Comments of the Western Power Trading Forum
On the California Air Resources Board's
Preliminary Draft Regulation
For a California Cap and Trade Program
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The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (ARB) on its Preliminary Draft Regulation for a California Greenhouse Gas Cap and Trade Program (PDR). WPTF supports establishment of a cap and trade program as the most cost-effective and efficient means of achieving emission reductions under AB32. But this alone will not be enough. ARB must also ensure that appropriate enabling policies are in place to support implementation of the state's greenhouse gas programs. We therefore urge ARB to work closely with the Energy Commissions and the federal government to streamline permitting facilities and to facilitate development of necessary infrastructure for clean energy.

An overview of our most significant concerns regarding the PDR and cross-cutting issues are provided below. We then provide section by section by section comments on the PDR, following the organization and headings used in that document.

General Comments

Cap and Trade rules should be reviewed in light of any future federal GHG legislation
While there remains considerable uncertainty about the timing and details of a federal system, ARB must be cognizant of the evolution of federal policy, and provide opportunities to revisit cap and trade rules to maintain consistency with any future federal program. Although the PDR overview notes that "California will work to link and or transition to the national program", this bare observation is insufficient. As much as ARB would like to influence the design of a federal system, the rules for recognition and transitioning of state-level programs will be set at the national level, not the state level. The PDR should include an explicit rule stating that the adoption of federal greenhouse gas legislation will trigger a process to review and possibly modify the California cap and trade program.

More specificity on the rules for the first jurisdictional deliverer (FJD) approach is necessary
WPTF is also concerned that there is not enough specificity provided in the PDR regarding the FJD approach as it relates to importers of electricity. We therefore recommend that the PDR be elaborated to include greater detail in the following areas:

- Rules for identifying and monitoring electricity imports, using a combination of the North American Electric Reliability Association's electricity schedules (NERC e-tags) and contracts as appropriate, and any exemptions to the general requirements (e.g. 'wheel-through' of power),
- How responsibility for imports will be assigned to entities, and
- Rules for attributing emissions to imported power, including the treatment of out-of-state renewable energy credits.

[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

We note the work done by the California Public Utilities Commission and the Western Climate Initiative's Electricity Subcommittee on elaborating the FJD approach, and urge ARB to draw on this work in elaborating rules for FJD in the next version of the regulation.

ARB should not waste state resources on the development and oversight of offset programs outside the state.

The PDR's proposal for the development and regulation of offsets created outside of California is complex, inefficient and wasteful; particularly in light of the fact that offsets can only be used for 4% of an entity's surrender obligation. WPTF particularly opposes any outcome that would place California in the role of building capacity for or verifying projects in other countries at the expense of California residents and business who will ultimate fund ARB's activities. Rather, ARB's role should be limited to evaluating the quality of external offset programs and determining whether to approve offsets generated by those programs for use in California.

Provisions for the cancellation of offsets will undermine the offset market

WPTF strongly opposes the PDR's provision that an offset credit may be invalidated after issuance or approval by ARB -- even after it has been surrendered for compliance, due to the misconduct by the project developers of project verifiers. Such a buyer liability rule would be patently unfair to covered entities, who would effectively be penalized for the misconduct of others. Instead, liability for the validity and permanence of offsets should be placed on offset project developers and verifiers, and enforced by ARB in its role as the issuing and approving authority for offsets.

The PDR should be streamlined

The PDR contains significant amounts of redundancy; concepts are repeated in many places and provisions are repeated in different sections in slightly different ways. This redundancy creates potential for inconsistency in the regulation. For this reason, WPTF recommends that the PDR be streamlined and more efficiently organized. For instance, rules relating to compliance instruments (banking, borrowing, quantitative limit on offsets, surrender) should be covered together in a single section.

Section by section comments

Subarticle 2. Purpose and Definitions

Definitions (§95802)

WPTF is not providing detailed comments on the definitions at this time. However, ARB should review the definitions closely for consistency with the underlying PDR, and to remove duplicate terms which may create confusion. For instance, the PDR should use "allowance budget" or "allowance cap" but not both.

