February 18, 2014

Dr. Steven Cliff, Assistant Division Chief, Stationary Source Division
Ms. Rajinder Sahota, Chief, Climate Change Program Evaluation Branch
Mr. Shelby Livingston, Chief, Climate Change Program Planning/Management Branch
Ms. Elizabeth Scheele, Manager, Program Development Section
Mr. Greg Mayeur, Manager, Program Operations Section
Ms. Mary Jane Coombs, Manager, Program Monitoring Section

California Air Resources Board
1001 I Street
P.O. Box 2815
Sacramento, CA 95812

Sacramento Municipal Utility District's Comments on Discussion Draft 15-Day Language -- Amendments to California's Cap-and-Trade Program

SMUD appreciates the opportunity to comment on the Discussion Draft 15-day Cap-and-Trade Language (Discussion Draft) detailing the latest proposed amendments to California's Cap-and-Trade program. SMUD generally supports the direction of change found in the Discussion Draft 15-day language. In these comments, SMUD responds to the request by ARB staff for stakeholder feedback on the issue of application of the 8% offset limit to the annual surrender requirement. SMUD also reiterates comments below regarding issues not included in the Discussion Draft yet, but which SMUD believes will help make the Cap-and-Trade program work better and are within the scope of the current rulemaking.

I. ARB Should Include Amendments To The Cap-and Trade Regulations That Allow Flexibility In CITSS Account Participation.

As SMUD commented last summer, the Cap-And-Trade regulations currently allow Primary and Alternative Account Representatives to register in CITSS and have the authority to transfer allowances among accounts as a "settlement" function per the definitions of these roles in §95802(13) and §95802(271), along with the registration structure established in §95832. These CITSS participants are also allowed to participate in the quarterly auctions per §95912 – in fact, a PAR or AAR CITSS registration is required to participate in these auctions (as well as the APCR auctions, when held).

However, in SMUD, and in many other companies, these "settlement" and "trading" or auction participation functions are strictly and explicitly separated for transaction integrity reasons, so the broad authority provided to PARs and AARs by the Cap-and-Trade regulations to participate in both CITSS allowance transfers and accounting as well as auction participation is inconsistent with standard protocols in this area. SMUD has previously requested a slight change in the Cap-and-Trade regulations in order to allow an eventual change in CITSS functionality to address this issue. ARB staff has presented no rationale for not making this slight change. Hence, SMUD continues to suggest that the Cap-And-Trade regulations should be modified to allow participating entities the eventual flexibility to designate specific roles in CITSS for entity personnel. The change recommended by SMUD would be to add the phrase ***"… as specified by the entity***" to the definitions for PARs and AARs in §95802(13) and §95802(271). These definitions would now read:

> 95802(13) "Alternate Account Representative" means an individual designated pursuant to section 95832 to take actions on an entity's accounts, as specified by the entity.
>
> 95802(271) "Primary Account Representative" means an individual designated pursuant to section 95832 to take actions on an entity's accounts, as specified by the entity.

SMUD believes that this change is within the scope of 15-day changes because §95802 already includes many modifications, including renumbering of the specific subsections for AAR and PAR, and there are proposed changes in §95912 where PARs and AARs have functional responsibilities. Other definitions in §95802 have been added in proposed 45-day and 15-day changes to reflect new changes in sections in which those definitions are used, and these changes are presumably defined as "in-scope" even when the particular definition added is entirely new. In addition, SMUD believes that the change will be useful for a variety of market participants in addition to SMUD, and that the proposed change is noncontroversial and uncomplicated. SMUD again encourages ARB to include this small change, finding it within the scope of 15-day comments.

II. SMUD Believes That The 8% Offset Limit Should Be Applied To Ensure It Is Fully Available To The Market.

The Discussion Draft requests stakeholder input regarding whether the ARB should apply the 8% limit on offsets to the 30% annual surrender process as well as the triennial surrender process at the end of a compliance period. The Discussion Draft 15-day language would not apply that limit to the annual surrender process, potentially resulting in loss of offsets to obligated entities and the market supply. SMUD believes that the ARB should find a way to apply the offset limit to annual surrender, or develop an equivalent process (as had been included in the 45-day language), to avoid the

confiscatory and supply-reducing potential loss of offsets if entities mistakenly place offsets into their compliance accounts in the initial years of a compliance period. Such a loss affects the entire Cap-and-Trade market.

