COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY TO THE CALIFORNIA AIR RESOURCES BOARD ON THE PRELIMINARY DRAFT REGULATION FOR A CALIFORNIA CAP-AND-TRADE PROGRAM

MICHAEL D. MONTOYA
CATHY A. KARLSTAD
NANCY CHUNG ALLRED

Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
Post Office Box 800
Rosemead, California 91770
Telephone: (626) 302-3102
Facsimile: (626) 302-1904
E-mail: Nancy.Allred@sce.com

Dated: **January 11, 2010**

COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY TO THE CALIFORNIA AIR RESOURCES BOARD ON THE PRELIMINARY DRAFT REGULATION FOR A CALIFORNIA CAP-AND-TRADE PROGRAM

TABLE OF CONTENTS

COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY TO THE CALIFORNIA AIR RESOURCES BOARD ON THE PRELIMINARY DRAFT REGULATION FOR A CALIFORNIA CAP-AND-TRADE PROGRAM

TABLE OF CONTENTS (CONTINUED)

I.

INTRODUCTION AND EXECUTIVE SUMMARY

Southern California Edison Company ("SCE") is pleased to submit these comments on the Preliminary Draft Regulation for a California Cap-and-Trade Program ("PDR") released by the California Air Resources Board ("CARB") on November 24, 2009. SCE appreciates the time and effort from CARB staff in preparing the PDR and in holding the December 14, 2009 workshop with stakeholders.

SCE encourages CARB staff to continue its work in designing a cap-and-trade program that will reduce greenhouse gas ("GHG") emissions in a way that is fair to all market participants and contain costs. SCE also urges CARB to design a cap-and-trade program such that it can be used as a foundation for designing a federal program or be easily integrated into a federal program in the event that federal legislation eliminates the need for a California-only cap-and-trade program. The cap-and-trade market should be as broad and inclusive as possible. A narrow California-only program makes it more likely that the California market will not function properly, or at least not allow entities within the State to achieve cost-effective compliance.

The cap-and-trade program should also be designed to be implementable on the first day of compliance for covered entities. Currently, the PDR contains a large number of compliance deadlines and mechanisms including initial surrender, auctions, evaluation of external trading systems, reporting, true-up periods, and placement of third-party support organizations. However, the PDR lacks initial deadlines or completion dates for tools, systems, verifications, registrations and certifications that require CARB approval or development. All of these mechanisms enumerated in the PDR should be in place in advance of program implementation or expected compliance. Without having the market mechanisms in place, covered entities will be unable to properly plan and prepare to enter an undefined market. In order to support a working market, CARB should develop a work plan and set implementation and completion deadlines for the tools, policies, and other mechanisms described in the PDR and publish these as part of the regulation development process.

SCE offers the following specific comments on the PDR.

- The PDR should revise its definition of renewable energy to be consistent with the California Energy Commission's ("CEC") requirements for Renewable Portfolio Standard ("RPS") eligibility.
- CARB's should clarify how the emission thresholds will apply to imported electricity.
- The cap-and-trade program should contain cost control instruments, not only to reduce the cost to California customers, but also to prevent opt-in participants from manipulating the allowance market.
- Covered entities should be able to use external compliance instruments or offsets in the California cap-and-trade system.
- In setting the annual caps on emissions as well as the proposed rate of decline, CARB should take into account the timing for development of new technologies and avoid a straight-line trajectory.
- The initial 2012 cap level should be adjusted upwards to reflect early emission reduction efforts.
- Three-year periods for compliance maintain essential flexibility as opposed to shorter, one-year periods.
- CARB's biomass policy should be carefully crafted to align with the State's renewables goals. CARB should make consistency across sectors a preferred goal when crafting its provisions for fuel deliverers.
- SCE supports a mechanism to assess the risk of default on an entity-specific basis. Such a mechanism should not require extra scrutiny for entities that do not present a compliance risk.
- The auction process for allowances should be kept transparent and simple.
- The allowance allocation process should minimize the economic burden of implementing a cap-and-trade program.

- For optimal operation of the market, SCE supports broad, inclusive cap-and-trade markets subject to strong reporting and transparency requirements.
- CARB should not delegate responsibility for design and implementation of the offsets program to a third party.
- CARB should not place geographic limits on CARB-issued offset credits.
- To ensure that parties can meet their surrender obligations, SCE supports the creation of financial insurance instruments that would fund the purchase of compliance instruments in the event an offset is cancelled or reversed.
- Until sector-based crediting is made available for international offsets, CARB should allow parties to use existing international offsets to meet their compliance obligations.
- Finally, SCE offers its recommendations on CARB's proposed amendments to the regulation for mandatory reporting.

II.