Subarticle 3. Applicability

Covered Entities (§95820)

The application of the regulation to electricity deliverers is unclear. Electricity deliverers should be defined as in-state generators and importers of electricity. For imported power, the surrender

obligation should accrue to the entity that is listed on the NERC e-tag as the Purchasing/Selling Entity for the first transmission leg into California. A corresponding definition of first deliverer should be added to the definition section.

Inclusion Thresholds for compliance entities (§ 95830)
The proposed approach to triggering the compliance obligation creates uncertainty for entities that operate near the margin of the emissions threshold. These entities would not know prior to exceeding the threshold whether they will be subject to a surrender obligation in that year. ARB may wish to consider an approach whereby an entity's passing of an emission threshold triggers a compliance obligation for the following year.

As WPTF stated in previous comments, we do not consider application of an emission threshold to be appropriate for imported power due to the fact that there is no direct link between the emissions associated with imported power and the size of the facility that produced that power. If ARB decides to apply an emission threshold to imports, then subparagraph (a)(2) should explicitly state that the threshold applies to the total of *all deliveries* by an entity in a calendar year, rather than to individual deliveries. This would ensure that electricity importers cannot avoid a surrender obligation simply by breaking power deliveries into smaller increments.

Opt-in Participants (§ 95840)
WPTF supports allowing entities without surrender obligations to hold, transfer and retire compliance instruments. Allowing market intermediaries to participate in the market will increase liquidity and ultimately reduce the transaction cost of trades. A larger and more liquid GHG market will provide less opportunity for market manipulation than a market with a smaller number of participants. Additionally, participation by brokers may be particularly important to help smaller entities plan for and manage compliance.

However, as currently written the language in section 95840, subparagraph (a) does not clearly establish the broad-based rights to hold, transfer and retire compliance instruments. This subparagraph should explicitly establish the right of the entities listed in subparagraph (a)(1) through (4) to hold, transfer and retire compliance instruments. Opt-in participants should be subject to the same rules for market transactions, and applicable penalties for non-compliance, as compliance entities.

Subarticle 4: Compliance Instruments

Compliance Instruments issued by the Air Resources Board (§ 95850)
WPTF presumes that in the next iteration of the PDR, this section will be expanded to address how allowances will be distributed to entities and on what basis they are placed in holding accounts. WPTF and its members will provide further comments on the allowance distribution proposal at that time.

The provision on surrender of offset credits in subparagraph (b)(2) is unnecessary, as it is covered elsewhere in the PDR.

Compliance Instruments issued by Approved External Greenhouse Gas Emissions Trading Systems (§ 95860)

Provisions under this section must ensure that compliance instruments issued by an external system and approved for use in California are equivalent to and fungible with instruments issued by the ARB.

It is not necessary that this section identify instruments from specific programs that are approved for use in California, as these are likely to change over time. However, ARB should ensure that it maintains and publishes an up-to-date list of approved instruments. Moreover, the circumstances under which an approved linkage may be changed or suspended must be clearly spelled out and must be prospective, so that transactions that have already occurred are not affected.

Subarticle 5: Registration and Tracking System

Registration and Tracking System (§ 95870)

Requirements for registration: A general provision should be added to require all covered entities to register in the tracking system. Currently the section appears to be optional for those entities that wish to hold compliance instruments.

Registration Dates: WPTF sees no need to delay the date for registration of opt-in participants. Subparagraph (b) should therefore be modified to enable opt-in participants to register as soon as the registry and tracking system is operational.

Creation of holding and compliance accounts: Subparagraph (a) of section 95840 allows an opt-in participant to voluntarily retire a compliance instrument. Subparagraph (d)(1) of this section should therefore be modified to provide both a holding and voluntary retirement account for opt-in participants.

Creation of holding and compliance accounts: Subparagraph (d)(2) should be changed so that, upon registration of a covered entity, the operator of the tracking system creates both a holding account and a compliance account for that entity. At the time of the surrender obligation, the entity would transfer compliance instruments from its holding account to its compliance account, in accordance with the provisions of section 95980.

