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August 2, 2013

Dr. Steven Cliff
Chief, Climate Change Program Evaluation Branch
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Air Resources Board
1001 I Street
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Submitted via web: http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=cap-trade-draft-ws&comm_period=1

RE: Comments on the Air Resources Board July 15, 2013 Discussion Draft Proposed Amendments to Cap and Trade Regulation

Dear Dr. Cliff:

Chevron has been a California company for more than 130 years and is the largest Fortune 500 corporation based in the state. We have participated in stakeholder meetings, broad-based industry and environmental group meetings, and discussions with ARB and its staff in order to make the program and this proposed rule workable for California, while meeting the goals of AB 32.

The proposed amendments to the cap-and-trade regulation offer a key opportunity to make needed changes, and address challenges and uncertainties. For example, Chevron strongly supports the proposed amendment to extend the industry assistance factor into the second and third compliance periods. This is an important step that will help to maintain the environmental integrity of the cap-and-trade program by limiting leakage and protecting jobs in California. We also recognize that progress is being made on cost containment both through future offset protocol development and limited borrowing. However, we are concerned that work remains to ensure expansion of offset supply, add further cost containment measures, and address market design elements. We look forward to continuing to work with ARB on these critical issues, including allowance allocation, trade exposure, offset supply, and market design.

Chevron appreciates the opportunity to submit our comments on the proposed amendments. Our comments are focused on the following specific topics:

- **Industry Assistance** – Chevron supports the proposed change in the application of the industry assistance factor that recognizes the competitive environment in the refining sector and other energy intensive trade exposed industries which if left unchanged, could lead to leakage and loss of California jobs.
- **Offsets** – Offsets afford California a critical opportunity to meet the AB 32 environmental goals in the most efficient and low cost means possible. The development of offsets under current protocols, and the addition of new protocols, will help to create real and permanent emission reductions. Chevron supports efforts to increase the availability of offsets.
- **Cost Containment** – Board resolution 12-51 recognized that a clear and transparent approach to address the potential for unnecessarily high allowance prices is needed. It is important that the changes made by staff fulfill the requirements under the resolution.
- **Market Design** – An efficient, liquid market facilitates the most cost effective emission reductions. Rules must enable a level playing field between allowance market participants. To this point, entity specific, market sensitive data must be protected to avoid unfairly exposing sensitive position information for compliance entities which could lead to a less competitive market.

Industry Assistance

Chevron strongly supports ARB'S proposed amendment to extend the first and second compliance period industry assistance factor into the second and third compliance periods as it may enable overall lower greenhouse gas emissions. Allocation decisions do not directly impact the environmental effectiveness of the program since aggregate emissions remain limited by the cap regardless of how the allowances are distributed.

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

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

Offsets

Chevron supports efforts to increase the availability of offsets. An adequate supply of offsets plays a significant role in containing program costs which has a positive impact on jobs and the environmental performance of the program. Further geographic limitations on offset projects would substantially increase program costs and may ultimately result in businesses and jobs leaving the state. We support ARB's efforts to bolster offset supply through development of offset protocols on Coal Mine Methane and Rice Cultivation. We urge ARB to continue to both develop additional protocols and explore options to streamline its adoption and offset review process. This is particularly important because under the six protocols, in the regulation and in process, several experts have predicted offset supply shortages.[1] Any ARB efforts to reduce future uncertainty regarding the role of offsets in the program will help offset supply as current uncertainty is holding back offset project investment. Additional specific comments are included in the attachment to this letter.

Cost Containment

In order for the cap and trade program to meet AB 32's legislative mandate, it must be implemented in a cost effective manner. Board Resolution 12-51 recognized the potential for prices to rise to an unacceptably high level and instructs staff to develop a mechanism to ensure that prices do not rise above the third tier of the allowance price containment reserve (APCR). While Chevron supports borrowing as a mechanism to reduce price volatility, the borrowing mechanism in the proposed amendments does not ensure that prices will not rise above the APCR price. As a result, the borrowing approach, while a necessary element to reduce price volatility, may not fully satisfy the Board Resolution. Chevron supports the Cost Containment approach presented by the Joint Utilities Group at the July 18, 2013 workshop which proposed, among other things, expanding offsets, changing holding limits, and limited borrowing. Further, to send a clear signal and offer the greatest impact on cost containment, the offset trigger measures in the second element of the Joint Utilities Group proposal should be implemented immediately, rather than require a trigger event before being implemented.[2] We are convinced that actions taken today to limit costs will benefit the environmental goals of the program by reducing the chance of leakage and protecting jobs and the California economy.

