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 JULY 15, 2013

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SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON PROPOSED CHANGES TO CAP AND TRADE REGULATION RELEASED ON JULY 15, 2013

I. INTRODUCTION AND SUMMARY.

The Southern California Public Power Authority ("SCPPA")[1] respectfully submits this comment on the discussion draft of the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms regulation ("Regulation") released on July 15, 2013, and discussed at the California Air Resources Board ("ARB") workshop held on July 18, 2013.

In summary, SCPPA recommends as following:

- The emissions report verification deadline should not be moved up to August 15 of each year. Accelerating the deadline would burden all covered entities. Rather, the Allowance Price Containment Reserve ("Reserve") sale should be moved to a later date. It would be easier for covered entities to manage overlapping registration periods for the Reserve sale and the next auction than to manage a shorter verification period.
- The definition of "futures" should include an additional part of the Commodity Futures Trading Commission's ("CFTC") definition of this term.
- The new sentence in the definition of "imported electricity" should refer to balancing authorities rather than independent system operators.
- The ARB should reconsider the new requirements for covered entities to provide details about their employees with access to cap-and-trade information and about their

[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.

contractors advising on cap-and-trade compliance. These provisions should be either removed or limited.

- The grounds on which account representatives can be denied registration should be clarified.
- The new resource shuffling provisions are welcome and do not require revision.
- SCPPA appreciates the proposed changes to the provisions on renewable energy credit ("REC") retirement for specified source electricity and the RPS Adjustment. However, the RPS Adjustment provision should be revised to avoid some unintended negative consequences.
- To allow covered entities to manage their compliance obligations in an effective and flexible way, covered entities should have the ability to specify a retirement order for instruments in their compliance accounts. This would give POUs a way to avoid a potential breach of the Regulation by using administratively allocated allowances to cover emissions from sales into the California Independent System Operator ("CAISO") markets. If an entity does not specify an order by a set date, the ARB's standard retirement order would apply.
- Excess surrendered offsets should be carried forward rather than being rendered worthless.
- 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 be not exceed the highest Reserve price. The ARB

should adopt a suite of cost containment measures as proposed in the Joint Utilities paper on cost containment. These measures should include a mechanism that provides unlimited additional allowances at the highest Reserve price and a companion mechanism for obtaining compensating emission reductions.

- Clarify that unexpected changes to the status of investigations will not prevent entities from participating in auctions or reserve sales.
- Section 95913(g)(7) is unclear and should be revised as recommended below.
- If a bidding advisor fails to provide information to ARB, the entity engaging the bidding advisor should not be penalized.
- There should be no requirement to complete transfer requests within 3 days of settlement of transaction agreement.
- Additional data on compliance instrument transactions should be minimized, and the ARB should explain how the ARB will use any additional data. Confidentiality must be assured.

These issues are discussed in more detail below in the order in which these issues arise in the Regulation, except for the proposed change to the verification deadline. That proposed change was not reflected in the Regulation but was presented at the July 18, 2013 workshop.

II. THE VERIFICATION DEADLINE SHOULD NOT BE CHANGED.

Slides 45 and 57 of the presentation at the July 18, 2013 workshop proposed moving the emissions report verification deadline two weeks earlier to August 15 each year and proposed moving the September Reserve sale back one week to allow time for natural gas suppliers to be informed of their emissions liability before the Reserve sale.

The verification deadline should not be accelerated. An earlier deadline would burden all covered entities. Verification is a detailed and time-consuming process which would be difficult to compress into a smaller timeframe. After initial investigations and site visits, there is a period of dialog between the verifier and the covered entity to address any questions the verifier may have. Shortening the time for verification would make it more difficult for the verifier to complete a thorough verification and for the covered entity to respond to any questions.

Moving the reporting deadline two weeks earlier so as to allow the same length of time for verification would impose a host of additional difficulties.

Rather than moving the verification deadline earlier, the Reserve sale should be moved to a later date if the ARB desires to accommodate the participation of natural gas suppliers. SCPPA understands that this may pose administrative difficulties. For example, the registration period for the Reserve sale might overlap with the registration period for the next allowance auction. However, it would be easier to manage overlapping deadlines than for all covered entities to compress their verification schedules. Participants are able to distinguish between and cope with deadlines for the Reserve sale and the auction.

III. THE DEFINITION OF "FUTURES" SHOULD INCLUDE AN ADDITIONAL PART OF THE CFTC DEFINITION.

In section 95802(a) of the Regulation, a new definition of "Futures" has been added. It is the same as the definition of "Futures Contract" in the CFTC glossary,[2] except that two parts of the CFTC definition have been excluded. The parts of the CFTC definition that are not included in the Regulation are as follows: "(3) that is used to assume or shift price risk; and (4) that may be satisfied by delivery or offset."