Accounts Under the Control of the Executive Officer: The account reference in subparagraph (f)(2) should be called a Retirement or Surrender Account, instead of compliance account, to differentiate this account from entity compliance accounts. This subparagraph should also allow for the creation of other accounts by the Executive Officer, as needed.

Operation of tracking system: Additional provisions are needed to clarify how transfers of compliance instruments will occur and to ensure that each instrument is only valid in one account at any given time. Specifically, this section should include procedures for transfer of compliance instruments between entity accounts within the California Cap and Trade Market Tracking system, as well as transfers between the California Cap and Trade system and any external systems to which the California system is linked. While other areas of the PDR

anticipate notifying linked systems when a compliance instrument is retired, it will be equally important to ensure that both systems are aware of any transfer of compliance instruments between systems, to ensure the unit is only valid in one system at any given time.

Publication of information: The PDR must clarify what information collected and maintained by the tracking system will be published. WPTF supports publication of the names of registrants, and information on overall volumes and transactions of compliance instruments and prices to provide market transparency. However, we oppose public disclosure of information on the quantity of compliance instruments held and transferred by individual entities, as this is competitively sensitive.

Subarticle 6. California Greenhouse Gas Allowance Budgets

Modifications to the Annual Base Allowance Budgets (§ 95910)

Administrative Adjustments: Once annual allowance budgets have been established, covered entities will begin to prepare for compliance by investing in opportunities to reduce their emissions, and by acquiring compliance instruments to meet future surrender obligations. Any change to allowance budgets made after they have initially been set will increase uncertainty and financial risk for covered entities, because they alter the supply and demand of allowances, and thus price. For this reason, WPTF strongly recommends that as a starting point, administrative adjustment of allowance budgets only be considered in extreme circumstances, and that the circumstances that will cause the allowance budget to be modified are clearly and specifically enumerated.

ARB staff has identified 3 situations where it believes administrative adjustment may be warranted to prevent any severe under- or over-allocation of allowances. The first is the case where expected emissions of covered entities are significantly different than the annual allowance budgets for the initial years of the program. This would be a significant risk if ARB had to set the allowance budget for 2012 without reliable data on facility-level emissions of covered entities, as was the case when the European Union set allowance budgets for the first phase of its emission trading program. Fortunately, by the time the cap and trade regulation is finalized and annual allowance budgets are established for California, ARB will have two years of facility level emissions data. The availability of this data greatly reduces the possibility that projected emissions for the early years of the program will be substantially wrong. WPTF therefore does not support administrative adjustments for the initial years of the program.

The second case identified is changes to the scope of the cap and trade program, or thresholds for inclusion of covered entities. Changes to the sectors included in the scope of the cap and trade program could significantly impact the quantity of emissions covered by the program, and could therefore be a valid reason to adjust allowance budgets. However, since any changes in the scope of the program would necessarily be done prior to the compliance period in question, any adjustment to allowance budgets should also be done prospectively, and with substantial advance notice. Changes in the threshold for inclusion of covered entities could theoretically have a

significant impact on covered emissions, but in practice, the impact is likely to be immaterial, and therefore should not warrant an administrative adjustment.

The final case identified is changes in linkage with external trading or offset systems. With respect to an external trading system, linking will only result in under-or over-allocation in California if the external system itself is under- or over-allocated. Rather than adjust the annual allowance budgets in the California system to compensate for under- or over-allocation in an external, linked system, ARB should instead evaluate whether an external program is appropriately allocated as part of the determination of whether to link to that system. With respect to an external offset program, addition or suspension of a linkage will not result in under- or over-allocation in California because the quantitative offset limit does not change.

For these reasons, WPTF recommends that subparagraph (a) of this section only allow for administrative adjustment to annual allowance budgets in the case where a change in scope of the cap and trade program results in a significant change in the level of emissions covered by the program. Any administrative adjustment should be made at least three years in advance of the compliance period affected.