Market Design

The proposed amendments provide relief in some areas, such as true up allowances and the treatment of future vintage allowances under the holding limit rule. However, other elements of market design, employee and transaction reporting include a broad gathering of all possible

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

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

information that Chevron believes can be best addressed in other ways. Additionally Chevron supports the option for compliance entities to choose the retirement order for compliance instruments. Under no circumstance should ARB take any compliance instruments that are not specifically needed to fulfill a compliance obligation. For example, the proposed amendments include a provision under which offsets would be taken from a regulated party's compliance account in excess of the 8% restriction, not applied for compliance, but also not returned to the regulated party. In order to promote cost containment and to avoid needlessly increasing the compliance costs for individual regulated entities, ARB must develop a mechanism to return any excess offsets taken by ARB. Additional detailed comments and recommendations are attached.

Chevron applauds the efforts by the ARB to improve cost containment. The proposed amendments include many important improvements to the regulation, including the application of industry assistance across all three compliance periods; however, more work remains. We look forward to continuing to work with closely with ARB. Attached are detailed comments on some of the issues above and on detailed aspects of the draft proposed amendments for consideration.

Sincerely,

(Original sent via email)
Lloyd Avram
State Government Affairs

Enclosure

Appendix

Detailed Comments on the Air Resources Board July 15, 2013 Discussion Draft Proposed Amendments to Cap and Trade Regulation

1) Refining benchmarking

   As noted in the draft proposed rule by staff at the July 18, 2013 Workshop, Chevron, other companies, and WSPA are working with ARB staff, ARB's consultant Ecofys and international refinery benchmarking experts Solomon to modify the current regulation from CWT to CWB. Chevron strongly supports this effort to move to CWB because it is more equitable and appropriate for California refineries. It is also consistent with units of measure, current equipment and processing units, and product slate applicable to US and CA refineries.

2) Limited Borrowing for True Up

   ARB will retire "the current calendar year's vintage allowances and allowances allocated just before the annual surrender deadline up to the True-up allowance amount …if an entity was eligible to receive true up allowances". Chevron supports this change. It is consistent with the spirit of the cost containment concepts addressed below and should smooth out potential volatility that could have occurred at the end of the compliance period.

3) Proposed Verification Deadline Changes

   Chevron does not support the staff proposal to move the mandatory reporting verification deadline up to August 15 as discussed in the July 18, 2013 workshop. The mandatory reporting process is very complex and iterative. This not only increases the work for the compliance entities, but also for verifiers who may not be able to review information to meet an earlier deadline.

4) Retirement Process

   a) At the July 18 workshop, ARB staff offered an alternative to the mandatory order in which compliance instruments would be retired. Under the offered alternative, regulated entities would have the choice to self-select the compliance instruments to retire and the order in which to retire them. Chevron supports this alternative. Chevron believes that such flexible retirement options would enable better management of the allowance portfolio by the regulated parties. Additionally, allowing such a self-selection approach would reduce the risk of an unlawful taking of property.

   b) In the event that the ARB chooses not to pursue the alternative approach discussed in a) above as preferred by Chevron, we request additional clarification of this provision. For example, please provide a definition of oldest offsets which would be retired first.

   c) Chevron also supports allowing entities to retire instruments early, prior to the compliance deadline.