ARB had indicated in the initial draft of Cap-and-Trade modifications in July 2013 that the offset limit would not be enforced for annual compliance, and hence the annual surrender process would simply take all offsets in a compliance account as the first contribution to the 30% requirement. This policy would raise the possibility that any offsets in an entity's compliance account beyond the overall 8% limit would be simply lost – to the compliance entity and to the market. SMUD sees no valid policy reason to add to the potential for higher compliance costs by enforcing the offset limit in this manner, where potential mistakes by obligated entities would reduce compliance period supply.

Subsequently, ARB's proposed 45-day language last fall avoided this problem by indicating that there would be no actual "surrender" of allowances during the annual, partial, compliance process – rather, ARB would simply confirm that sufficient instruments were in each entity's compliance account to reach compliance had annual surrender been required. This would have preserved any offsets in an entity's compliance account above the 8% limit, allowing them to, in effect, be banked for the following compliance period. The 15-day Discussion Draft rescinds this 45-day change, returning to the earlier concept from July 2013.

SMUD believes that the ARB should return to the 45-day language structure, or otherwise find a way to avoid the possibility of confiscating offsets from entities and reducing the overall supply of compliance instruments in the market. If the proposed 45-day language solution is no longer considered viable, SMUD suggests that ARB consider the following alternatives:

- Apply the 8% limit only on the actual 30% annual surrender, so that any offsets above 2.4% of actual annual emissions would remain in compliance accounts, unsurrendered. This would preserve the most flexibility for offsets to remain in compliance accounts for the triennial application of the 8% limit.

- Apply the 8% limit to the actual emissions for the prior year (to which the 30% is applied). Here, then, one's annual surrender might be comprised of 27% offsets from one's compliance account (with any additional offsets held in the compliance account left for future compliance), and 73% from other compliance instruments.

SMUD does not see any valid policy reason to potentially increase compliance costs by not enforcing the offset limit in some fashion for the annual surrender process, where potential mistakes by obligated entities would reduce compliance period supply. In any revised solution here, ARB should ensure that any application of the offset limit to annual surrender preserves full use of the limit in triennial surrender.

SMUD also suggests two other changes to the offset policy to help preserve the offset limit and reduce potential Cap and Trade costs. First, SMUD suggests that the ARB allow entity's to "carry over" any unused portion of the offset limit across compliance periods or by spreading unused amounts over the broader market. Otherwise, it is clear that some entities will not, for one reason or another, avail themselves of their full offset potential for compliance, which will simply increase compliance costs in the market for all entities without any additional reduction in GHG emissions.

Second, SMUD suggests that ARB exempt from the offset limit any offsets that provide in-state ancillary environmental benefits similar to actual reductions at capped sector facilities. One way to structure this would be to exempt offsets from the 8% limit if they could prove one or more of the following:

- a direct reduction or avoidance of any criteria air pollutant in California,
- a direct reduction or avoidance any impacts on water quality in California,
- a direct alleviation of a local nuisance within California associated with the emission of odors;
- direct environmental improvements to land uses and practices in California's agricultural sector;
- direct environmental improvements to California's natural forest resources and other natural resources;
- a direct reduction of the need for mitigation of the impacts within California of rising global greenhouse gas emissions;

SMUD believes that since the application of the 8% limit is a topic of change in the Discussion Draft 15-day changes, and the earlier 45-day language, consideration of modifications in this area is within the scope of 15-day language.

III. The ARB Should Slightly Expand Ability Of POUs To Place Allowances In Other Compliance Accounts To Cover Retail Sales Obligations.

As SMUD commented last October, the current Cap-and-Trade regulation allows a POU to designate what amounts of administratively provided allowances that the Executive Director should place in the POUs limited use holding account or in the compliance accounts of: 1) an electrical generating facility operated by the POU; 2) an electrical cooperative; or 3) a JPA in which the POU is a member and with which it has a power purchase agreement.

SMUD suggests adding a fourth component to the allowable compliance accounts that can be designated, as follows:

95892(b)(2)(A): In the compliance account of an electrical generating facility operated by a publicly owned electric utility, an electrical cooperative, or a Joint Powers Agency in which the electrical distribution utility or electrical cooperative is a member and with which it has a power purchase agreement, or a federal power authority that is importing electricity products on the behalf of the electric distribution utility; or

SMUD would prefer the reduced cost, convenience and flexibility of an option to simply place administratively provided allowances directly in the federal power authority's compliance account in these cases, rather than having to provide allowances through a seemingly unnecessary sell/buy operation in a Cap-and-Trade auction. SMUD does not understand why the ARB desires to force this transaction into the auction, as it appears very similar to the other designation options allowed in §95892(b)(2)(A). SMUD believes that the added language referring to such transfers in §95921 (explicitly allowing the entry of a zero price in a CITSS transfer agreement if "… the proposed transfer is from a public utility to a federal power authority to cover emissions associated with imported power") implies that a conforming or related change in §95892, as indicated above, is within the scope of the rulemaking and open for 15-day changes.