Adjustments to the Base Budgets to Account for Voluntary Investment in Renewable Sources of Electricity Generation: ARB is considering a set-aside and retirement of allowances for voluntary renewable energy purchases, because of the fact that these purchases will not reduce the overall level of emissions in California under the cap and trade system. Under the proposed set-aside, allowances would essentially be matched to, and retired on behalf of, voluntary renewable investors, but those investors would not actually be required to pay for the allowances.

WPTF agrees that voluntary renewable purchases are desirable, but does not consider that implementation of the cap and trade program will in any way diminish the environmental validity of voluntary renewable investments. Voluntary purchases of renewable energy will still increase the electricity load that is met through renewable generation beyond that required by mandatory renewable policies.

Providing a set-aside for voluntary renewable purchases will not improve the environmental justification for these purchases because allowances retired through the set-aside can simply be replaced by offsets or allowances from other systems (because the quantitative limit on their use is determined by an entity's emissions, not the allowance budget.) Instead, the set-aside will result in higher allowance prices for covered entities, without any additional environmental benefit. For this reason, WPTF opposes adjustment to base budget to account for voluntary renewable investments.

Subarticle 7. Surrender Requirements for Covered Entities

Duration of Compliance Periods (§ 95930)

WPTF believes that temporal flexibility for capped entities is an important means of containing compliance costs within the cap and trade system. However, discrete three-year compliance periods essentially provide entities with flexibility to use future year allowances during the first two years of the compliance period, but no flexibility in the final year. To address this

shortcoming, WPTF recommends that ARB require annual surrender of allowances, but allow entities to borrow allowances from the subsequent year. Such an approach would effectively operate as a rolling compliance period, by always providing entities with flexibility to use the next year's allowances. This approach provides temporal flexibility comparable to a multi-year compliance period, but ensures that this flexibility is available in all years. This approach is currently in use under the European Emission Trading System, and is consistent with the approach taken in the American Clean Energy and Security Act passed by the US House of Representatives and the proposed Clean Energy Jobs and American Power Act being considered in the US Senate.

Phase-in of Surrender Obligation for Covered Entities (§ 95930)
In general, WPTF believes that the broader the scope of the cap and trade program, the more effective, and cost-efficient it will be. For this reason, we have consistently supported inclusion of transportation fuels and fuel consumption in the program as soon as practically possible. However, we have also called for the cap and trade program to be operational as soon as possible; any difficulties in including these sectors should not delay implementation of the program. WPTF therefore supports the PDR's recommendations, provided the challenges of tracking and enforcing the program on these fuels can be surmounted.

Timing for Calculation of Covered Entity's Surrender Obligation (§ 95960)
As discussed above, WPTF supports shortening the compliance period to one year with annual surrender of allowances in conjunction with the flexibility to borrow from the subsequent annual allowance budget. Such an approach would eliminate the risk that ARB would not be able to capture allowances from entities that go bankrupt within a compliance year, but would still retain flexibility for covered entities.

Quantitative Usage Limit on Designated Compliance Instruments (§ 95970)
WPTF supports implementation of the quantitative limit on use offsets as an individual usage limit, set as a percentage of each covered entity's overall surrender obligation. An additional provision should be added to this section to ensure that any unused offset rights carry over to the individual entity in the subsequent compliance period, rather than to the system as a whole.

Surrender of Compliance Instruments by a Covered Entity (§ 95980)
As discussed above, WPTF supports annual surrender of compliance instruments, in conjunction with borrowing from the subsequent annual allowance budget. We therefore recommend modifying the timeframe to correspond to an annual surrender requirement.

Subarticle 8. Distribution of Allowance Value

No comment at this time.

Subarticle 9. Auction Design and Mechanisms for Distributing Auction Proceeds

Auction Operation and Registration (§ 96040)

WPTF believes that the timely public disclosure of information on auction clearing prices and total volume will be essential for price discovery and to ensure transparency of the market

conditions. While we do not see a need for public disclosure of the volumes of individual sales, we can support such disclosure provided that information on individual bidders is kept confidential.

WPTF would also support establishment of financial assurances requirements and buy limits for auction participants.

