and chilled water solely to buildings and facilities owned by a~~the~~ local government as defined in Government Code section 53720(a) or to a publicly-owned education facility pursuant to Education Code section 94110(e), and may also provide electricity to its own facilities or for sale to an electrical distribution utility.

E. The new sentence in the definition of “Qualified Positive Offset Verification Statement” should be clarified.

A new sentence is proposed to be added to the definition of “Qualified Positive Offset Verification Statement” in section 95802(a)(292) of the Regulation:

> Non-conformance, in this context, does not include disregarding the explicit requirements of this article or applicable Compliance Offset Protocol and substituting alternative requirements not approved by the Board.

It is unclear from this new sentence how such disregard and substitution would be treated, if they do not constitute a non-conformance. It would seem that such actions should constitute a non-conformance. This sentence should be revised for clarity.

The Initial Statement of Reasons prepared for the proposed amendments to the Regulation, dated September 4, 2013 (“ISOR”), provides a helpful description of the purpose of this change:

> This modification is necessary to clarify that the qualified positive offset verification statement is not allowed when the offset project operator or authorized project designee substitutes an explicit requirements of the Regulation with a method not approved by the Board.[3]

This should be reflected in the Regulation, as the currently-proposed drafting does not clearly reflect this position.

SCPPA's proposed changes to section 95802(a)(292) are set out below:

> (292) "Qualified Positive Offset Verification Statement" means an Offset Verification Statement rendered by a verification body attesting that the verification body can say with reasonable assurance that the submitted Offset Project Data Report is free of an offset material misstatement.~~, but t~~The Offset Project Data Report may include one or more nonconformance(s) with the quantification, monitoring, or metering requirements of this article and applicable Compliance Offset Protocol which do not result in an offset material misstatement. However, a qualified positive offset verification statement cannot be provided if the offset project operator or authorized project designee ~~Non-conformance, in this context, does not include~~ disregarded~~ing~~ the explicit requirements of this article or applicable Compliance Offset Protocol and substituted~~ing~~ alternative requirements not approved by the Board.

F. The definition of "Resource Shuffling" should be revised for clarity.

The proposed changes to the definition of "Resource Shuffling" in section 95802(a)(317) define it as:

> any plan, scheme or artifice undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation. Resource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A).

SCPPA supports this revised definition and the safe harbors listed in section 95852(b)(2)(A). However, while the safe harbors will cover most of the legitimate transactions

[3] ISOR page 89.

SCPPA members can envisage, it is important that the prohibition on resource shuffling does not impede other legitimate (but as yet undefined) transactions that are not specifically covered in the safe harbors.

Therefore, as proposed by both the Northern California Power Agency and the M-S-R Public Power Agency in their comments to the ARB dated August 2, 2013, a phrase should be added to the definition of "Resource Shuffling" in section 95802(a)(317) to clarify this point.

In addition, the purpose of the word "resources" in the repeated phrase "electricity deliveries from sources with relatively higher emissions resources" is unclear; this word may need to be removed.

SCPPA's proposed changes to section 95802(a)(317) are set out below:

> (317) "Resource Shuffling" means any plan, scheme or artifice undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions ~~resources~~ to reduce its emissions compliance obligation. Not all substitutions of electricity between sources with different emission levels constitute resource shuffling, and r~~R~~esource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions ~~resources~~ when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A).

III. CLARIFY THAT RETIREMENT OF ALLOWANCES UPON FACILITY CLOSURE APPLIES ONLY TO INDUSTRIAL ENTITIES.

Proposed new sections 95812(f) and (g) provide as follows:

> (f) If an entity receives a direct allocation of allowances pursuant to section 95870, but ceases all operation or "shuts down" before it incurs a surrender obligation for the entire compliance period, the following shall apply:
>
> (1) Within 30 days of *facility* shut down the facility operator must inform ARB in writing to close its tracking system account or remain in the cap and trade program as a voluntarily associated entity pursuant to 95814(a)(1);

> (2) In the case of *facility* shut down, a facility must either fulfill its prorated compliance obligation pursuant to subarticle 7 or surrender allowances equivalent to all the directly allocated allowances minus those already used for compliance within the compliance period that the facility shuts down;
>
> (3) If the entity closes its account in the tracking system and there are compliance instruments remaining in the entity's accounts, ARB will auction the allowances pursuant to 95831(c)(4).
>
> (g) If a *facility* ceases production but does not shut down and has received directly allocated allowances, then the facility shall submit to the Executive Officer for the retirement the number of allowances equivalent to the directly allocated allowances for the corresponding budget years in which it had no production. The submittal for retirement must occur within three years of the production cessation. If the facility is eligible for a true-up equation in section 95891, this provision does not apply. [emphasis added]

SCPPA understands from discussions with ARB staff members that these proposed new sections were intended to apply to entities in the industrial sector. This interpretation is supported by the discussion of this section in the ISOR that refers to allocation for "transition assistance and to minimize leakage."[4] These concepts are associated with allocation to industrial entities, not allocation to electric distribution utilities ("EDUs"), which is to protect ratepayers.

However, the intended scope of these provisions is not clear from the wording of the provisions themselves. The first sentence of section 95812(f) refers to entities that receive a direct allocation of allowances pursuant to section 95870. Section 95870 provides for allocation not just to industrial entities, but also to EDUs, universities, public service facilities, legacy contract generators, and natural gas suppliers.

Further confusion arises from the shift, within sections 95812(f) and (g), from references to *entities* shutting down, to references to *facilities* shutting or ceasing production in subsections

[4] ISOR page 15.

(f)(1), (f)(2) and (g). There is an important distinction between entities and facilities. An entity may operate more than one facility.

These sections should be revised to clarify that they apply only to industrial entities. In particular, it would be incorrect for these sections to apply to EDUs that shut down, or cease production at, one generating facility. In such a case, the EDU would still have the same customer load to serve as it had prior to the shut-down, and the EDU would have to seek alternative sources of power to serve its load. If an EDU were required to return allocated allowances in this situation, it would need to purchase additional allowances on the market and its ratepayers would be adversely affected. It is not comparable to the situation where an entity operates one factory, then closes that factory and has no further emissions liability in California.

In recognition of the unique situation of EDUs, which will always have to provide electricity to their customers, the ARB developed a complex allowance allocation method for EDUs. Allowances are not allocated for particular generating facilities, but for the EDU as an entity, based on a range of factors including compliance burden, projected energy efficiency and mandated renewable energy levels. The outcomes of this allocation method were specified in the Regulation for each EDU for each year of the cap and trade program to 2020.[5] Unlike the allocation to industrial entities, the allocation to EDUs is fixed and is not subject to updating and true-up.