IV. The Cap-And-Trade Regulations Should Be Modified To Clarify That Release of Entity-Specific Compliance Account Balances Is Not Required, and ARB Should Only Release Aggregate Compliance Account Data.

SMUD has weighed in on the issue of compliance account balance disclosures twice in the past year, in comments for the initial information disclosure workshop on January 25, 2013, and comments on the June 25, 2013 workshop. SMUD understands the need for a balance between transparency and protection of market sensitive information in the Cap-and-Trade program. SMUD believes that a proper balance here is achieved without revealing entity-specific compliance account balances. Implicit in the ARB staff discussion of this issue is a continued assertion that entity-specific compliance account information is required to be released publicly by the current Cap-and-Trade regulations. SMUD continues to assert that the Cap-and-Trade regulations do not require release of entity-specific compliance account data in the first place, for reasons explained in our June 25th workshop comments. However, in order to clarify this provision, SMUD recommends that Section 95921(e)(4) be modified as follows:

(4) Releases information on the aggregated quantity ~~and serial numbers~~ of compliance instruments contained in compliance accounts in a timely manner.

There are significant changes proposed to Section 95921, implying that the section is open for the potential change as described above to be within scope for 15-day language.

V. Changes To Employee Disclosure Requirements In Section 95830(c)(1)(I) Are Welcome, But Require Further Modification.

SMUD appreciates the reduced employee disclosure requirements in Section 95830(c)(1)(i) that are included in the Discussion Draft. However, the employee disclosure requirements are still overly and unnecessarily broad, and further modifications should be included in the official 15-day language later this spring. SMUD recommends the following additional changes to the section:

> Names and contact information for all persons employed by the entity ~~in a capacity giving them access to information on compliance instrument transactions or holdings, or involving them in decisions on compliance instrument transactions or holdings~~ who have authority ~~clearance from the entity~~ to approve, initiate, or ~~review~~ recommend modifications to 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.

These recommended changes concentrate the disclosure requirements more clearly on employees that have active interaction with these decisions and responsibilities, or authority for such interaction, without unnecessarily including employees that simply may have knowledge of or clearance to view an entity's allowance transactions for budgetary, accounting, or other administrative functions.

VI. Changes To Requirements For Certain Information To Remain Static 30-days Prior To And 15-days After Each Auction In Section 95912(d)(5) Are Welcome, But Require Further Modification.

SMUD understands that the potential restrictions in auction participation when certain entity information changes are intended to ensure efficient market settlement and

enhance market monitoring. SMUD also appreciates the revised language in the Discussion Draft that reduced the amount of information that must remain static 30 days prior to and 15 days after an auction or risk denial of auction participation. However, the information included here is still too broad, posing unnecessary risk to auction participation by covered entities. SMUD suggests the following additional changes in this section:

> An entity with any changes to the auction application information listed in subsection 95912(d)(4) ~~or account application information listed in section 95830~~ within 30 days prior to an auction, or an entity whose auction application information or account application information listed in section 95830(A) or (H) will change within 15 days after an auction, may be denied participation in the auction.

Without this additional change, the ARB is unreasonably putting entities at risk of auction participation if officers or directors move at the wrong time, or if an employee with some allowance authority at the entity moves to a new job and is replaced. The information that should be restricted from changes around an auction should be minimized to only that that has a clear impact on direct participation in that auction, or monitoring of that participation, without imposing undue restrictions on the personal lives of directors, officers, or employees of the entity.

VII. SMUD Believes That Voluntary Renewable Energy Provisions Should Be Further Modified.

Under the RPS, a covered entity can reduce its reported emissions and hence compliance obligation either by procuring directly delivered renewables, which come with zero or near zero specific source GHG emission factors, or by procuring firmed and shaped renewables along with substitute energy delivered to the state, and taking advantage of the "RPS adjustment" to reduce the emissions associated with the substitute energy. Both instances reduce the covered entity's reported emissions and hence allow commensurate emissions elsewhere under the cap. ARB's voluntary renewable energy (VRE) set-aside provisions recognize that the Cap acts to reduce the incentive to procure renewables for a voluntary program (as GHG emissions are not altered under the Cap), and therefore sets aside some allowances that can be retired to ensure that GHG reductions actually occur with these voluntary programs, despite the existence of the cap.