Cost Containment (§ 96040)

WPTF believes that intervention in the carbon market is warranted in the event of "extraordinary circumstances, catastrophic events or the threat of significant economic harm", as laid out in AB 32. WPTF would support the establishment of an oversight body to monitor market conditions, and to advise the Governor (through ARB) if intervention in the market is needed. Establishment of such a body would provide flexibility in identifying and responding to unforeseen circumstances without the need to rely on an inflexible, prescriptive price trigger. The price of allowances should be one factor to be considered by the oversight body in identifying unacceptable consequences, but should not be used as an automatic trigger for market intervention. The body should also consider other possible indicators for early warning of economic harm, such as energy availability, affordability and reliability. Any cost-containment mechanisms should be limited to true damage control and should not be triggered by short-term allowance price volatility.

With respect to the options for cost-containment mechanisms, WPTF considers it important to maintain the environmental integrity of the cap and trade system. Thus, any loosening of the cap in one year through, for instance, issuance of additional allowances should be compensated by a reduction in the cap in future years. Given the strict limit on the use of offsets, WPTF believes that an approach that would release allowances from a future year allowance budget would be more immediately effective in avoiding significant economic harm than expanding the limit on offsets or offset project types.

On the question of a price floor, while WPTF recognizes the importance of establishing clear price signals for long-term investments in GHG control technologies, we believe that these price signals are best ensured through setting an appropriately tight cap – not by interfering in the market. Emission reductions required under AB32 are much deeper than those under Phase I of the EU ETS and RGGI. Allowance prices are therefore expected to be much higher. For this reason, WPTF does not consider a price floor to be justified for California.

Subarticle 10. Free Allocation Mechanism

No comment at this time.

Subarticle 11. Trading and Banking

Trading (§ 96080)

WPTF notes that this section does not actually contain provisions for transactions of compliance instruments, but rather attempts to prevent market manipulation through transparency

requirements and restrictions on certain anti-competitive behavior. For this reason, we suggest changing the title of this subarticle to "Market Oversight".

General prohibitions on trading: Subparagraph (a) prohibits certain anti-competitive behaviors, such as attempts at market manipulation, or fraud without explicitly defining these behaviors or providing a means of determining whether such behavior has occurred. It also relies on expectations about the availability of reliable information on secondary market transactions, but does not describe how such market information will be assembled or disseminated.

To address this deficiency, WPTF recommends the establishment of a Market Monitor, similar to that established under RGGI, to assist in collecting, analyzing and disseminating market information and to monitor behavior of market participants. The Market Monitor should have access to all information on any auctions and should collect available information on the secondary and derivative allowance markets from publicly available sources. The Market Monitor should also be authorized to alert the relevant federal authorities, such as the Commodity Futures Trading Commission, in the event that suspicious behavior is identified.

The PDR should also promulgate clear rules for market behavior, so that participants will know what is expected of them. To this end, we recommend that ARB consider work done by various federal agencies, including the Federal Energy Regulatory Commission, to define inappropriate behavior.

WPTF notes that information on holding and actual transactions of allowances (rather than contracts) by individual entities will be collected and maintained in the allowance tracking system. Information on entity level holdings of allowances could be made available to the Market Monitor as an additional input to its market analysis. However, information on the market position of individual entities or accounts should be kept confidential. Only aggregate holding and transaction information should be made publicly available.

Holding limit: The provisions of the proposed regulation, including participation by non-covered entities, disclosure of auction and transaction information, periodic distribution of allowances, including through an auction mechanism, purchases limits and annual surrender of allowances will together prevent hoarding of compliance instruments. For this reason, WPTF opposes establishment of holding limits as anticipated in subparagraph (b). Neither the EU ETS nor RGGI have established holding limits on market participants.