For these reasons, sections 95812(f) and (g) should be revised to specify that they apply only to entities that receive an allocation of allowances pursuant to section 95870*(e)* – industrial entities. For further clarity, these sections should be moved to section 95891, Allocation for

[5] Regulation § 95892, Table 9-3.

Industry Assistance, which addresses changes to industrial allocation in a range of circumstances.

SCPPA's proposed changes to sections 95812(f) and (g) are set out below:

§ 958~~91~~12

(~~f~~g) If an entity receives a direct allocation of allowances pursuant to section 95870(e), but ceases all operation or "shuts down" before it incurs a surrender obligation for the entire compliance period, the following shall apply:

(1) Within 30 days of facility shut down the facility operator must inform ARB in writing to close its tracking system account or remain in the cap and trade program as a voluntarily associated entity pursuant to 95814(a)(1);

(2) In the case of facility shut down, the~~a~~ facility operator must either fulfill its prorated compliance obligation pursuant to subarticle 7 or surrender allowances equivalent to all the directly allocated allowances minus those already used for compliance within the compliance period that the facility shuts down;

(3) If the entity closes its account in the tracking system and there are compliance instruments remaining in the entity's accounts, ARB will auction the allowances pursuant to 95831(c)(4).

(h~~g~~) If a facility ceases production but does not shut down and the facility operator has received directly allocated allowances pursuant to section 95870(e), then the facility operator shall submit to the Executive Officer for the retirement the number of allowances equivalent to the directly allocated allowances for the corresponding budget years in which it had no production. The submittal for retirement must occur within three years of the production cessation. If the facility operator is eligible for a true-up equation in section 95891, this provision does not apply.

IV. THE NEW REQUIREMENT TO PROVIDE DETAILS ABOUT EMPLOYEES WITH ACCESS TO CAP AND TRADE INFORMATION SHOULD BE RECONSIDERED.

Proposed new section 95830(c)(1)(I) of the Regulation requires entities seeking to register for accounts to report to the ARB the names and contact information for all employees

who will have access to any information on compliance instrument transactions or holdings, or who will be involved in decisions on compliance instrument transactions or holdings.

This type of information is not typically required in other markets, including highly regulated markets such as the electricity market. The ARB should consider whether the benefit it will obtain from this information justifies the burden that this new reporting requirement may impose on covered entities. Given the broad scope of the section, it will cover many employees at each covered entity – upwards of 50 people at larger entities. It will take time to gather and report this information initially, and the information will need to be updated frequently as people are hired, resign, change positions, or assume new responsibilities.

SCPPA understands that the ARB's key concern is with employees of covered entities who themselves become voluntarily associated entities under the cap and trade program and may be able to trade using their knowledge of their employer's holdings. However, this concern is already addressed in section 95814(a). Rather than including a broad new reporting requirement for all covered entities, the notarized letter required under section 95814(a)(3) could be expanded to state that the employee in question does not have access to any information about the covered entity's compliance instrument transactions or holdings and is not involved in decisions about compliance instrument transactions or holdings by the covered entity. This would prevent any individuals with such knowledge from opening their own accounts while keeping the new reporting requirements to a minimum.

SCPPA's proposed changes to section 95814(a) are set out below in markup. Section 95830(c)(1)(I) should then be deleted.

> (3) An individual employed by an entity subject to the requirements of MRR, or employed by an entity subject to the Cap-and-Trade Regulation, or by an organization providing consulting services related to those Regulations who chooses to register as a voluntarily associated entity in

> the tracking system, must provide a notarized letter from the individual's employer stating the employer is aware of the employee's plans to apply as a voluntarily associated entity in the Cap-and-Trade Program,~~ and~~ that the employer has conflict of interest policies and procedures in place which prevent the employee from using information gained in the course of employment as an employee of the company and using it for personal gain in the Cap-and-Trade Program, and that the employee does not have access to any information regarding the employer's compliance instrument transactions or holdings, and is not involved in decisions regarding the employer's compliance instrument transactions or holdings. ...
>
> (6) Individuals identified by registered entities pursuant to sections 95830(c)(1)(B), (C), and (I)~~, and (J)~~ are not eligible to register as voluntarily associated entities.

However, if the changes above cannot be made, at a minimum section 95830(c)(1)(I) should be revised to narrow the categories of employees who must be reported. ARB staff members have indicated that their key concern is with employees who must have access to information on compliance instrument transactions or holdings to perform their role, not with employees who merely come across this information from time to time in the course of other duties. Revisions clarifying this in section 95830(c)(1)(I) are set out below:

> (I) Names and contact information for all persons employed by the entity in a capacity that requires~~giving them~~ access to information on compliance instrument transactions or holdings in order to perform their key duties, or who make~~involving them in~~ decisions on compliance instrument transactions or holdings.

See also section XIII below on changes to this information prior to an auction or Reserve sale in sections 95912 and 95913.

V. CLARIFY THE TIMEFRAMES IN SECTION 95830(f)(1) APPLY TO THE DATE THE UPDATE WAS SUBMITTED.

Proposed new section 95830(f)(1) provides that registrants must update their registration information within 30 days of a change to the Regulation and within 10 working days of a change to the information. For some types of registration information, registrants can update their information directly; in other cases, registrants must submit the updated information to the

ARB and the ARB then processes the change. In the latter case, it may take some time for the change to the information to be recorded. This processing time should not count towards the 30- or 10- day deadline.

Therefore, section 95830(f)(1) should be revised to clarify that the deadlines to update information apply to the date the new information was submitted, not the date the change was actually recorded on the relevant platform. Additional clarity regarding the different meanings of the word "change" in the first and second sentence of this section would also be welcome.

SCPPA's proposed changes to section 95830(f)(1) are set out below:

> (1) Registrants must submit updates to their registration information as required by any change to the provisions of 95830(c) within 30 days of the changes to those provisions becoming effective. When there is a change to the information registrants have submitted pursuant to 95830(c), registrants must submit updates to the registration information within 10 working days of the change to the registration information.

VI. REVISE THE KYC RE-VERIFICATION PROVISION TO ALLOW ENTITIES TO SPECIFY INFORMATION THAT HAS NOT CHANGED.

Proposed new section 95834(c)(2) provides that the Executive Officer may re-verify all documents required pursuant to the Know-Your-Customer ("KYC") requirements in section 95834 every two years, and that upon request individuals must provide updated documentation.