However, the Cap-and-Trade regulations currently reserve the use of the VRE program for only directly delivered renewables, not covering the "RPS adjustment" pathway. SMUD continues to recommend that the Cap-and-Trade Regulations allow use of the VRE provisions for renewable procurement that could take advantage of the RPS Adjustment if the procurement was associated with an entity's RPS obligation, rather

than part of a VRE procurement. This will provide equal treatment for RPS procurement and VRE procurement.

Note that SMUD is not recommending application of the VRE to renewables that are not eligible for the RPS – SMUD agrees with the ARB policy of reserving the VRE adjustment for only those renewables that are RPS-eligible. Rather, SMUD is requesting greater equivalency between the VRE provisions and the RPS, allowing both directly delivered and RPS adjustment provisions to lead to GHG reductions through allowance retirement from the VRE, just as both of these pathways are accepted in the RPS.

SMUD also understands that the ARB established a direct delivery requirement for the VRE in order to implement a VRE that is based on the location of the renewable generator rather than the location of the VRE purchaser. With this structure, even a non-obligated entity under the Cap-and-Trade program – for example, someone that sells unbundled RECs to customers outside of California -- can ensure GHG reductions for the purchasers of this voluntary renewable product – even for those renewable generators located here in California and thus under the GHG cap in place in the state (and linked jurisdictions).

SMUD contends that it is not just the location of the renewable generator that is important but also the context of the renewable procurement. We recommend including "RPS-Adjustment renewables" in the VRE structure, although these RPS-eligible are typically located outside of California, because as with directly delivered renewables, RPS procurement of renewables via the RPS Adjustment yields a GHG benefit to the procuring obligated entity in California. Such procurement provides a reduction of their GHG obligation, but other obligated entities in the capped jurisdiction (California) can then emit more GHG. Hence, just like a voluntary procurement of directly delivered renewables by an obligated entity, a voluntary procurement of RPS Adjustment eligible renewables by an obligated entity would yield no change in overall GHG emissions unless covered by the VRE structure. Both types of transactions should be covered by the VRE when procurement is by a Cap-and-Trade obligated entity, to allow full use of renewable options while ensuring that the voluntary procurement leads to GHG reductions. Only directly-delivered renewables should be covered by the VRE when procurement is by a non-obligated entity, because there is no GHG obligation change for the procuring entity, and the important concept for ensuring GHG reduction is limited to the impact on the actual electricity grid implied by directly delivered renewables.

In the FSOR for the Cap-and-Trade regulations, ARB staff suggested that: " … If electricity under SMUD's green pricing program meets the established [CEC] RPS requirements, then it will be allowed to take the RPS adjustment." (FSOR, page 2132.) However, the regulations as drafted would limit the RPS Adjustment to only situations of actual RPS compliance, thereby constraining its use for green pricing programs that are not subject to RPS compliance. The following changes would allow resources that would normally count for the state's RPS to also be fully viable for voluntary program procurement by a covered Cap-and-Trade entity, without incurring a compliance

obligation or challenging the GHG benefits expected from voluntary renewable procurement.

> 95841.1(a) Program Requirements: The end-user, or VRE participant acting on behalf of the end-user, must meet the requirements of this section. Generation must be new and not have served load prior to July 1, 2005. Allowance retirement for purposes of voluntary renewable electricity will begin in 2014 for 2013 generation. Voluntary renewable electricity must be directly delivered to California, or associated with a transaction that uses the RPS adjustment. RECs, if created, must be retired within the year for which VRE retirements are requested.

> 95852(b)(4)(B) The RECs associated with the electricity claimed for the RPS adjustment must be placed in a ~~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 399.25 and either designated as retired for the purpose of compliance with the California RPS program; or designated as retired for purposes of a voluntary green pricing program operated by a covered entity ~~used to comply with California RPS requirements~~ during the same year ~~in~~ for which the RPS adjustment is claimed.

SMUD again appreciates the opportunity to comment on the Discussion Draft 15-day language modifications to the Cap-and-Trade Program.

/s/

_____

WILLIAM W. WESTERFIELD, III
Senior Attorney
Sacramento Municipal Utility District
P.O. Box 15830, M.S. B406, Sacramento, CA 95852-0830

/s/

_____

TIMOTHY TUTT
Program Manager, State Regulatory Affairs
Sacramento Municipal Utility District
P.O. Box 15830, M.S. B404, Sacramento, CA 95852-0830

cc: Corporate Files