<u>Use of Selected Trading Facility for Secondary and Derivative Market Transactions for CA GHG Allowances (Discussion of Concept)</u>

WPTF strongly opposes any attempt to regulate the secondary or derivatives carbon markets. Regulation of these markets falls under the purview of existing federal agencies, such as the Commodity Futures Trading Commission (CFTC), not state governments. Both the EU ETS and the RGGI have worked well without any direct regulation of the secondary and derivatives carbon markets, beyond the existing regulations that are already in place for commodity exchanges and brokers. To the extent that California allowances, offsets or derivatives are traded through existing exchanges, such as the Chicago Climate Exchange (CCX) or New York Mercantile Exchange (NYMEX), these trades will be subject to the oversight and authority of the

CFTC. As discussed above, WPTF believes that it would be appropriate for the ARB to monitor, through a Market Monitor, activity and behavior of the secondary and derivatives market to the extent possible. However, if inappropriate behavior is suspected, ARB should alert the CFTC or other appropriate authority and leave the investigation and enforcement of any perceived violations to the federal agency with clear authority and regulatory responsibility for policing these types of matters.

With respect to ensuring transparency of bilateral transaction, WPTF expects that additional market data (e.g., clearing prices, volumes) will be available on secondary trades of allowances, offsets and derivatives that occur through existing exchanges, such as NYMEX or CCX. The Market Monitor should be required to collect and synthesize publicly available information and to make these syntheses available to ARB and the public. WPTF would also support any effort to facilitate the sharing of information between the Market Monitor and the CFTC and other appropriate oversight agencies.

Banking (§ 96090)

WPTF recommends that the title of this section be changed to "Transactions of Compliance Instruments" as it covers, in addition to banking, voluntary retirement and other transaction rules. Further, we would support moving all rules regarding transactions and use of compliance instruments to a single section of the PDR, preferably the section on the Registry and Tracking mechanism.

With respect to the specific rules elaborated in this section, we recommend the following modifications, consistent with our other comments on the PDR.

Allowances issued for a current or previous compliance period and allowances issued for a future compliance period: WPTF supports an annual compliance period, with one year borrowing and unlimited banking. Therefore, this provision should be modified to allow allowances that have been issued for any previous calendar year, the current calendar year and the *next* calendar year to be used to meet a surrender obligation in the current calendar year.

Offset credits: The proposed language provides that "[a]n offset credit issued or approved by ARB pursuant to Subarticle 13 may be held or used to meet a surrender obligation if is has been verified." Subarticle 13 already provides that an offset credit should not be issued or approved until it has been verified. Thus, any issued or approved credit has, by definition, already been verified. The language in this section is therefore superfluous and should be deleted.

Expiration of Compliance Instruments: The text provides that a California compliance instrument will be removed from the tracking system if it is retired by an approved external GHG emission trading system to which the California system is linked. While this is appropriate, what is not clear is what happens when a California compliance instrument is transferred to an entity in another trading system. Ideally, the trading systems would also have linked tracking systems, in which case the compliance instrument should be removed from the California tracking system and transferred into the linked tracking system. If this is not possible, then a specific account should be created for holding instruments that have been transferred out of the California trading

system. This will insure that each compliance instruments is only valid for use in one trading system at any point in time.

Use of a Selected Clearing Facility for Bilateral Trades of Offset Credits (Discussion of Concept)
As we discuss in our response to section 96390 (Cancellation of Offset Credits), WPTF strongly opposes buyer liability for offset credits. In order to ensure that offset credits are a viable means of controlling costs, covered entities must have confidence that offset credits are permanently valid, and fully fungible with allowances. This can be achieved through rigorous requirements for monitoring and verification of offset credits, and by enforcing offset quality through make-whole contracts between ARB (or another issuing body) and offset project developers and verifiers. This will enable use of standardized contracts and the trading of offsets through exchanges. WPTF therefore opposes requiring a bilateral trade of offsets to be cleared through a commercial clearing mechanism.