The KYC requirements are extensive and require individuals to provide a considerable amount of information to the ARB. It would be very burdensome if full re-verification was required every two years. Rather than providing additional notarized copies of documents, individuals should be given the option to attest that there have been no changes to their information. Individuals should only be required to provide documents again if the relevant piece of information has changed since the previous submission.

SCPPA's proposed changes to section 95834(c)(2) are set out below:

(2) The Executive Officer may re-verify all documents required pursuant to Section 95834 every two years. To allow verification, upon request, the individual must provide updated documentation required pursuant to section 95834(b), or an attestation that the documentation remains unchanged since it was previously submitted pursuant to section 95834.

VII. THE NEW RESOURCE SHUFFLING PROVISIONS ARE WELCOME, BUT ONE MINOR ADDITION WOULD BE HELPFUL.

SCPPA commends the ARB on the changes to the resource shuffling provisions in section 95852(b)(2) of the Regulation. The revised provisions are consistent with the resource shuffling guidance developed by the ARB in 2012 after extensive consultation with electric sector stakeholders.

However, it would be helpful to clarify that it is not resource shuffling if a high-emitting generator has been ramped down, reducing its power output and emissions, and the power is replaced with power from a low-emitting generator. This clarification can be made in "safe harbor" five, in section 95852(b)(2)(A)(5).

SCPPA's proposed changes to section 95852(b)(2)(A)(5) are set out below:

(5) Electricity deliveries that substitute for power previously supplied by a specified source that has been retired or that has reduced its output.

VIII. THE CHANGES TO REC RETIREMENT PROVISIONS ARE WELCOME, BUT SOME ADDITIONAL CHANGES WOULD BE HELPFUL.

A. Changes to section 95852(b)(3)(D) on REC reporting for specified sources are welcome.

Section 95852(b)(3)(D) of the Regulation has been revised to require REC serial numbers to be reported instead of requiring the RECs to be retired in order to claim renewable specified source imports. SCPPA commends the ARB on this change. Reporting REC serial numbers avoids the problem of double-counting RECs without restricting a covered entity's flexibility as to when to retire the REC under the Renewable Portfolio Standard ("RPS").

B. Changes to section 95852(b)(4) on the RPS Adjustment are helpful but some minor further revisions would be helpful.

SCPPA's preferred position continues to be that the ARB should not require RECs to be retired to claim the RPS Adjustment. REC retirement is a crucial part of the RPS program administered by the California Energy Commission. To avoid interfering with that program and to avoid making it more difficult for utilities to meet its challenging goals, no other agencies should require RECs to be retired. The ARB should adopt the same approach to RPS Adjustment RECs as it proposes for specified source RECs: reporting rather than retirement.

However, if this solution cannot be adopted, minor additional changes to sections 95852(b)(4)(A) and (B) should be made to allow for the full variety of transactions that currently take place in relation to electricity eligible to be counted towards the RPS Adjustment. For example, the importer of the electricity substituting for the renewable energy may or may not be the entity that holds title to the RECs and may or may not be the entity that is subject to the RPS program.

SCPPA's proposed changes to sections 95852(b)(4)(A) and (B) (accepting the changes proposed in the September 4, 2013, amendments) are set out below:

> RPS adjustment. Electricity procured ~~by an electricity importer~~ from an eligible renewable energy resource reported pursuant to MRR must meet the following conditions to be included in the calculation of the RPS adjustment:
>
> (A) The electricity importer that imports electricity in substitution for the electricity from the eligible renewable energy resource must have:
>
> 1. Ownership or contract rights to procure the electricity or substituted electricity and the associated RECs generated by the eligible renewable energy resource; or
>
> 2. A contract to import~~procure~~ electricity ~~and the associated RECs~~ on behalf of an entity subject to the California RPS that has ownership or contract rights to the electricity or substituted electricity and associated

> RECs generated by the eligible renewable energy resource, as verified pursuant to MRR.
>
> (B) The RECs associated with the electricity claimed for the RPS adjustment must be placed in the retirement subaccount of the entity subject to the California RPS~~party to the contract in 95852(b)(4)(A)~~, in the accounting system established by the CEC pursuant to PUC 399.13 and designated as retired for the purpose of compliance with the California RPS program during the same year for which the RPS adjustment is claimed.

IX. REVISE DRAFTING IN SECTION 95856 AND AVOID USING THE INACCURATE TERM "SURRENDER."

SCPPA supports the changes to sections 95856(g) and (h) that remove the retirement of compliance instruments for the annual compliance obligation, replacing it with an evaluation of the number and type of compliance instruments in each covered entity's compliance account. However, given this change, it is inappropriate to continue using the term "surrender" in relation to meeting compliance obligations. The word "surrender" indicates that an action must be taken by the covered entity, such as retiring or moving compliance instruments, or nominating compliance instruments to be retired. But no such steps are necessary. The covered entity merely needs to ensure it has sufficient valid compliance instruments in its account on each compliance deadline. The ARB takes all other steps that need to be taken – evaluating (for the annual deadline) or retiring (for the triennial deadline) the compliance instruments. The word "surrender" does not adequately describe this situation. References to "fulfilling" compliance obligations would be more appropriate; this term is already used in some parts of section 95856.

Section 95856(c) requires a covered entity to transfer compliance instruments from its holding account to its compliance account to meet its compliance obligation, and similar language is used in section 95856(f)(1). However, publicly-owned utilities ("POUs") that choose to have some or all of their allocated allowances deposited directly into their compliance accounts may not need to move instruments from their holding account into their compliance

account in order to meet their compliance obligation – they may already have enough instruments in their compliance accounts. Therefore, these sections should be revised.

Section 95856(f)(3) provides that the number of compliance instruments required for the triennial compliance obligation equals the triennial compliance obligation calculated pursuant to section 95853 less compliance instruments surrendered to fulfill the annual compliance obligation for the years in the compliance period. This section should be revised to reflect the fact that compliance instruments will no longer be retired for the annual compliance obligation.

Section 95856(h)(1) provides that the Executive Officer will determine compliance with the annual compliance obligation by evaluating the number and type of compliance instruments in the compliance account in the following order: offsets, Reserve allowances, normal allowances, true-up allowances. However, it is unclear why the order needs to be specified for the annual compliance obligation, as the instruments are not actually being retired, just counted. As long as they are valid (i.e. come from the correct vintage), there is no need to count the instruments in any particular order. Establishing an order is necessary only when retiring instruments for the triennial compliance obligation.

