COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY TO THE CALIFORNIA AIR RESOURCES BOARD ON THE JANUARY 2014 INFORMAL DISCUSSION DRAFT OF AMENDMENTS TO THE CALIFORNIA CAP-AND-TRADE PROGRAM

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I.

INTRODUCTION

Southern California Edison Company ("SCE") respectfully submits its comments to the California Air Resources Board ("ARB") on its January 2014 Informal Discussion Draft on Proposed Amendments to the California Cap-and Trade Regulation[1] ("Discussion Draft").[2] SCE appreciates the ARB's release of this informal discussion draft so that interested parties have ample opportunity to comment on the proposed amendments. SCE supports the ARB's proposed language (1) allowing an investor-owned utility ("IOU") to disclosure auction information pursuant to a California Public Utilities Commission ("CPUC") directive and (2) modifying the requirements for transfer requests. In addition, SCE's proposes the following changes to the Discussion Draft:

- Auction applications should not be required to disclose information regarding market investigations concerning other entities with which they share a corporate association;
- A change in the status of a market investigation should not be a basis for denying an entity's auction application;
- The Compliance Instrument Tracking System Service ("CITSS") User Terms and Conditions should protect confidential information from public disclosure, and should make the Western Climate Initiative ("WCI"), Inc. responsible for the proper functioning of the CITSS web platform;
- Additional modifications should be made to the Renewable Energy Credit ("REC") retirement requirements for Renewable Portfolio Standard ("RPS") adjustment claims;

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[1] Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms ("Cap-and-Trade Regulation"), Cal. Code Regs., tit. 17, § 95856(f)(1).

[2] California Air Resources Board, Cap-and-Trade Regulation Informal Discussion Draft January 2014 ("Discussion Draft") .

- Entities should be permitted to select which compliance instruments they will use to meet their own compliance obligations;
- The ARB should modify draft regulation language requesting employee contact information.

II.

THE ARB SHOULD REMOVE THE REQUIREMENT FOR AUCTION APPLICANTS TO DISCLOSE INFORMATION REGARDING MARKET INVESTIGATIONS OF ASSOCIATED CORPORATED ENTITIES

The proposed amendments to Section 95912(d)(4)(E) in the Discussion Draft require entities applying to participate in an ARB auction to disclose "the existence and status of any ongoing investigation or an investigation that has occurred within the last ten years" for market rule violations committed by an entity with which the participating entity shares a direct or indirect corporate association. As discussed below, state and federal agency rules and regulations may frustrate ARB auction participants' ability to comply with this draft amendment.

Specifically, SCE operates as a wholly-owned subsidiary of a parent company that also wholly or partially owns other subsidiary entities. State and federal regulators of IOUs refer to those other subsidiary companies as "affiliates." Those regulators' rules and regulations governing the conduct of affiliated entities may prevent entities like SCE from fully complying with this proposed amendment. For instance, existing affiliate rules, in some instances, may prohibit SCE employees from accessing information regarding previous or ongoing investigations of affiliated entities. It is therefore not reasonable to impose a duty on SCE and other similarly situated entities to make the disclosure required by the proposed amendment.

III.

THE ARB SHOULD NOT MAKE A CHANGE IN THE STATUS OF A MARKET INVESTIGATION A BASIS FOR DENYING AN ENTITY'S AUCTION APPLICATION

SCE appreciates the ARB's revision of the requirements for an auction application in Section 95912(d)(4)(E) of the Discussion Draft specifying that the attestation associated with the application need only disclose the existence of any market investigations against the entity, rather than attesting to the absence of any such investigations. This change should give compliance entities significantly more certainty and confidence regarding their ability to participate in the ARB quarterly auctions. To provide auction participants with full confidence, however, the ARB should also amend Section 95912(d)(5) of the Discussion Draft to clarify that any changes in the existence or status of market investigations that have been disclosed in the auction application will not provide a basis for denying that entity participation in the auction.

It is not reasonable to deny an entity participation in an auction solely based on the opening or status change of an investigation against that entity, without any conviction or penalty assessed, within 30 days prior to or 15 days following the auction date. First, it is common practice for regulators in power, natural gas, securities, and other markets to investigate the actions of many market participants in response to any abnormal functioning of the market. Such regulators do not always inform the market participants that they are being investigated, and the investigations frequently conclude with many, if not all, of the investigated entities cleared of any charges.