Subarticle 12. Linkage to External Trading or Offset Crediting Systems

General Requirements (§ 96150)
WPTF supports a requirement that any system to which California has a bilateral linkage (i.e., California compliance instruments that may be used for compliance in the external system) have a Memorandum of Understanding (MOU) in place with ARB. However, we are concerned that a requirement for an MOU may create an insurmountable hurdle for unilateral linkage with external systems. In particular, we are not certain that it would be possible for ARB to establish an MOU with the United Nations Framework Convention on Climate Change (UNFCCC) in order to allow international offset credits issued under the Clean Development Mechanism (CDM) to be used in California. The UNFCCC system is implemented through a system of national registries, not through MOUs with participating governments: CDM credits are issued and transferred into entity accounts within national registries. As the United States is not a party to the Kyoto Protocol, this avenue will not be available to California entities. While it may be possible to set up an alternative mechanism to enable use of CDM credits within California (for example, through voluntarily retirement of those credits within the UNFCCC system by a national government), the PDR should not preclude these alternatives by requiring an MOU with the external system as the *only* allowable mechanism for unilateral linking.

Requirements for approval of External Greenhouse Gas Emissions Trading Systems (§ 96160)

Requirements for External GHG ETS for Registration, Market Tracking, Enforcement and Information Transfer: WPTF agrees that an external tracking system should be able to track transactions of compliance instruments, enforce compliance of participants with the trading system rules and monitor market conditions and behavior. However, many of the requirements of subparagraph (c) would inappropriately impose California rules and standards on external systems, and thus create a barrier to linking with those systems. For instance, subparagraph (c)(1)(B) requires an external, linked system to maintain information on prices and counterparties for all individual transactions. Not only is this information not currently required by any other GHG trading systems in existence, it is not yet clear whether it is possible to obtain this information for bilateral trades in any degree of detail.

Similarly, subparagraph (c)(3) would require an external system to transfer "market sensitive information necessary to monitor market trends on a regional basis … including aggregate emissions, positions of major market participants" to ARB. WPTF does not dispute the legitimate interest and right of ARB to monitor the emissions and positions of major market participants within the California GHG trading system, but we challenge the presumption that ARB should be entitled to monitor participants in other trading systems. This subparagraph should be deleted and replaced by a more general requirement that the external trading system be sufficiently transparent.

Requirements for approval of GHG Offset Crediting Systems (§ 96170)
As discussed above, WPTF believes that the requirement that an operator of an offset crediting system must enter into an MOU with ARB is overly restrictive and may prevent use of international offset credits from the CDM within California. We recommend deletion of subparagraph (a)(2).

Agreement (§ 96190)
As currently written, this requires an MOU with both unilaterally- and bilaterally-linked programs. WPTF recommends that an MOU be required only for bilaterally-linked programs, since the nature of bilateral linkage requires agreement and cooperation of both systems. In contrast, ARB can choose to approve or suspend a unilateral linkage; a unilateral linkage therefore should not require the consent and cooperation of the external program.

Subparagraph (a)(2) of this section requires an MOU to cover appropriate enforcement, verification and tracking systems for the external program. Consideration of the appropriateness of an external system's enforcement, verification and tracking procedures should be a fundamental part of the decision to link with the external system, not part of the MOU. The MOU should not specify particular procedures, but instead require that the external system continues to maintain and implement enforcement, verification and tracking procedures as a condition for ongoing linkage.

With respect to subparagraph (a)(3), WPTF believes that a key function of the MOU should be to establish the means for tracking the transaction of compliance instruments between the linked programs. This is a much broader task than merely providing for the disqualification of compliance instruments, as currently suggested by this subparagraph. This paragraph should be modified to require that the MOU cover arrangements for linking the tracking systems of the linked programs.

Suspension of linkage (§ 96210)
WPTF recommends that the rules for suspension of linkage must be clear and transparent. Suspension of a linkage with a trading program must be prospective (e.g., apply to future year allowance or offset vintages) and should not impair the ability of entities to use external compliance instruments that they have already purchased in conformity with system rules to meet surrender obligations in California .

Subarticle 13. Offset Credits

Role of ARB in the Offset Market (Discussion of Concept)
WPTF support the PDR's proposed role for ARB in issuing California offsets. For external offset systems, we do not see a role for ARB beyond determining whether to link with an external offset system, and in monitoring the external offset system to ensure it continues to meet the criteria for linking. Any credit issued by a linked, external offset system should be automatically approved by ARB and valid for surrender in California.