SCPPA's proposed changes to section 95856 are set out below:

> **§ 95856. Timely Fulfillment~~Surrender~~ of Compliance Obligations~~Instruments~~ by a Covered Entity.**
>
> (b) Compliance Instruments Valid to Fulfill Compliance Obligations~~for Surrender~~. …
>
> (c) A covered entity must ~~transfer from its holding account to~~ have in its compliance account a sufficient number of valid compliance instruments to meet the compliance obligation set forth in sections 95853 and 95855.
>
> (d) Deadline for Fulfillment~~Surrender~~ of Annual Compliance Obligations. For any year in which a covered entity has an annual compliance obligation pursuant to section 95855, it must fulfill that obligation: …
>
> (f) Fulfillment~~Surrender~~ of Triennial Compliance Obligation.

(1) The covered entity must have~~transfer~~ sufficient valid compliance instruments in~~to~~ its compliance account to fulfill its triennial compliance obligation by November 1, 5 p.m. Pacific Standard Time (or Pacific Daylight Time, when in effect), of the calendar year following the final year of the compliance period.

(2) The total number of compliance instruments that may be used~~submitted~~ to fulfill the triennial compliance obligation is subject to the quantitative use limit pursuant to section 95854.

(3) The number~~surrender~~ of compliance instruments in the compliance account must be equal to or greater than the triennial compliance obligation calculated pursuant to section 95853~~ less compliance instruments surrendered to fulfill the annual compliance obligation for the years in the compliance period~~.

(g) In determining whether the covered entity has fulfilled its compliance obligations, the Executive Officer shall:

(1) In the case of annual compliance obligations, ~~determine the status of compliance with the annual compliance obligation by ~~evaluate~~ing~~ the number and types of compliance instruments in the Compliance Account in accordance with section 95856(h)(1); and

(2) In the case of triennial compliance obligations:

(A) Retire ~~the ~~compliance instruments in accordance with section 95856(h)(2)~~surrendered~~; and …

(h) Annual and Triennial Compliance Instrument Requirements

(1) ~~When a covered entity or opt-in covered entity surrenders compliance instruments to meet its annual compliance obligation pursuant to section 95856(d), t~~The Executive Officer will determine a covered entity's or opt-in covered entity's compliance with the annual compliance obligation by evaluating the number and type of compliance instruments in its~~the~~ ~~C~~compliance ~~A~~account ~~in the following order ~~and ensuring there are enough valid~~eligible~~ compliance instruments to cover the annual compliance obligation.~~:~~

~~(A) Offset credits specified in section 95820(b) and sections 95821(b) through (d) without consideration of 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); and~~

~~(D) The current calendar year's vintage allowances and allowances allocated just before the annual surrender deadline up to the True-up allowance amount as determined in sections 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 sections 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).~~

(2) ~~When a covered entity or opt-in covered entity surrenders compliance instruments to meet its~~ After each triennial compliance obligation deadline pursuant to section 95856(f), the Executive Officer will retire a covered entity's or opt-in covered entity's compliance instruments~~them~~ from its~~the~~ c~~C~~ompliance a~~A~~ccount in the following order: …

(3) An entity that is not 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), cannot use the current calendar year's vintage allowances or allowances allocated just before the current compliance obligation~~surrender~~ deadline to meet the timely fulfillment~~surrender~~ of compliance obligations~~instrument~~ requirements in section 95856.

X. SPECIFY THAT THE APPLICATION OF THE SET RETIREMENT ORDER WILL NOT RESULT IN POUS BREACHING SECTION 95892(d)(5).

The compliance instrument retirement order in proposed new section 95856(h)(2) raises the prospect of inadvertent breaches of existing section 95892(d)(5). A new sentence should be added to section 95892(d)(5) to address this issue.

POUs are not permitted to use the allowances freely allocated to them by the ARB to cover compliance obligations arising from the generation of electricity that is sold into the CAISO markets (effectively, wholesale sales). Section 95892(d)(5) provides:

> Use of the value of any allowance allocated to an electrical distribution utility, other than for the benefit of retail ratepayers consistent with the goals of AB 32 is prohibited, including use of such allowances to meet compliance obligations for electricity sold into the California Independent System Operator markets.

Proposed new section 95856(h)(2) sets out a mandatory retirement order for compliance instruments on the triennial compliance obligation deadline: offsets, Reserve allowances, normal allowances with earlier vintages retired first, and lastly true-up allowances.

The application of this retirement order may result in a POU inadvertently breaching section 95892(d)(5). This could occur if the POU's retail sales for a year turn out to be lower and its wholesale sales for the year turn out to be higher than expected when the POU distributed its freely-allocated allowances for that year between its compliance account and its limited use holding account.

For example, assume a POU receives (for simplicity) 100 free allowances for 2014. It expects to have 90 tons of emissions from power used to serve its native load in 2014, so it directs 90 of the allowances into its compliance account. The POU expects to have 10 tons of emissions from wholesale power in 2014, for which it cannot use its free allowances, so it sends 10 allowances to its limited use holding account. However, by the end of 2014 it turns out that the POU's emissions from power used to serve its native load were only 80 tons, and its emissions from wholesale power were 20 tons. Assuming that the POU's allocation of free allowances for 2013 matched its native load emissions, and that its governing board has not approved the purchase of offsets, it has 10 too many free allowances in its compliance account for the first compliance period. Even if it purchases 20 allowances at auction to cover its wholesale power emissions, the POU has no way to ensure only 80 of the free allowances are retired. If all 90 are retired, the POU will have inadvertently used free allowances to meet part of its wholesale power emissions liability, breaching section 95892(d)(5).

Furthermore, even if a POU correctly projects its native load and wholesale sales, the fixed retirement order forces the POU to auction the allowances that are in excess of its expected

native load to avoid breaching section 95892(d), even though the POU might have preferred to keep the extra allowances in its compliance account to cover its native load emissions obligation in a future year.

Presumably setting the retirement order was not intended to cause these issues. This should be clarified by inserting a sentence in section 95892(d)(5) stating that the retirement of freely-allocated allowances is not a breach as long as the utility has procured enough other compliance instruments to cover its wholesale power emissions liability.

SCPPA's proposed changes to section 95892(d)(5) are set out below:

> (5) Use of the value of any allowance allocated to an electrical distribution utility, other than for the benefit of retail ratepayers consistent with the goals of AB 32 is prohibited, including use of such allowances to meet compliance obligations for electricity sold into the California Independent System Operator markets ("Non-Retail Compliance Obligation"). Retirement of allocated allowances in accordance with section 95856(h)(2) will not constitute a breach of this section provided that the electrical distribution utility has a quantity of alternative valid compliance instruments in its compliance account at least equal to its Non-Retail Compliance Obligation.