Detailed Comments on the Air Resources Board July 15, 2013 Discussion Draft Proposed Amendments to Cap and Trade Regulation

5) Tax and Accounting Considerations

Chevron is concerned that the proposed retirement order in conjunction with other market policies could inadvertently have negative tax and accounting consequences.

a) EPA's Acid Rain Program may serve as an example in determining the importance of an entity's ability to choose which compliance units it retires in light of tax implications. In the Acid Rain Program, an entity has the option of placing into a compliance account those allowances that it decides it wants EPA to retire for that year. Embedded in the selection of allowances for retirement is the ability to choose to retire specific allowances based on their tax basis (this is often referred to as "specific identification" by the accountants).

   In the Acid Rain Program, for tax purposes the basis of a freely allocated allowance is zero. That contrasts with a purchased allowance, where for tax purposes the basis would be the purchase price. Because either type of allowance is fully fungible, an entity could then choose to retire an allowance based on its tax basis. Since SO2 allowances are treated as a capital asset, using specific identification, a company could choose allowances based on how it would impact its capital gains posture for a given year.

b) We ask ARB to consider whether there might be a tax consequence if ARB uses a default compliance retirement order that prevents entities from indicating which specific units they want to retire. In addition to retirement order a is that without access to serial numbers or other unique identifiers, an entity would not be able to indicate which type of allowance it wants to retire for tax reasons.

c) A second consideration with regards to retirement order concerns the different inventory accounting methodologies that entities in the California market can choose to use. An entity could choose to use LIFO, FIFO (first-in, first-out), specific identification, or average cost for its methodology of book accounting. Importantly, if an entity uses LIFO, FIFO or specific identification for book accounting purposes, then it must have the ability to tell ARB which allowances to retire consistent with its chosen inventory accounting methodology.

6) Offsets

ARB's proposal to shift the invalidation risk for forestry projects raises a number of serious issues:

a) ARB's existing rule places responsibility with forestry owners because forests are a unique type of offset. The forest owner has control over the forest and can manage it in accordance with the requirements or choose not to do so. Therefore the rules correctly place invalidation risk with the forest owner because the forest owner is in the best position to manage the invalidation risk over time. We are concerned that by changing

the invalidation risk to the covered entity that uses the offset, ARB is adding unworkable burden and risk to forestry offset buyers which will ultimately discourage use of this important resource to reduce greenhouse gases under ARB's cap and trade program.

b) The proposal would result in a significant change in risk transfer to existing transactions which were negotiated and priced based on current regulations. We urge ARB to reconsider this change and at a minimum not apply it retroactively to projects already negotiated or listed. Applying the change to previously negotiated or listed projects would introduce further uncertainty to the nascent offset market, a particularly vulnerable time for any market. Changing rules after a market has begun punishes early market participants that have already made investments and undertaken significant risk to create a market that furthers the program's objectives – contrary to AB 32's directive to encourage early action to reduce greenhouse gas emissions.

c) Chevron is also concerned that ARB continues to introduce additional administrative requirements in the offset program. Chevron supports high quality offsets. However, there is no indication that the level of multiple external and internal reviews currently imposed contributes to the quality of the offset or if at best, the extensive review process outlined below slows the approval of high quality offsets. At worst, this process may have the opposite effect of ARB's intentions by precluding certification of high quality offsets and ultimately slowing offset development.

   i) For example, there are currently eight distinct approvals required to convert early action offset credit into a double-verified ARB offset credit. The proposed regulatory amendments (indicated in italics) would add two additional approvals, as follows:
   (1) ARB certification of Offset Project Registry ("OPR")
   (2) ARB certification of verification body and verifier
   (3) OPR listing and initial review of the project
   (4) Third-party verification of emissions reductions pursuant to early action protocol
   (5) OPR review of verification documentation and issuance of early action offset credits
   (6) Desktop review of verification documentation pursuant to early action protocol and ARB regulations
   (7) ARB review of desktop report and issuance of ARB offset credits
   (8) Second verification of Offset Project Data Report for the project (requirements vary depending on protocol)
   (9) Review of the second verification documentation by OPR
   (10) Review of OPR's report by ARB

We are opposed to adding even more administrative burden on a system that already imposes extraordinary review. We urge ARB instead to streamline the existing process. For example, we recommend that ARB eliminate steps (6) and (10) because they involve two redundant

reviews of the OPR's and the verifiers' work. Once the OPR has been approved by ARB, further double-checking of the OPR's work would appear to be unnecessary.