Second, the ARB's existing regulatory controls are sufficient to govern auction conduct and monitor the market. There is no basis for concluding that further restricting participation merely because of the existence of an incomplete investigation, which may be unrelated to the entity's participation in the ARB allowance market, will enhance the proper functioning or security of the auction process. To the contrary, such an arbitrary restriction could encourage market players to forego the quarterly auctions in favor of secondary markets for allowances,

which tend to have significantly lower liquidity and ARB oversight. Thus, unduly restrictive regulatory control measures could have the unintended consequence of raising compliance costs for all entities and impeding the functioning of the allowance market.

IV.

THE CITSS USER TERMS AND CONDITIONS SHOULD CONFORM WITH INDUSTRY STANDARDS REGARDING THE PROTECTION OF CONFIDENTIAL INFORMATION AND WEBSITE RELIABILITY

As currently proposed in Appendix B of the Discussion Draft, the Compliance Instrument Tracking System Service ("CITSS") User Terms and Conditions contain provisions that are inconsistent with industry standards for website reliability and the confidentiality of user information. SCE proposes that the ARB harmonize its regulations with those industry standards because inconsistencies may force participating entities to choose between obeying their internal risk policies governing the use of internet platforms or complying with the cap-and-trade regulation, which provides for no alternative compliance mechanism outside of the CITSS.

The proposed language of the CITSS User Terms and Conditions inadequately safeguards the confidential information compliance entities and others store on the CITSS web platform. For example, the Terms and Conditions state that the ARB "may disclose Content to the public to the extent the disclosure is … [not prohibited] by California law," where Content is defined as "all information, data, text, or other materials that User provides to ARB or Western Climate Initiative ("WCI"), Inc. through use of CITSS." The ARB likely lacks sufficient resources to determine whether information is protected as confidential under California law, which is vast and exists in agency regulations, case and common law, and statutes, much less whether compliance entities protect the privacy of information as a matter of policy or contractual obligation. This regulation therefore presents a risk that ARB could inadvertently run afoul of California law.

In fact, with respect to market sensitive information, the California Public Utility Commission ("CPUC") Matrix of Allowed Confidential Treatment Investor Owned Utility ("IOU") Data protects the IOUs' Net Open Position Information as confidential due to its market-sensitive nature. Thus, position information stored in CITSS is clearly protected from disclosure by regulations promulgated by another State agency. The protection of market sensitive information is critical to proper operation of the allowance market. If, for instance, the proposed language is interpreted as giving the ARB the discretion to release holding and compliance account information to the public without a significant lag time (i.e. after the end of a compliance period), such a release could encourage manipulation of the allowance market because the public could gain insight into compliance entities' bid strategies and take advantage of any entity with a short position near the end of a compliance period.

In addition, the Discussion Draft's reliability standards for CITSS represent a significant departure from established industry standards. CITSS is presently the only available mechanism for meeting compliance obligations, but Section 4.1 of the CITSS User Terms and Conditions prohibits compliance entities from seeking any legal recourse or damages against the ARB or WCI, Inc. for any failure of the CITSS platform. The ARB and WCI, Inc. are thus insulated from liability if the CITSS platform fails and prevents compliance entities from meeting their compliance obligations in a timely manner. As a result, if a compliance entity is unable to meet its compliance obligation due to a CITSS platform failure, the compliance entity would be exposed to penalties without any corresponding recourse against the platform operator.

The current industry standard for user agreements involving Internet platforms includes an availability guarantee by the platform operator of 99 percent availability or more. Not only does the ARB fail to make any such guarantee of the availability of the CITSS, it places the burden of economic harm on compliance entities in the event its Internet platform malfunctions. To be consistent with well-established standard industry practice, the ARB should revise the liability provisions of the CITSS User Terms and Conditions to specify that WCI, Inc., as the creator and operator of the platform, will guarantee the availability of the CITSS platform to

registered users at least 99 percent of the time, and that the ARB will postpone compliance deadlines in the event of a failure of the CITSS platform at any point during the 72-hour period preceding a compliance deadline.

V.