[2] Available at: http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/glossary_f.

SCPPA appreciates that the ARB is endeavoring to maintain consistency with the CFTC definition. The definition should be made more consistent by including part 4 of the CFTC definition. This is an important part of the definition. (Part 3 is less important.) If the ARB is concerned about the potential for confusion with the reference to "offset," a reference to the CFTC definition of the term could be inserted. Alternatively, a different word or phrase could be used that conveys a similar meaning.

SCPPA's proposed changes to the definition of "Futures" are set out below:

> (XX) "Futures" means an agreement to purchase or sell a commodity for delivery in the future at a price that is determined at the initiation of the contract and that obligates each party to fulfill the contracts at a specified price, and that may be satisfied by delivery or offset (as defined by the Commodity Futures Trading Commission).

IV. THE NEW SENTENCE IN THE DEFINITION OF "IMPORTED ELECTRICITY" SHOULD REFER TO A BALANCING AUTHORITY, NOT AN INDEPENDENT SYSTEM OPERATOR.

In section 95802(a)(137) 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 meet NERC Reliability Standard EOP-002. However, the NERC standard refers to balancing authorities and reliability coordinators, not to independent system operators.[3] Balancing authorities that are not known as "Independent System Operators" may be required to import electricity for reliability purposes under NERC Reliability Standard EOP-002. Furthermore, the term "Independent System Operator" is not defined in the Regulation, whereas the term "balancing authority" is defined in section 95802(a)(23).

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

To avoid inadvertently restricting the application of the new sentence in the definition of "Imported Electricity" and to maintain consistency with existing defined terms, the reference to "Independent System Operator" should be replaced with "balancing authority."

SCPPA's proposed change to section 95802(a)(137) is 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 meet NERC Reliability Standard EOP-002.

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

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 instruments, transactions, or holdings or who will be involved in decisions about transactions or holdings of compliance instruments.

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.

If the ARB's key concern is with employees of covered entities who themselves become voluntarily associated entities under the cap and trade program, 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 instruments, transactions, or holdings and is not involved in decisions about transactions or holdings of compliance instruments 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) and section 95830(c)(1) are set out below in markup:

> **§95814(a)**
>
> (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 instruments, transactions, or holdings, and is not involved in decisions regarding the employer's transactions or holding of compliance instruments. ...
>
> (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.
>
> **§95830(c)(1)**
>
> ~~(I) Names and contact information for all persons employed by the entity that will either have access to any information regarding compliance instruments, transactions, or holdings; or be involved in decisions regarding transactions or holding of compliance instruments; or both. An entity already registered in the tracking system must provide the notarized letter from their employer no later than January 31, 2015. Failure to provide such a letter by the deadline will result in suspension, modification, or revocation of his/her tracking system account.~~

(~~J~~I) Information required under section 95923 for individuals serving as consultants and bid advisors ...

VI. THE GROUNDS ON WHICH ACCOUNT REPRESENTATIVES CAN BE DENIED REGISTRATION SHOULD BE CLARIFIED.

New section 95830(c)(8) of the Regulation provides that an individual who requires access to the tracking system, including primary and alternate account representatives and account viewing agents, may be denied registration on any one of several grounds, including "Based on the information provided." It is not clear what kind of information, if provided, would result in an individual being denied registration "based on the information provided." Individuals need access to the tracking system to perform important functions for their employers. The grounds for denying registration should be clear.

SCPPA's proposed changes to clarify section 95830(c)(8) are set out below:

> An individual may be denied registration based on the information provided:
>
> ~~(A) Based on the information provided;~~
>
> ~~(B)~~(A) If the Executive Officer determines the individual has provided false or misleading information; ...

VII. THE NEW RESOURCE SHUFFLING PROVISIONS ARE WELCOME AND DO NOT REQUIRE REVISION.

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. As these provisions are the product of careful consideration of complex scenarios by the ARB and stakeholders, no changes to these provisions are needed at this time.

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").

For clarity and consistency with the summary of the proposed changes in the Notice of Public Availability of Cap-and-Trade Discussion Draft and Workshop,[4] the heading "Specified Sources" should be added at the start of section 95852(b)(3).

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, SCPPA appreciates that the ARB has at least addressed one concern with section 95852(b)(4)(B) by changing "the same year **in** which the RPS adjustment is claimed" to "the same year **for** which the RPS Adjustment is claimed" (emphasis added).

[4] Page 9 of the Notice states that "Section 95852(b)(3) was modified to add the title "Specified Sources"."