XI. THE PROPOSED COST CONTAINMENT MECHANISM IS USEFUL BUT MAY BE INSUFFICIENT.

The cost containment mechanism set out in proposed new sections 95870(i) and 95913(f)(5) of the Regulation involves taking allowances that would otherwise be auctioned in future years of the cap-and-trade program and putting them into the Reserve. This mechanism is welcome as it would help to contain prices if there is a short-term price spike.

However, this mechanism would not be sufficient to contain allowance prices if there were a long-term supply/demand imbalance. Only a limited number of additional allowances are made available in the Reserve, and in some circumstances such as an extended period of low hydropower and nuclear power availability, low offset availability, and high economic growth the additional supply could be exhausted. Furthermore, the sale of these additional allowances

from the Reserve would increase the scarcity of allowances in later years of the program, potentially contributing to higher prices towards the end of the program.

Therefore, the proposed cost containment mechanism does not appear to satisfy the Board's resolution, which requires a mechanism that ensures that allowance prices will be no higher than the highest price of the Reserve.[6] Insofar as studies show the risk of prices exceeding this level is between 3 percent and 22 percent, depending on the scenario modeled,[7] SCPPA considers that it is very important to comply with the Board's resolution.

To meet the resolution, the ARB should adopt additional measures to constitute a suite of cost containment measures.

A. Provide additional allowances at the highest Reserve price.

The June 25, 2013 ARB paper entitled "Policy Options for Cost Containment in Response to Board Resolution 12-51" ("ARB Paper")[8] outlines in section 3.1 a cost containment option that would provide unlimited additional allowances at the highest price tier of the Reserve. This appears to be the only feasible option presented to date that would ensure that allowance prices will not exceed the highest price tier of the Reserve.

This option should be adopted. The usual Reserve rules would apply, with sales to covered entities only and allowances placed directly in compliance accounts. There does not appear to be any reason to restrict availability of these additional allowances to the final Reserve sale each year or each compliance period. Instead, the additional allowances should be available

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[6] California Cap-and-Trade Program Resolution 12-51, adopted October 18, 2012 ("Resolution") directs ARB staff to recommend cost containment mechanisms that "will achieve the policy objective of ensuring that the allowance prices will not exceed the highest price tier of the Allowance Price Containment Reserve ...". Available at: http://www.arb.ca.gov/cc/capandtrade/final-resolution-october-2012.pdf.

[7] The results are summarized on slide 3 of the June 25, 2013 workshop presentation by James Bushnell for the Emissions Market Assessment Committee, available at: http://www.arb.ca.gov/cc/capandtrade/meetings/062513/jim-bushnell-presentation.pdf.

[8] Available at http://www.arb.ca.gov/cc/capandtrade/meetings/062513/arb-cost-containment-paper.pdf.

at each Reserve sale. Covered entities will only purchase allowances at the highest price tier of the Reserve when no other cheaper compliance instruments are available. Making the additional allowances available at each Reserve sale, not just the September sale, would help prevent prices being driven to extremes during the twelve months between each September Reserve sale. The holding limit should apply to these allowances, as there does not appear to be any rationale for different rules to apply.

B. Maintain environmental integrity by procuring additional emission reductions within California.

The Resolution directs ARB staff to propose measures that contain costs "while minimizing the impact on existing allowances and maintaining the environmental objectives of the program." Therefore, if additional allowances are issued as discussed above, additional emission reductions must be achieved to maintain the environmental integrity of the cap-and-trade program as a whole. There are many ways in which this may be done.

Option 4.3 in the ARB Paper, "Mandate additional emission reductions from California sources," is an option that should be considered. This option is likely to be the most consistent with the current legislative directions about the use of the State's cap and trade revenue,[9] including revenue from the sale of additional Reserve allowances.[10] It may provide a useful part of the solution.

C. Additional measures should be taken to reduce the likelihood of resorting to the above cost containment mechanisms.

In addition to adopting the approach set out in sections XI.A and XI.B above as the only feasible ways to ensure the Resolution is met, the ARB should consider further cost containment

[9] See e.g. Assembly Bill 1532 (2012).

[10] Payments for Reserve allowances will be deposited into the Air Pollution Control Fund pursuant to Regulation section 95913(h)(3).

mechanisms to help avoid, delay, or reduce the need to obtain compensating emission reductions. These measures fall into two categories, both of which are important:

1) Measures that would take effect now and gradually over time reduce the likelihood of prices rising above the Reserve in the future by reducing demand for compliance instruments, increasing the supply of compliance instruments, and ensuring that compliance instruments are accessible in the marketplace.

2) Measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time to address short-term price spikes. A possible trigger is the percentage level of depletion of the Reserve.

For the first category of cost containment measures, the proposals by the Joint Utilities in the paper presented at the June 25, 2013 workshop include:

- Approve more offset protocols to increase the supply of offsets.
- Exempt offsets from projects within California from the 8 percent offset limit.
- Allow each covered entity to carry over any unused portion of its 8 percent offset limit to use for future compliance.
- Address constraints imposed by the current holding limit.

For the second category of cost containment measures, in addition to the mechanism currently proposed in section 95913(f)(5), measures proposed by the Joint Utilities include:

- Unused offset proposal: The ARB would track the number of offsets used for compliance (cumulatively) compared to the number of offsets that would have been used if every covered entity exhausted its 8 percent limit. The difference between the two numbers would be the “8 percent offset shortfall.” Each covered entity would be given the option

to register through the tracking system to receive a proportional share of the 8 percent offset shortfall if the trigger is reached. The registration process ensures that only the entities that are interested in procuring additional offsets are given the ability to do so. Entities that do not register would remain subject to the 8% limit. When the trigger is reached, the ARB would distribute rights to use additional offsets among the registered entities up to the 8 percent offset shortfall in total. The new offset limits for those entities would be calculated to ensure that, if all registered entities surrender offsets up to the new higher level, the 8 percent offset shortfall would be used up but not exceeded. If the 8 percent offset shortfall is not exhausted in that compliance period, a new offset level would be calculated for the registered entities for the next compliance period.[11]

- Compliance account proposal: When the trigger is reached, allow covered entities the flexibility to transfer surplus allowances from their compliance account to their limited use holding account. This allows entities that have built up a bank of allowances in excess of their compliance needs to re-inject those allowances into the market.
- Limited borrowing proposal: When the trigger is reached, allow covered entities to surrender for compliance allowances with vintages of the current year and the following year.
- Offset geographic scope proposal: When the trigger is reached, increase the number of compliance-grade offsets by expanding the geographic scope of the approved offset protocols to North America.