SCE REQUESTS ADDITIONAL MODIFICATION TO REC RETIREMENT REQUIREMENTS FOR RPS ADJUSTMENT CLAIMS

SCE appreciates the ARB's attempts to clarify the Renewable Energy Credit ("REC") retirement requirements for RPS adjustment claims. SCE suggests that ARB adjust the language to ensure that it is consistent with the compliance timeframe established under California's RPS program. Specifically, SCE suggests the following modifications to Section 95852(b)(4)(B) of the Discussion Draft:

> The RECs associated with the electricity claimed for the RPS adjustment must be placed in the retirement subaccount of the entity 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~~ within 45 days of the reporting deadline in section 95103(e) of **the** MRR for the year which the RPS adjustment is claimed. **The RECs must be designated as retired for the purpose of compliance with the California RPS program on a schedule consistent with the rules governing that program.**

VI.

COVERED ENTITIES SHOULD BE PERMITTED TO SELECT THE COMPLIANCE INSTRUMENTS THEY WILL USE TO MEET COMPLIANCE OBLIGATIONS

A. SCE Supports the Retirement Flexibility ARB Staff Proposed at the July Workshop

At the July 18, 2013 ARB Workshop to discuss Proposed Amendments to the California Cap-and-Trade Program, regulated entities expressed their opposition to the compliance instrument retirement order proposed by ARB staff. To address those concerns, ARB Staff suggested that they might allow covered entities to select which compliance instruments in their

compliance account to retire prior to a compliance deadline. If entities were permitted to self-select the compliance instruments they wish to retire, the ARB-proposed compliance instrument retirement order would only need to be exercised if a covered entity failed to select enough instruments to fulfill its compliance obligation.

SCE supports the ARB's suggested framework and urges the ARB to adopt provisions in the Cap-and-Trade Regulation for compliance entities to self-select compliance instruments for retirement. Such retirement flexibility will allow compliance entities to better manage their portfolios and will reduce the administrative burden for the regulatory agency. By allowing covered entities to select compliance instruments for retirement, the ARB's regulations would also be consistent with other environmental compliance trading programs, including the United States Environmental Protection Agency's Acid Rain Program and California's RPS program.

B. The Proposed 8 Percent Annual Offset Usage Limit Would Reduce Compliance Flexibility and Put Additional Pressure on the Holding Limits of Covered Entities

The proposed amendments released in the ARB's July 2013 discussion draft for the California Cap-and-Trade Regulation would have allowed the ARB to take offsets from an entity's compliance account in excess of the current 8 percent offset usage limit. Staff had indicated that excess offsets would not be returned to the compliance entity's account, nor would they be used for compliance anywhere within the cap-and-trade program.

In the current Discussion Draft, staff has contemplated solving this problem by applying an 8 percent offset usage limit to each annual compliance obligation[3]. Imposing an annual compliance limit of 8 percent does not solve the serious problems associated with excess taking of compliance instruments. The 8 percent limit would reduce compliance flexibility for covered entities. Instead of imposing an annual limit on the volume of offsets that can be surrendered to meet a compliance obligation, the ARB's staff should enable covered entities to select the

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[3] Discussion Draft, Section 95830(c)(1)(i), at 75

individual compliance instruments they will surrender for compliance. As stated above, the ARB should only retire compliance instruments from a covered entity's compliance account according to the proposed retirement order if the entity fails to select sufficient compliance instruments to meet its own compliance obligation.

C. Compliance Instruments Should Only Be Retired to Satisfy Compliance Obligations

If the ARB pursues the current regulatory approach for retiring offsets according to the proposed retirement order, staff should develop an approach in which any offsets taken in excess of the 8 percent limit for a given compliance period would be returned to the regulated entity's General Account and be eligible for retirement to meet a compliance obligation in a future compliance period. Additionally, the ARB should affirm its commitment to only retire compliance instruments used to satisfying a direct compliance obligation. In addition to the potential for the excess taking of offsets referenced in Section 95830, the Discussion Draft describes a scenario in which future vintage compliance instruments allocated to an entity that ceases operations will be submitted to the Executive Officer for retirement.[4] Pursuant to the definition of "retirement," any compliance instruments submitted to the Executive Officer for retirement cannot be removed and used for compliance.[5] Retiring compliance instruments that have previously been allocated to entities that have since ceased operations would artificially reduce the cap, raising compliance costs for all covered entities in the cap-and-trade program. To avoid that outcome, the ARB should explicitly clarify that compliance instruments will only be retired to satisfy a direct compliance obligation. Furthermore, staff should add language to the Discussion Draft that clearly presents a mechanism for returning any surrendered compliance instruments that cannot be used to satisfy a compliance obligation back to the entity that surrendered them, or else to the market in general.