Minor additional changes to sections 95852(b)(4)(A) and (B) are also required 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 July 15, 2013 discussion draft of the Regulation) 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. ~~Have a~~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. COVERED ENTITIES SHOULD BE ALLOWED TO CHOOSE THE ORDER IN WHICH THEIR COMPLIANCE INSTRUMENTS ARE RETIRED.

New section 95856(h) of the Regulation sets out a standard order in which compliance instruments will be withdrawn from compliance accounts on surrender deadlines: offsets (oldest first), allowances (oldest first), true-up allowances, and lastly Reserve allowances.

This retirement order is acceptable as a default retirement order, provided that covered entities are given the option to specify a different order. To allow covered entities to manage their compliance obligations in an effective and flexible way, covered entities should have the ability to specify a retirement order for instruments in their compliance accounts.

There are several reasons why covered entities may wish to specify a retirement order that differs from the ARB's proposed order.

A. POUs need a way to avoid using allocated allowances for emissions from wholesale sales.

Publicly-owned electric utilities ("POUs") are not permitted to use the allowances freely allocated to them by the ARB to cover "compliance obligations for electricity sold into the California Independent System Operator markets." Regulation 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."

The proposed retirement order may result in a POU inadvertently breaching Regulation section 95892(d)(5) if the POU's retail sales for a year turn out to be lower and its sales into the CAISO markets for the year turn out to be higher than expected when the POU distributed its allowances for the year between its compliance account and its limited use holding account. 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.

These problems could be avoided if POUs were permitted to determine which allowances they want to be retired from their compliance account. Although allowance serial numbers will not be visible, the freely allocated allowances could easily be identified by the date they were transferred into the account and by the party initiating the transfer (the ARB). A POU could indicate that it wishes a certain number of its freely allocated allowances to be retired on a particular deadline equal to the emissions associated with its native load, with the remainder of the POU's compliance obligation that relates to sales into the CAISO markets being met with allowances it purchased at auction or on the secondary market. The remaining free allowances would be left to cover native load emissions in the future.

B. The ARB's retirement order would remain the default position.

At the July 18 workshop, ARB staff raised concerns that if entities were given the ability to specify the compliance instrument retirement order, there would be a risk of inadvertent breaches of the compliance obligation due to late or incomplete specification of the retirement order. This concern can be alleviated by using the retirement order set out in section 95856(h) as a default retirement order. If a covered entity does not specify its own retirement order by a set date, the ARB's default order should be applied.

Similarly, if a covered entity specifies the order of retirement of some compliance instruments in its compliance account but does not specify enough to meet its compliance obligation, the specified instruments should be retired, and the ARB's default order should then

be applied to the remaining compliance instruments in the compliance account until the entity's compliance obligation has been met.

X. EXCESS SURRENDERED OFFSETS SHOULD BE CARRIED FORWARD.

As part of the retirement order provisions, the new section 95856(h) provides that if an entity holds in its compliance account at an interim surrender deadline offsets equal to more than 8 percent of its triennial compliance obligation, all those offsets would be retired, but the offsets that were in excess of the 8 percent would not count towards the triennial compliance obligation and would remain in the ARB's retirement account. Thus, the excess offsets would be rendered worthless.

It would be possible for an entity to use offsets while reducing or avoiding the risk of having them become worthless. For example, an entity could avoid putting any offsets into its compliance account until the triennial surrender deadline. However, the possibility that offsets could become worthless would tend to further reduce the already low likelihood that entities will seek to use their full 8 percent share of offsets. Entities that are contemplating procuring offsets will see this risk as one more reason not to invest money and staff time in buying offsets, understanding the rules applying to offsets, and developing and implementing strategies to minimize offset risks, including buyer liability for retroactive invalidation. Entities that do procure offsets will be very cautious in surrendering offsets and will tend to surrender fewer rather than more offsets if the ARB's proposal is implemented.

The diminished use of offsets would have the effect of increasing the cost of compliance with the cap and trade program as a whole, given the important cost containment benefits of offsets as shown by the ARB's own studies. To avoid increasing cap-and-trade costs, offsets should not be rendered worthless if too many are in an entity's compliance account on an interim surrender deadline. Instead, the excess surrendered offsets should be counted towards the entity's

next surrender obligation and the 8 percent offsets limit in the next compliance period. This would maintain the value of offsets without violating the 8 percent limit.