[11] The distribution mechanism that is proposed here is revised from the Joint Utilities proposal.

- Offset project start date proposal: When the trigger is reached, increase the number of compliance-grade offsets by changing the Offset Project Commencement date in sections 95973(a)(2)(B) and (c) of the Regulation to an earlier date.

SCPPA recommends that several (or all) measures from each of category one and category two be adopted to complement the key cost containment mechanisms.

XII. CLARIFY THAT A PREVIOUS OR ONGOING INVESTIGATION, IF DISCLOSED, WILL NOT PREVENT AUCTION PARTICIPATION.

The proposed revisions to section 95912(d)(4)(E) of the Regulation require an entity to attest, as part of its application to participate in an auction, that it:

> has not been subject to any previous or ongoing investigation with respect to any alleged violation of any rule, regulation or law associated with any commodity, securities, or financial market, including a change in the status of an ongoing investigation.

It follows that if an entity has been subject to any previous investigations, it would not be able to make this attestation and therefore could not apply to bid at any auction. This would exclude a large number of covered entities from the auctions. For example, many electric sector entities were investigated as a result of the California electricity market crisis.

At a meeting with utilities on October 3, 2013, ARB staff members stated that this section was not intended to have such a draconian effect, and that entities that were subject to relevant investigations merely need to list them (as provided in the July 2013 discussion draft of the Regulation), and can then participate in the auctions. This position is reasonable. The drafting of section 95912(d)(4)(E) needs to be revised to reflect the staff's intent, as the currently-proposed wording of this section does not allow entities to provide a list of investigations.

ARB staff members also stated that they do not require entities to list all investigations they have been subject to over their history (which would include investigations that were concluded decades ago), but only investigations that (a) are ongoing at the time of the auction

application; or (b) were ongoing at the time of a previous auction application and thus were listed on a previous auction application. These limits are welcome and should be reflected in the Regulation.

Finally, section 95912(d)(4)(E) should be revised to remove the impossible requirement for an attestation that the entity "has not been subject to … a change in the status of an ongoing investigation." All investigations will have changes in their status at some stage. It should suffice for an entity to list its ongoing investigations and note any change in status since the previous auction application.

SCPPA's proposed changes to section 95912(d)(4)(E) are set out below:

> (4) … The entity must provide information and documentation including:
>
> (E) An attestation that the entity participating in the auction, and all other entities with whom the entity has a corporate association, direct corporate association, or indirect corporate association pursuant to section 95833, has not been subject to any previous or ongoing investigation with respect to any alleged violation of any rule, regulation or law associated with any commodity, securities, or financial market~~, including a change in the status of an ongoing investigation~~. If the entity participating in the auction is not able to make this attestation, it must provide a list of such investigations that are ongoing at the time of the auction application or were ongoing at the time of a previous application under this section, noting any change in the status of the investigation since the previous application.

XIII. LIMIT THE ENTITY INFORMATION THAT MUST NOT CHANGE IN THE WEEKS SURROUNDING AN AUCTION OR RESERVE SALE.

A. Revise section 95912(d)(5) on information that cannot change in the 45 days surrounding an auction.

Proposed new section 95912(d)(5) provides that an entity whose auction application information listed in section 95912(d)(4) or account application information listed in section 95830 will change 30 days prior or 15 days after an auction may be denied participation in the auction. If an entity wishes to participate in all four auctions in a year, it must ensure that this

information does not change for 180 days in total – nearly half the year. It will be very difficult, if not impossible, to ensure this information does not change for such a large part of the year.

Account application information listed in section 95830 includes the proposed new requirement to list the entity's employees with information on compliance instrument transactions or holdings (section 95830(c)(1)(I)), as well as the entity's directors and officers and cap-and-trade consultants and advisors (sections 95830(c)(1)(B) and (J)). These people, particularly the employees with information on compliance instrument transactions or holdings, may change from time to time. An entity cannot prevent its employees from resigning for 180 days of the year. Entities should not be barred from participating in auctions merely because one of their employees chooses to leave in the 45-day period surrounding an auction.

Auction application information includes an attestation that the entity and its associates have not been subject to any previous or ongoing investigations, including a change in the status of an ongoing investigation (section 95912(d)(4)(E)). Even if the changes requested in section XII above are made, an investigation may be unexpectedly commenced or the status of an existing investigation may change in the 45-day period surrounding an auction. This should not prevent an entity participating in the auction.

SCPPA understands that the ARB wishes to ensure certain basic information, such as an entity's legal status and its ownership of a holding account, remains unchanged for a reasonable period surrounding each auction, so the ARB can correctly process auction applications and correctly distribute allowances to winning bidders. However, the list of information that must remain unchanged as per proposed new section 95912(d)(5) goes far beyond this objective. This section should be revised to allow changes to an entity's employees with information on

compliance instrument transactions or holdings, its directors and officers, its cap-and-trade consultants and advisors, and its list of investigations.

SCPPA's proposed changes to section 95912(d)(5) are set out below:

> (5) An entity with any changes to the auction application information listed in subsection 95912(d)(4) (other than subsection 95912(d)(4)(E)) or account application information listed in section 95830 (other than subsections 95830(c)(B), (I) and (J)) within 30 days prior to an auction, or an entity whose auction application information (other than information pursuant to subsection 95912(d)(4)(E)) or account application information listed in section 95830 (other than subsections 95830(c)(B), (I) and (J)) will change within 15 days after an auction, may be denied participation in the auction.

B. Revise section 95912(e) regarding maintenance and modification of auction approval.

Section 95912(e)(1) states that once an entity is approved for an auction, it does not need to submit an application for future auctions unless:

> there is a material change to the information contained in the approved application, there is a material change in the entity's Cap-and-Trade Program registration pursuant to section 95830 …

If a change in the status of an investigation (section 95912(d)(4)(E)), or the arrival or departure of an employee with information on compliance instrument transactions or holdings (section 95830(c)(1)(I)), constitute a "material change", large entities would have to complete full auction applications for virtually every auction. The information that should be excluded from section 95912(d)(5), as discussed above, should also be excluded from section 95912(e)(1).