Registration of Offset Projects for ARB Issued Offset Credits (§ 96260)
WPTF believes that ARB cannot cost-effectively verify projects and offsets generated outside California. Therefore, ARB should issue offsets only for projects located in California. However, since the PDR does not place geographic restrictions on external programs to which the California system can be linked, ARB may approve offset credits from projects located anywhere, in accordance with linking rules.

Cancellation of Offset Credits (§96390)
The PDR's provision for cancellation of offset credits essentially places liability for the quality of offsets on the buyers of those offsets, which are ultimately covered entities. Contrary to ARB's assertion, the placing of liability on offset buyers will not remove incentives for deficient offset credits, but will instead stifle the offset market by creating too much uncertainty for potential purchasers of offsets and thereby investment in offset projects. In recognition of this fact, emission trading systems have generally avoided placing liability on offset buyers, and instead opted for establishment of rigorous requirements and procedures for ensuring that offset credits are additional, verified and real, and through strong oversight of offset verifiers.

In the case of California offsets, the PDR notes that ARB has the legal authority to take action against offset project developers and third-party verifiers. This legal authority means that ARB, itself, can enforce the validity of offsets, and ensure that any deficient tonnes are replaced. Rather than placing liability on offset buyers, ARB should instead require as a condition for accreditation of project verifiers and issuance of offset credits to project developers that those entities be liable for replacement of offsets that are found to be deficient due to that entity's negligence or misconduct.

California could also require as a condition for approving offsets issued from other systems that the issuing authority be responsible for the validity of offsets, and must have in place procedures to replace tonnes for any deficient or reversed offsets. Offsets from systems or project types for which offset developers and verifiers are not liable for the validity and permanence of offsets should not be approved for use in California.

For these reasons, WPTF strongly urges ARB to delete section 96390 of the PDR in its entirety.

Offset Credits Issued by External program (§96400)
In general, WPTF supports innovative approaches to offsets, such as the crediting of sectoral emission reductions that is being considered as a possible modification of the CDM. These approaches may have benefits beyond those provided by traditional project-based offsets,

including the potential to stimulate policy change in developing countries. However, we do not consider it ARB's role to attempt to drive innovation or policy change at the international level. Instead, ARB should focus on positioning California to take advantage of these changes if and when they occur.

For this reason, we recommend that the PDR simply provide for ARB to evaluate offsets generated by sector-based crediting for use in California once such sector-based crediting systems are in place, either in the CDM or through other mechanisms. ARB should not be involved with analysis, capacity-building or other activities to set up sectoral-based systems, as this would be expensive, inefficient and beyond the scope of AB32.

Requirements for Offset Credits Issued by an External program for Project Locate in the United States or Canada (§96410)

WPTF notes that, with the exception of the prohibition on projects that apply to sources that are covered by California's cap and trade program, all other provisions of this section are covered in other sections of the PDR. We therefore suggest that this section be eliminated, and the limitation on project types be moved to section 96220 (General requirements for offset credits).

Requirements for Offset Credits Issued by an External program for Project Located in Developing Countries (§96420)

Similarly, provisions of this section are also covered elsewhere in the PDR. The exception is the preference given to offset projects located in least developed countries. WPTF considers this preference to be completely inappropriate – the purpose of approving offsets for use in California, as guided by AB32 and recognized by the Scoping Plan, is to reduce emissions and compliance costs – not to promote economic development in least developed countries. We therefore recommend deletion of this entire section.

Requirements for Sector-based Crediting (§96430)

As discussed above, we believe elaboration of rules for approval of sector-based credits is premature, unnecessary and prejudges further development of sector-based crediting mechanisms elsewhere. WPTF recommends that this section simply authorize ARB to consider approval of sector-based credits from external systems, once such systems are developed.

Subarticle 14. Enforcement and Penalties

Enforcement and Penalty Provisions (Discussion of Concept)

ARB should ensure that in elaborating this section, it also provide for due process in any enforcement cases. Specifically, ARB should adopt a protocol by which respondent entities can review and respond to allegations before penalties are assessed.