7) Market Design
   a) Holding Limits: Among the proposals in the Joint Utilities Proposal is an element that includes changes to the restrictive holding limits. Chevron supports changing the requirements for the limited exemption, enabling allowances corresponding to the limited exemption to be placed in the compliance entity's holding account, not requiring those allowances to be placed in the compliance account.

   b) Transaction Reporting: ARB requests all possible information with the apparent intent to use it to look for some type of unspecified irregularities. The overwhelming majority of the information gathered will never be useful and represents a waste of resources. Chevron recommends that ARB take a "for cause" or "as needed" approach for anything beyond the current regulatory language. We believe that giving the ARB leeway to ask for additional information when the need arises can accomplish ARB's need to investigate unusual situations without burdening every compliance entity with reporting data that will never be the subject of concern. This type of conditional data request which is used in other market settings provides the ARB an efficient and effective means to gather data when needed.

   c) Registration Requirements: the requirement to report all employees who are knowledgeable of cap and trade strategy is unreasonable and similarly challenging from an enforcement perspective. Companies have internal governance processes to manage market sensitive information. We recommend that ARB use the same guidance as they developed for "know your customer" employee reporting requirements.

   d) Complexity of Market Rules: Chevron requests that ARB provide guidance to clarify the application of its prohibitions on certain market behavior. We understand that the agency thinks that it needs a level of appropriate latitude to identify bad actors however honest parties must be able to avoid inadvertent missteps. For example, the language around "any trick, scheme, or artifice" is very broad with a large potential range of applications that could apply in an enforcement context. We need guidance similar to guidance issued for resource shuffling that explains specific safe harbors or specific examples of bad behavior. This is needed in the rulemaking to provide some measure of definition to allow regulated parties to understand the limits or boundaries that ARB mean to enforce.

8) General Prohibition on Trading
   Prohibitions on trading requiring that "an entity cannot acquire allowances and hold them in its own holding account on behalf of another entity" are generally overbroad and should be curtailed to permit legitimate transactions that support program objectives and create liquidity. For example, it should be interfere with the ability of entities to purchase

allowances from market makers at auction prices. Our concerns and recommendations include:

a) Forward Contracts: we recommend that ARB provide a safe harbor for forward contracts under the trading prohibition. The new proposal includes additional language that deviates materially from the guidance provided by ARB in December 2012 (which we support). The new language uses very broad language that could be read to mean that the safe harbor is practically inaccessible. This language needs to be scaled back to be consistent with the December 2012 guidance – or at the very least, ARB needs to explain why it is making changes to its December 2012 position.

b) Escrow accounts: the beneficial holdings provisions do not allow escrow arrangements (because by definition, they involve a holding on behalf of another). Escrow is a fundamental component of corporate transactions and this could create unnecessary obstacles to numerous corporate transactions involving covered entities. We support the addition of a safe harbor for escrow accounts, in addition to the safe harbor for forward contracts and for direct corporate associations.

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

9) Security Interest

Chevron recommends that cap and trade program by allowing the creation of security interest. To achieve the emissions reductions mandated by the program, many entities will need to make investments in energy-efficient technology and/or carbon offset projects. Such investments may be capital intensive and require access to financing and credit. Security interests provide lenders the confidence needed to provide the loans necessary to make these investments, and ultimately facilitate the achievement of the program's environmental objectives. Further details on this issue are included in the attached letter from Latham and Watkins.

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August 2, 2013

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1001 I Street

RE: Comments on the July 15, 2013 Discussion
Draft Proposed Amendments to Cap and Trade Regulations

Dear Dr. Cliff,

Thank you for giving us the opportunity to comment on the draft proposed amendments to the cap-and-trade regulations.

Latham & Watkins LLP is a global law firm that is committed to helping clients achieve their business strategies and providing outstanding legal services around the world. We have been closely involved with the design and implementation of all major environmental programs in California and at the federal level. We are submitting this letter on behalf of Chevron.