SCPPA's proposed changes to section 95912(e)(1) are set out below:

> (1) Once the Executive Officer has approved an entity's auction participant application, the entity need not complete another application for subsequent auctions unless there is a material change to the information contained in the approved application (other than information pursuant to subsection 95912(d)(4)(E)), there is a material change in the entity's Cap-and-Trade Program registration pursuant to section 95830 (other than subsections 95830(c)(B), (I) and (J)) ...

Section 95912(e)(2) provides that:

> An entity approved for auction participation must inform the Auction Administrator at least 30 days prior to an auction when reporting a change to the information disclosed, otherwise the entity may not participate in that auction. …

The purpose of this section is unclear. From section 95912(e)(1), it appears that if an entity has a material change to the relevant information since it was previously approved for an auction, it must complete another full auction participant application pursuant to section 95912(d)(4). Is the report to the Auction Administrator under section 95912(e)(2) intended to be in addition to, or in substitution for, a full auction participant application?

If a full auction participant application is required, an additional report (with the same deadline) under section 95912(e)(2) seems unnecessary, and this section should be revised to direct the applicant to comply with section 95912(d)(4) again.

If this report is in substitution for a full auction participant application, section 95912(e)(1) should be amended to make this clear. In addition, section 95912(e)(2) should be amended to clarify that a "change to the information disclosed" does not include changes to information disclosed under sections 95830(c)(B), (I) and (J), or section 95912(d)(4)(E).

C. Revise section 95913(e)(2) on information that cannot change in the 35 days surrounding a Reserve sale.

Proposed new section 95913(e)(2) provides that an entity with auction application information listed in section 95912(d)(4), or account application information listed in section 95830, that changes 20 days prior to or 15 days after a Reserve sale may be denied participation in that Reserve sale. For the reasons outlined in section XIII.A above, this section should be revised to allow an entity to participate in a Reserve sale despite changes to its employees with information on compliance instrument transactions or holdings, its directors and officers, its cap-and-trade consultants and advisors, and its list of investigations.

SCPPA's proposed changes to section 95913(e)(2) are set out below:

> An entity with any auction application information listed in subsection 95912(d)(4) (other than subsection 95912(d)(4)(E))~~above~~ or account application information listed in section 95830 (other than subsections 95830(c)(B), (I) and (J)) that changes within 20 days prior to a reserve sale, or within 15 days after a reserve sale, may be denied participation in a reserve sale.

XIV. IF A BIDDING ADVISOR FAILS TO PROVIDE INFORMATION TO ARB, THE ENTITY ENGAGING THE BIDDING ADVISOR SHOULD NOT BE PENALIZED.

Revised section 95914(c)(3) requires information regarding bidding advisors to be provided to the ARB by both the entity engaging the bidding advisor and the bidding advisor itself. Section 96010 (Jurisdiction) does not appear to provide the ARB with authority to regulate bidding advisors, as they will not be registering for accounts, holding compliance instruments, verifying offsets, or receiving compensation from transfers of compliance instruments. If a bidding advisor fails to provide the ARB with the information requested under section 95914(c)(3)(D), the ARB should not penalize the covered entity in place of the bidding advisor. A bidding advisor may work as an independent contractor to several covered entities, and the covered entities will not necessarily be aware of, and should not be liable for, the acts or omissions of independent contractors.

XV. DEADLINES TO COMPLETE TRANSFER REQUESTS SHOULD BE REVISED.

Section 95921(a)(1)(E) of the Regulation requires compliance instrument transfer requests to be completed within three days of "settlement" of the transaction agreement for which the transfer request is submitted. Section 95921(a)(3) further provides that entities will be in violation and penalties may apply if compliance instrument transfer requests are completed:

> (A) More than three days after the initial submission of the transfer request; or

(B) More than three days after the execution date or termination date of the transaction agreement for which the transfer request is submitted; or

(C) More than three days after the transfer of consideration from the purchaser of the compliance instrument to the seller as provided by the transaction agreement; or

(D) More than three days after the execution of the underlying trade on an exchange or other trading platform.

"Execution date" in section (B) means a date set out in the agreement by which compliance instruments must be transferred (section 95802(a)(130)).

A. Sections 95921(a)(1)(E) and 95921(a)(3)(B) to (D) should be deleted.

These provisions are problematic from a policy perspective and a practical perspective. It is unnecessary and inappropriate for the ARB to impose a transfer deadline relating to the transaction agreement. Transaction agreements themselves will contain provisions on the dates by which transfers must be completed, and they will also contain penalty provisions if these dates are not met. It should not be relevant to the ARB whether an entity completes a transfer request by the date specified in the transaction agreement or within a certain time of the transfer of consideration, or completes it later, as the ARB does not enforce transaction agreements. Therefore, SCPPA considers that sections 95921(a)(1)(E) and 95921(a)(3)(B) to (D) should be deleted.

For the purposes of comparison, the provisions in the Quebec "Regulation respecting a cap-and-trade system for greenhouse gas emission allowances" on emission allowance transactions contain only a requirement to complete a transfer within three days of the start of the transfer process,[12] similar to section 95921(a)(3)(A) of California's Regulation. There are no transfer deadlines that relate to the underlying transaction agreement.

[12] Section 26 of the Quebec regulation.

B. If section 95921(a)(1)(E) is not deleted, change the term "settlement date."

If these sections must be retained, they require several amendments. Section 95921(a)(1)(E) currently refers to the "settlement date." However, not all agreements have a defined settlement date. Furthermore, agreements for multiple transfers of compliance instruments over time will have multiple dates by which transfers must be made, and none of these may be referred to as "settlement dates." In the rationale for the proposed changes to section 95921(a)(3)(B), the ISOR notes that the term "settlement date" is unclear in relation to certain types of agreements.[13] For these reasons, the term "settlement date" should be avoided in section 95921(a)(1)(E) also.

C. Section 95921(a)(3)(C) is unnecessarily restrictive.

Section 95921(a)(3)(C) is particularly problematic. It prohibits transfers of compliance instruments more than three days after the transfer of consideration under the agreement. The meaning of "consideration" is unclear, but assuming it refers to payment for the compliance instruments, this provision prohibits all types of down payments, advance payments, deposits or early lump sum payments. This unnecessarily restricts the ability of contracting parties to enter into agreements that suit them.

For bundled transactions, e.g. those that transfer allowances and electricity for a bundled price, this provision would also prohibit the parties from agreeing a payment schedule that matches the schedule for delivery of electricity. The parties must instead agree a payment schedule that matches the transfer of allowances, which may be on a very different timeframe from the delivery of electricity. For example, electricity may be required in particular seasons or times of day due to load considerations, whereas the parties may agree to transfer allowances a

[13] ISOR page 193.

month before the annual compliance deadlines. The application of section 95921(a)(3)(C) to agreements that do not provide a price for the compliance instruments (such as the types of agreements listed in section 95921(b)(6)) is also unclear.