Using the ARB's example on slides 11-12 of the presentation at the June 25, 2013 workshop, the 14,000 offsets surrendered in 2014 that were in excess of the 8 percent limit for the first compliance period would be counted towards the compliance obligation due in November 2016. The entity would need to surrender a further 16,000 compliance instruments to meet the 30 percent compliance obligation for 2015, assuming it continues to emit 100,000 mtCO_2e per year. The 14,000 offsets applied to the November 2016 obligation would also count towards the entity's 8 percent offset limit for the second compliance period, so the entity could surrender an additional 10,000 offsets in that period.[5] If it surrenders more than 10,000 offsets, the excess would be applied towards the entity's third compliance period obligation and offset limit. The number of offsets that are counted towards the next deadline could be tracked in the Compliance Instrument Tracking System Service ("CITSS") so the entity would be aware of the status of these offsets.

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

The cost containment mechanism set out in sections 95870(j) and 95913(f)(5) of the Regulation appears to involve 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

[5] 100,000 mtCO2e per year x 3 years x 8% = offset limit of 24,000 for second compliance period.

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 as proposed in the Joint Utilities paper on cost containment presented at the June 25, 2013 workshop. These measures must include a mechanism that provides unlimited additional allowances at the highest Reserve price, together with a mechanism for obtaining compensating emission reductions

A. Provide unlimited 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 option is similar to Measure C in the Joint Utilities cost containment paper. This

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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.

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 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.

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]

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

including revenue from the sale of additional Reserve allowances.[10] It may provide a useful part of the solution. However, given the broad scope of the Regulation, it may be difficult to obtain a large number of cost-effective emission reductions from uncovered sectors in California, so additional sources of emission reductions should be considered.

Option 4.4 in the ARB Paper, "Obtain emission reductions outside of California," seems to be the best option for obtaining additional emission reductions. Large pools of reputable international offsets[11] are currently available at comparatively low prices. There will no doubt be changes in the prices and availability of some of these instruments over the period to 2020 and beyond. However, given the increasing number of cap and trade programs with offset components around the world,[12] SCPPA expects that there will be sufficient instruments available for purchase whenever they are needed at prices lower than the top Reserve price. As Brian Murray of the Nicholas Institute noted at the June 25, 2013 workshop, any concerns regarding the stringency and integrity of other offset programs could be addressed by setting a multiplier, for example, one California allowance equals 1.5 offsets from the other program.

Although the ARB does not have control over revenues from the sale of allowances from the Reserve, the ARB does provide input into the investment plan for those funds[13] and could recommend that funds from the sale of additional Reserve allowances be set aside to procure compensating emission reductions in the form of offsets from other programs. If the ARB does

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

[11] Certified Emission Reductions ("CERs") under the Kyoto Protocol's Clean Development Mechanism are one example. As per the European Union emissions trading system, the ARB could choose to procure only CERs from certain protocols, or certain countries, to set a higher standard of additionality.

[12] In addition to the EU, Japan and New Zealand have cap and trade programs with offset components, and programs in Australia and the Republic of Korea are planned to commence in 2015. Large new regional cap and trade systems are currently being established in China. Mexico, Chile, Brazil and Turkey are also considering cap and trade. See "Mapping Carbon Pricing Initiatives 2013: Developments and Prospects", available at: http://www.ecofys.com/files/files/world-bank-ecofys-2013-mapping-carbon-pricing-initiatives.pdf.

[13] See Assembly Bill 1532 (2012).

not wish to procure those instruments itself, an independent contractor could be engaged to do so, operating under detailed and transparent rules imposed by the ARB.

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 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 CITSS 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.[14]
- 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.

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

- 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.
- 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 UNEXPECTED CHANGES TO THE STATUS OF INVESTIGATIONS WILL NOT PREVENT PARTICIPATION IN AUCTIONS OR RESERVE SALES.

Revised section 95912(d)(4) of the Regulation requires an entity to identify, as part of its application to participate in an auction, any ongoing investigations relating to alleged breaches of financial market rules, including a change in the status of such an investigation. New section 95912(d)(5) then provides that an entity whose auction application information will change 30 days prior or 15 days after an auction will be denied participation in the auction.

An entity may not know, by the auction application deadline, whether the status of an investigation will change within 15 days after the auction. The entity should not be denied participation in the auction on this ground. Section 95912(d)(5) should be revised to clarify this.

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

An entity with any changes to the auction application information listed in subsection 95912(d)(4) within 30 days prior to an auction, or an entity that

is aware that its~~whose~~ auction application information will change within 15 days after an auction, will be denied participation in the auction.

Section 95913(e)(2) provides that an entity with changes to the information listed in section 95912(d)(4) (including the status of investigations) 30 days prior to or 15 days after a Reserve sale cannot participate in that Reserve sale. This section should also be revised for the reason outlined above.