Our comments pertain to the following issues: (1) general prohibition on trading, (2) auction-related information disclosure, (3) security interests on allowances and offsets, (4) contract information submission requirements; (5) serial numbers; (6) registration requirements; and (7) Cap-and-Trade Contractor Reporting Requirements.

1. General Prohibition on Trading – Section 95921(f)(1)

ARB has proposed several changes to the prohibition in Section 95921(f)(1). The prohibition serves an important market objective – preventing market participants from avoiding the holding limit and auction purchase limit – but new safe harbors need to be included in the regulations and the proposed modifications may inadvertently prevent legitimate market transactions.

A. New Safe Harbors for Fundamental Market Transactions

We support the current prohibition in 95921(f)(1) as clarified by the December 2012 Guidance describing a safe harbor for forward transactions because it establishes a relatively clear prescription that the market can understand and follow.

We believe that two additional safe harbors need to be included in the 95921(f)(1) prohibition to protect certain useful transactions that do not raise risks of market manipulation, such as an escrow or a pledge. In transactions involving escrow, which are very common in commodities transactions and in offset transactions, the buyer typically delivers cash to the escrow agent and the seller delivers the allowances to the escrow agent. Upon receipt of both, the escrow agent would deliver cash to the seller and instruments to the buyer. Escrow agents are typically financial institutions that agree to provide this service for a fixed fee. A "pledge" or "security interest" would involve the transfer of an interest in the allowances or offsets to the lender pending repayment of the loan.

In each of these cases, the party holding allowances on behalf of another is typically contractually prohibited from selling, transferring, retiring using or misusing them. Accordingly, these arrangements (and others like them) do not raise a risk of market manipulation and should be permitted, provided they are disclosed.

B. Proposed Changes to Forward Contract Safe Harbor

The proposed modifications to the forward contract safe harbor are vague and confusing, as discussed below.

First, ARB's proposed new addition of 95921(f)(1)(A) regarding "ownership or financial interest" (which terms are undefined) is so vague and overbroad that it could potentially be construed as prohibiting derivative-type instruments, including call options, put options, rights of first refusal, rights to match terms, and certain forward and future contracts (including hedging agreements). We hope that this is not what ARB had in mind in proposing the changes, and we would like to better understand your concerns with the current language to help you tailor the regulatory changes accordingly.

Second, the addition of "control over the acquisition of allowances" in Section 95921 (f)(1)(B) is confusing and should be deleted or clarified. ARB's December 2012 guidance does not include this limitation and it is unclear if ARB is changing its position on the safe harbor. Specifically, ARB needs to protect the ability of market participants to enter into transactions where one party (the hedge provider) assists a covered entity by selling allowances through repeated deliveries to keep pace with the entity's daily greenhouse gas emissions. It is clear that these contracts are in full compliance with the current prohibition because no party is holding an allowance on behalf of another. It should be clear that close coordination between such parties, however, does not trigger the 95921(f)(1) prohibition. These transactions are particularly important for smaller merchant generators who do not have trading desks, but who need continuous hedging services because they price allowances in their daily power offers.

Finally, the proposed new requirement that agreements "include no terms applying to allowances residing in another entity's account" is too broad. Many standard contracts contain terms applying to allowances in the seller's account – for example, representations and warranties that the Seller has good title to the allowances. These terms could be construed as violating the plain meaning of ARB's new language, which would be an absurd outcome. We propose using language more in keeping with the December 2012 Guidance as an alternative.

2. Auction-Related Information Safe Harbor

As ARB knows, participation in the allowance auction is complex and not necessarily accessible to all covered entities. In our experience, for example, smaller entities may want to acquire allowances at auction prices, but they do not have the resources, capacity or willingness to go through the auction registration and participation process.

To address this market need, the market has developed products to sell allowances at the clearing price of a future auction. These transactions are very common in markets where instruments are auctioned and they fully comply with the current prohibition in Section 95921(f)(1). In some other, more complex (i.e., structured) transactions, however, the parties may want to exchange information about an auction (e.g., to include a ceiling price). Unlike other markets, however, such transactions are not permitted in California, even if they serve a legitimate market purpose and even if the disclosure takes place after the auction.