In the rationale for section 95921(a)(3)(C), the ISOR states that payments need to be immediately followed by the transfer of compliance instruments to avoid creating the type of "holding on behalf" that is prohibited under section 95921(f)(1).[14] This section provides that:

> An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity Including [*sic*] 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*. ... [emphasis added]

However, if Entity A transfers compliance instruments to Entity B more than three days after Entity B paid for them,[15] this would not give Entity B any ownership interest in, or control over, the compliance instruments in Entity A's account. Entity B only has a contractual right to receive the compliance instruments by the dates specified in the agreement. If Entity A does not transfer the instruments on time, Entity B could pursue the remedies provided in the agreement, for example liquidated damages. Note also the italicized sentence in section 95921(f)(1)(B), above.

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[14] ISOR page 193.

[15] For example, in accordance with an agreement that provides for a deposit to be paid at the start of the year with transfers scheduled for later in the year and a true-up payment at the end of the year.

Furthermore, given that section 95921(f)(1) exists, there is no need to include other provisions that seek to prohibit situations that are already prohibited (with the appropriate caveats) under section 95921(f)(1).

For these reasons, section 95921(a)(3)(C) must be deleted, even if the other subsections of section 95921(a)(3) are retained.

D. If section 95921(a)(3) is not deleted, it should be revised for clarity and the deadlines should be reconsidered.

Section 95921(a)(3) should be redrafted for clarity – presumably it means penalties may apply if transfers are not completed within three days of the earliest to occur of events (A)-(D). However, a period of three days is not appropriate in all cases. Furthermore, the termination date mentioned in (B) should be a separate subsection. It is listed apparently as an alternative to the "execution date", but it bears no relationship to that date. As noted in section II.A above, the term "execution date" should be changed to "agreement transfer date," as "execution date" is easily confused with the date on which the parties signed the agreement. This term may be appropriate for section 95921(a)(1)(E) also, in place of the unclear "day of settlement."

For these reasons, sections 95921(a)(1)(E) and (a)(3) of the Regulation should revised as follows, if they cannot be deleted entirely:

> (1)(E) The completed transfer request must be received by the accounts administrator no more than 30~~three~~ days following the agreement transfer date~~day of settlement~~ of the transaction agreement for which the transfer request is submitted. ...
>
> (3) The parties to a transfer will be in violation and penalties may apply unless~~if~~ the above process is completed by the earliest to occur of the following dates:
>
> (A) ~~More than t~~Three business days after the initial submission of the transfer request; or

(B) ~~More than three~~Thirty days after the agreement transfer~~execution~~ date ~~or termination date~~ of the transaction agreement for which the transfer request is submitted; or

(C) Thirty days after the termination date of the transaction agreement for which the transfer request is submitted~~More than three days after the transfer of consideration from the purchaser of the compliance instrument to the seller as provided by the transaction agreement~~; or

(D) ~~More than three~~ Fifteen days after the execution of the underlying trade on an exchange or other trading platform.

XVI. MINIMIZE ADDITIONAL DATA ON COMPLIANCE INSTRUMENT TRANSACTIONS AND CLARIFY HOW ARB WILL USE THIS DATA.

The proposed revisions to section 95921(b) of the Regulation require entities to provide more information on compliance instrument transactions when requesting transfers of compliance instruments in the tracking system, particularly for customized bilateral transactions and exchange-traded contracts.

For customized bilateral agreements, the additional information includes:

- If the contract contains provisions for further compliance instrument transfers, the transfer frequency (e.g. quarterly);
- If the contract is a “bundled” purchase of instruments and other products, the products, for example, natural gas; and
- How the price is determined, for example, fixed price or base plus margin.

For exchange-traded contracts, the additional information includes:

- Name of exchange and exchange code;
- Type of contract (spot, future);
- Date of close of trading for the contract; and
- Price at close of trading.

ARB staff members have stated that this information is required for market monitoring purposes. However, the extent to which the ARB can or should regulate the secondary market in allowances and offsets is debatable. Other agencies that currently monitor commodities and financial markets will have jurisdiction over this market and have the tools and expertise to monitor it.

The ARB should clearly state how it intends to analyze the data reported under section 95921(b) and provide assurances as to the confidentiality of this data. Transaction information is commercially sensitive, and the ARB must ensure that if it provides any transaction data to the market, the data is aggregated so that it cannot be traced to individual entities.

XVII. CLARIFY THAT CONSULTANT AND ADVISOR DISCLOSURE REQUIREMENTS DO NOT INCLUDE ATTORNEYS.

Proposed new section 95923 requires registered entities to report to the ARB details on "Cap-and-Trade Consultants or Advisors", defined as a person or entity that is not an employee of the registered entity but is paid for information or advice related to the Cap-and-Trade Program for the registered entity.

The reference to advice related to the Cap-and-Trade Program would, on its face, include attorneys advising clients on the program. If an entity discloses the work performed by its attorneys under section 95923(b)(2),[16] this may constitute a waiver of attorney-client privilege. Entities may wish to preserve this privilege. Furthermore, attorneys are already subject to stringent confidentiality and conflict of interest requirements under the California Rules of Professional Conduct. Therefore, there is no need for this section to include attorneys. ARB staff members confirmed in a teleconference on October 10, 2013, that this section is not intended to cover attorneys.

[16] This section requires "A brief description of work performed by the Consultant or Advisor."

This section should be revised to clearly exclude attorneys. In addition, to reduce the reporting burden a simple online form should be developed, perhaps in the tracking system, for an entity to complete if it engages a consultant or advisor.

SCPPA's proposed changes to section 95923(a) are set out below:

> (a) A "Cap-and-Trade Consultant or Advisor" is a person or entity that is not an employee of an entity registered in the ~~c~~Cap-and-T~~t~~rade Program, but is paid for information or advice related to the Cap-and-Trade Program specifically for the entity registered in the Cap-and-Trade Program. Cap-and-Trade Consultants and Advisors do not include attorneys.

XVIII. CONCLUSION

SCPPA appreciates the opportunity to submit these comments to the ARB and urges the ARB to consider these comments when preparing revisions to the Regulation for 15-day public comment. If further information is required, we would be happy to discuss any of the proposals in these comments with ARB staff. We look forward to continuing to provide input to the ARB as these revisions to the Regulation are finalized.

Respectfully submitted,

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