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[4] Discussion Draft, Section 95812(f)(3), at 67.
[5] Discussion Draft, Section 95802(322), at 53.

D. The Regulations Should Address the Proper Order of Retirement if an Entity Fails to Self-Select

Even if SCE's proposed self-selection framework is adopted, the regulations must still address the proper order for the retirement of compliance instruments if an entity fails to self-select. SCE proposes that in the event of such a failure, in November following the first year of the compliance period, the Executive Officer would retire offsets equal the lessor of all the offsets in the regulated entity's compliance account or eight per cent of the annual compliance obligation (2.4 percent of the reported emissions for that year). The remaining annual compliance obligation would be satisfied with allowances. The same formula would be followed for the second year of the compliance period. Following year three of the compliance period, the EO would retire offsets equal to eight per cent of emissions reported for Year One (less) the number of offsets retired for the Year One annual compliance obligation plus eight per cent of the emissions reported for Year Two (less) the number of offsets retired for the Year Two annual compliance obligation plus eight per cent of the emissions reported for Year Three.

VII.

THE ARB SHOULD MODIFY DRAFT REGULATION LANGUAGE REQUESTING EMPLOYEE CONTACT INFORMATION

The ARB should modify the Discussion Draft language requesting disclosure of employee contact information by further clarifying what type of employee responsibilities would necessitate a disclosure. As currently proposed, the ARB is requesting names and contact information for "all persons employed by the entity who have clearance from the entity to approve, initiate, or review transaction agreements, transfer requests, or account balances involving compliance instruments in the Cap-and-Trade Program or any External GHG ETS linked pursuant to subarticle 12."[6] The requirements imposed by the proposed language in

[6] Discussion Draft, Section 95830(c)(1)(i), at 75.

Section 95830(c)(1)(I) of the Discussion Draft are unclear,[7] would result in the reporting of a large number of employees, and could present an onerous administrative challenge for covered entities.

The requirements of Section 95830(c)(1)(I) are particularly onerous for large market participants, as many large covered entities have hundreds of employees with the ability to review compliance instrument holdings information, though most have no role in transaction decision-making.[8] Because the roles and responsibilities of these employees change frequently, managing and updating a list with contact information for all these employees would require a large and sustained administrative effort.

In addition, the consequences for failing to submit this information appear to be directed at Voluntary Associated Entities ("VAEs") and individual tracking accounts, making the implications unclear for large covered entities such as SCE. The ARB's efforts to prevent conflicts of interest would be better addressed by focusing its efforts on VAEs and consultants hired as market advisors, rather than requiring large covered entities to undertake onerous reporting processes that provide little value to the ARB's market monitoring efforts.

VIII.

SCE SUPPORTS THE ARB'S PROPOSED LANGUAGE REGARDING DISCLOSURES PURSUANT TO CPUC ORDER AND TRANSFER REQUEST REQUIREMENTS

SCE supports the ARB's proposed modifications to Section 95914(c)(2)(D) of the cap-and-trade regulation to allow CPUC-required disclosures of confidential auction information by IOUs. SCE encourages continued interagency collaboration between the ARB and the CPUC on disclosure and other overlapping requirements. SCE also supports the ARB's proposed

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[7] For example, it is not clear what "review" would mean in this proposed section.

[8] Taken to the extreme, covered entities would have to include contact information for administrative assistants that type up contracts, file clerks, or even IT personnel responsible for data systems.

modification to Section 95921(a)(3) to clarify the timing requirements for transfer requests. The revised language is compatible with established transactional processes.

IX.

CONCLUSION

SCE appreciates the opportunity to comment on the Discussion Draft, as well as the ARB's continuing consideration of SCE's proposed changes regarding cost containment, confidentiality, and market design issues as it develops the proposed amendments to the Cap-and-Trade Regulation.

Respectfully submitted,

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