To address the issue, we propose that program participants should be allowed to disclose certain limited auction-related information as part of a bona fide sale and purchase transaction on the following conditions: (1) the recipient of the information is subject to a confidentiality agreement; (2) the purchaser of the allowances does not participate in the auction or enter into a similar agreement for the same auction with other market participants; and (3) this relationship is disclosed to ARB. Taken together, these conditions will ensure that covered entities do not use these mechanisms to avoid the auction purchase limit and will permit the market monitor to fulfill its functions.

3. Security Interests on Allowances and Offsets

A. Role of "Security Interests" in General Commercial Transactions

"Security Interests" are property interests that help facilitate a significant proportion of the commercial transactions taking place in our economy. A mortgage, for example, is a security interest that a bank will take on real property to guarantee the debt of the property owner. Security interests play an important role in financings because they allow the security interest holder to have a senior status vis-à-vis other creditors. The creation of security interests is governed by the Uniform Commercial Code (the "UCC") which has been enacted with some variations in all 50 states and the District of Columbia.

B. Importance of Security Interest to the Cap-and-Trade Program

To achieve the emissions reductions mandated by the program, many entities will need to make investments in energy-efficient technology and/or carbon offset projects. Such investments may be capital intensive and require access to financing and credit. Security interests provide lenders the confidence needed to provide the loans necessary to make these investments, and ultimately facilitate the achievement of the program's environmental objectives.

C. Issue Arising from Historical Definition of Instruments

The California cap-and-trade regulations explicitly define "Compliance Instruments" as "not constitut[ing] property or a property right." Historically, this language originates from the 1990 amendments to the federal Clean Air Act, which according to the legislative history of the statute, are intended to protect the federal government from takings claims arising from potential governmental interference with compliance instruments.[1]

This definition was ultimately repeated in most other U.S. federal and state environmental programs (including RGGI for example). However, the definition has created a significant level of uncertainty as to whether a security interest can validly be created in environmental commodities, including allowances and offsets. This is because, under the UCC, one of the pre-requisites for creating a valid security interest is that the debtor "has rights in the collateral or the power to transfer rights in the collateral to a secured party." UCC 9-203(b)(2). Statutory language indicating that the compliance instruments are not property or a property right calls into question whether the holder would have sufficient rights to grant a security interest therein. Needless to say, this has nothing to do with the policy objective pursued by the U.S. Congress in 1990 and by ARB in the Cap-and-Trade regulations.

The issue for the environmental markets is real as this uncertainty is preventing some transactions from occurring. In some other cases, transactions may still take place, but at a higher cost to the parties involved because of the credit risk that is left unaddressed. Based on the foregoing, we wish to propose an amendment to the regulations that will allow for these security interests, while simultaneously achieving ARB's policy objective.

D. Changes to Section 95820(c)

To allow for a security interest to be taken in a compliance instrument, while simultaneously shielding ARB from potential takings claims, we propose revising Section 95820(c) so that it reads as follows:

> (c) "Compliance Instruments Issued by the Air Resources Board." As between the State of California (including the Air Resources Board) and the holder of any Compliance Instrument or any interest (including any security interest) therein, Compliance Instruments are not property or a property right and the Executive Officer is authorized to terminate or limit

[1] S. REP. NO. 101-228, at 861 (1993).

any such Compliance Instrument. Subject to this authority and other restrictions in this article, Compliance Instruments may be traded, sold, bought, purchased, retired, pledged or subjected to any security interest.

4. Contract Information Submission Requirements

We appreciate ARB's efforts to tailor its CITSS transfer request submission requirements to the needs of various types of transactions, but ARB's proposed revisions to 95921(b) are nonetheless unnecessary and overly burdensome. These proposed revisions need to be rolled back for several reasons:

- The information requested by ARB for these transactions will be difficult to accurately and timely provide given the level of detail required and the short timeframe for completing the request.

- ARB does not need to collect extremely detailed information on this market or play a public role as a data repository given that many trades will take place on an exchange, and therefore be subject to CFTC reporting requirements.