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

> An entity with any auction application information listed in subsection 95912(d)(4) ~~above~~ that changes within 30 days prior to a reserve sale, or an entity that is aware that this information will change within 15 days after a reserve sale, cannot participate in a reserve sale.

XIII. SECTION 95913(g)(7) IS UNCLEAR AND SHOULD BE REVISED.

New section 95913(g)(7) states that:

> The intent to bid notification requirements in subsection 95913(e) and bid guarantee submittal requirements in subsection 95913(g) shall be at least four business days before the bid guarantee submittal due dates.

This section is unclear. It seems to provide that bid guarantees are due at least four business days before bid guarantees are due. Correspondence with ARB staff indicated that this section was intended to provide a period of at least four business days between the due date for intent to bid notices (due 20 days before an auction) and the due date for bid guarantees (due 12 days before an auction). It would be helpful to ensure such a minimum period. However, this section must be revised to clarify this position.

SCPPA's proposed changes to section 95913(g)(7) are set out below in markup:

> The Executive Officer may revise the due dates for~~The~~ intent to bid ~~notification requirements~~notices in subsection 95913(e)(1) and for submission of bid guarantees ~~submittal requirements~~ in subsection 95913(g) to ensure a period of~~shall be~~ at least four business days ~~before the bid guarantee submittal~~between the two due dates.

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. THERE SHOULD BE NO REQUIREMENT TO COMPLETE TRANSFER REQUESTS WITHIN THREE DAYS OF SETTLEMENT OF TRANSACTION AGREEMENT.

Sections 95921(a)(1)(E) and (a)(3)(B) of the Regulation require transfer requests to be completed within three days of settlement of the transaction agreement for which the transfer request is submitted. Although no changes to these provisions were included in the July 15, 2013 discussion draft of the Regulation, slide 48 of the ARB's presentation at the July 18 workshop states that transfer requests must be completed within three days of:

- Execution date or termination date of the agreement;
- The "transfer of consideration" from purchaser to seller under the agreement;
- The execution of the underlying trade on an exchange or other trading platform.

This proposal appears to be intended as a revision to sections 95921(a)(1)(E) and (a)(3)(B).

However, the current sections as well as the proposed changes are problematic. First, 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 is not relevant to the ARB whether an entity completes a transfer request by the date specified in the transaction agreement, or completes it later, as the ARB does not enforce transaction agreements.

Second, from a practical perspective, it would be very difficult to define a date that applies to all possible types of transaction agreements. The Regulation 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."

The language proposed in slide 48 goes some way towards addressing the complexity of transaction agreements. However, it would not accommodate a transaction agreement for multiple transfers of compliance instruments over time for a zero price. This type of agreement is permissible under sections 95821(b)(2)(B) and (b)(6). In fact, a group of SCPPA members are currently finalizing such an agreement. Under such an agreement, transfers would not be made within three days of execution or termination, the transfer of any consideration would not necessarily be coincidental with compliance instrument transfers, and the trade would not be made on an exchange.

For these reasons, sections 95921(a)(1)(E) and (a)(3)(B) of the Regulation should be deleted.

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

Revised section 95921(b) of the Regulation requires entities to provide more information on compliance instrument transactions when requesting transfers of compliance instruments in CITSS, 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.

At the July 18 workshop ARB staff noted 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. RECONSIDER CONTRACTOR DISCLOSURE REQUIREMENTS.

New section 95923 requires covered entities to report to the ARB details on each contractor engaged to work on cap-and-trade compliance, including contractors engaged to provide verification services and advice regarding compliance with the cap-and-trade program.

The need for this provision and the scope of this provision should be reconsidered. First, the identity of a covered entity's verifier will already be known to the ARB through the provision of verification statements under the Mandatory Reporting Regulation. Second, the reference to advice regarding compliance would include attorneys advising clients on the cap-and-trade program. If an entity discloses the work performed by its attorneys under section 95923(b)(2),[15] 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 verifiers or attorneys.

Given these points, it appears that the ARB is unlikely to obtain much useful information from this section and should consider deleting it. If the ARB wishes to retain this section, it should be revised to more clearly define the types of contractors it covers. In addition, to reduce the reporting burden a simple online form should be developed, perhaps on CITSS, for an entity to complete if it engages such a contractor.

[15] This section requires "A brief description of work performed by the Contractor."

XVIII. CONCLUSION

SCPPA appreciates the opportunity to submit these comments to the ARB and urges the ARB to consider these comments when preparing the revisions to the Regulation for formal 45-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 the 2013 revisions to the Regulation are developed and finalized.

Respectfully submitted,

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