- ARB's current right to request contracts is sufficient to address any concerns if it feels that there are problems related to market monitoring.

- The difficulties discussed here are compounded by the risk that any inaccurate or incomplete report submitted to ARB could be prosecuted as a violation and become subject to potentially major fines and penalties. Data entry requirements such as this are better left uncodified in the regulations, or at the very least, subject to a more limited range of penalties than the cap-and-trade program currently provides.

5. Serial Numbers

As discussed by stakeholders in prior comments, the inability to identify allowances or offsets individually (by serial number or otherwise) raises a number of issues for the market:

- Parhelion, a company that has developed an offset invalidation insurance product, has indicated that it would be preferable for the underwriter to be able to track offsets individually. The reason is that the underwriter needs to be able to identify specific offsets in the event that a purchaser wants to insure the purchase of only a portion of offsets issued pursuant to an Offset Project Data Report.

- Creating a security interest typically requires the registration or filing of the interest with a state registry where the encumbered assets (*e.g.*, the allowances or the offsets) must be identified with a sufficient level of precision (*e.g.*, cars are identified through VINs). Under the current regulations, therefore, market participants would only have the choice of offering all or none of their allowances for a specific vintage year. This is not optimal and should be re-considered at some point in the future.

- Disclosure of serial numbers or other identification numbers would permit more precise auditing of trader books and positions.

- Finally, it is unclear why ARB has decided to hide serial numbers from account holders. As a general matter, we feel that this issue has not been thoroughly aired with stakeholders and should be reconsidered in the future.

    - If ARB's rationale is to prevent market participants from identifying the jurisdiction where the instruments were issued, we note that the serial numbers do not need to include this information. Second, even if the origin of instruments were visible and the market priced the instruments differently on that basis, it is unclear whether this would a negative outcome. Surely, from the market's perspective, there would be nothing wrong with this (for example, offsets from different projects and registries are pricing differently).

    - If ARB's rationale is to follow the European Union's footsteps in this area, we note that the considerations underlying the EU's decision do not apply to California. In 2011, the EU decided to hide serial numbers on its registry to prevent another situation of widespread market confusion, which occurred after certain allowances were stolen and the associated serial numbers were published. The EU's decision remains controversial to this day because the problem that afflicted the EU trading system was based on security lapses at domestic registries and hiding serial numbers just prevented the market from locating the stolen property. The situation in California is different for two reasons: (1) ARB has designed a robust registry intended to prevent the situation that took place in Europe and (2) the concerns discussed above in connection with providing security interests (i.e., a lien) for financing largely do not arise in the EU.

6. Registration Requirements

The proposed amendments to registration-related requirements raise several issues:

- The new amendments to the program registration requirements at 95830(c)(1)(I) and (J) reference requirements to submit a "notarized letter". The program registration requirements do not include a notarization requirement, however. It appears that this is a transcription error from 95814(a)(3), which includes a substantially similar requirement. Accordingly, the notarization requirement should be removed from 95830(c)(1)(I) and (J).

- We find impracticable the expansion of 95830(c)(1)(H) to require disclosure of all entities with whom the registering entity has a corporate association, regardless of whether they are registered in the program. This proposed expansion suffers from a similar problem apparent in other ARB proposals: it would require substantially more burdensome and involved reporting than previously required, with little benefit to the program.

7. Cap-and-Trade Contractor Reporting Requirements

The proposed additional "Cap-and-Trade Contractor" reporting requirements are concerning in that they could be read to require program participants to disclose attorney-client relationships to ARB. This would raise serious issues under the California Professional Responsibility Code and other states' legal ethics rules for practicing attorneys. This should be addressed by specifically excluding attorney-client relationships from the scope of the requirement.

*** * ***

Thank you again for this opportunity to comment. We will be submitting proposed regulatory language under separate cover using ARB's submittal process and will appropriately cross-reference our concerns discussed in this letter.

Sincerely,

[Original Signed]

Jean-Philippe Brisson
of LATHAM & WATKINS LLP