SUBARTICLE 2, SECTION 95802: THE PDR'S DEFINITION OF "RENEWABLE ENERGY" SHOULD BE CONSISTENT WITH CEC REQUIREMENTS FOR RPS ELIGIBILITY

In the PDR, "renewable energy" is defined as "energy from sources that constantly renew themselves or that are regarded as practically inexhaustible."[1] The definition also states that renewable energy "includes, but is not limited to, energy derived from solar, wind, geothermal, hydroelectric, wood, biomass, tidal power, sea currents, and ocean thermal gradients."[2] The current definition is too broad and should be revised to ensure consistency between and among the State's GHG reduction programs. To the extent that the definition of renewable energy is included in the final PDR, SCE recommends that this definition be modified to be consistent

[1] PDR at 20, Section 95802(127).
[2] *Id.*

with the CEC requirements for RPS eligibility.[3] This will make the definition of renewable energy in the PDR consistent with the proposed approach for CARB's Renewable Electricity Standard ("RES") regulation.[4] It is also consistent with PDR's definition of "renewable energy credit" or "renewable energy certificate," which means "a certificate of proof, issued through the accounting system established by the Energy Commission, that one MWh of electricity was generated and delivered by a renewable energy source."[5] Utilizing a different definition of renewable energy than the definition that is used in the CEC's WREGIS accounting system will significantly complicate reporting and create inconsistencies among the State's renewable energy and GHG reduction programs.

III.

SUBARTICLE 3, SECTION 95830: CARB SHOULD CLARIFY HOW EMISSION THRESHOLDS WILL APPLY TO IMPORTED ELECTRICITY

During the first compliance period, beginning in 2012, covered entities will include electricity deliverers. The threshold for electricity deliverers is 25,000 metric tons of CO_2e per year.[6] According to the PDR, an electricity deliverer "has a surrender obligation for . . . emission[s] associated with electricity imported into California from a jurisdiction where a GHG emission trading system has not been approved by the Board . . . "[7] CARB has not yet clarified how the 25,000 MT CO_2e threshold will apply to imported electricity transactions.

For stationary sources, such as electricity generation facilities located within California, this threshold can be applied on a facility-specific basis. However, the emissions associated with an individual imported electricity transaction are unlikely to ever exceed the 25,000 MT CO_2e threshold. It would be meaningless to subject individual electricity transactions to the cap-and-trade compliance threshold. Instead, SCE suggests that CARB require electricity deliverers to

---

[3] *See* Renewables Portfolio Standard Eligibility Commission Guidebook, CEC-300-2007-006-ED3-CMF (January 2008).
[4] *See* Proposed Outline for the California Renewable Electricity Standard at 9 (October 2009).
[5] PDR at 20, Section 95802(129).
[6] *Id.* at 27, Section 95830(a)(2).
[7] *Id.* at 38, Section 95950(b)(1).

aggregate all their imported electricity transactions over one calendar year and subject the aggregate emissions related to their annual imported electricity to the threshold. However, CARB should ensure that it does not create a loophole for electricity deliverers to create multiple individual corporate entities, none of which individually exceed the 25,000 MT CO_2e threshold.

IV.

SUBARTICLE 3, SECTION 95840: IF CARB DESIGNS A CAP-AND-TRADE PROGRAM WITHOUT SUFFICIENT COST CONTROL INSTRUMENTS, OPT-IN PARTICIPANTS MAY BE ABLE TO MANIPULATE THE ALLOWANCE MARKET

SCE recognizes the role of market makers, such as bankers and traders, as a means to maintain a liquid, efficient market for allowances. However, SCE is concerned that the combination of a declining cap, needlessly restrictive offset regulations, and insufficient cost control instruments create a circumstance in which opt-in participants could manipulate the allowance market in a manner that is inconsistent with cost minimization.

SCE has consistently supported reasonable offset rules that will allow for the use of real, permanent, quantifiable, verifiable, and enforceable emission reductions for compliance. Additionally, SCE supports allowance borrowing and a price cap that would discipline the market and assure the long run success of the cap-and-trade program. These tools are critically important to control costs and reduce the opportunity for manipulation in the allowance market. While SCE appreciates the inclusion of banking and offsets as crucial cost containment measures in the cap-and-trade program design, CARB has not supported allowance borrowing and has supported certain restrictive offset regulations. SCE encourages CARB to allow borrowing and increase the number of offsets allowed in the system. Otherwise, significant controls on the ability for opt-in participants to hold allowances, particularly between compliance periods, will be needed to reduce the risk of market manipulation. CARB staff should investigate limitations on the ability of opt-in participants to buy and hold compliance instruments.

V.

SUBARTICLE 4, SECTION 95860: ENTITIES SHOULD BE ALLOWED TO UTILIZE EXTERNAL COMPLIANCE INSTRUMENTS AND OFFSETS IN CALIFORNIA'S CAP-AND-TRADE PROGRAM

CARB staff notes that the article in Section 95860 may determine that compliance instruments issued by external GHG emissions trading systems, or offsets issued by external GHG offset crediting systems, will be allowed to meet surrender obligations in California's cap-and-trade program.[8] If these external systems were not available, the cap-and-trade market would be so narrow that trading between entities to achieve compliance could become problematic. Regulated entities could be unable to purchase sufficient allowances from other entities to meet their compliance obligations.

CARB should create a viable and robust offsets system to allow businesses to continue operating within the State. SCE encourages CARB to allow California covered entities to use these outside compliance instruments, as a broad supply of allowances and offsets is a key tool in containing the costs of GHG emissions abatement. Both external allowances and offsets should be approved at the outset of the California cap-and-trade program to provide certainty to covered entities.

VI.

SUBARTICLE 6, SECTION 95890: WHEN SETTING ANNUAL CAPS ON EMISSIONS, CARB SHOULD NOT ESTABLISH STRAIGHT-LINE CAP TRAJECTORIES

Section 95890, when completed, will identify how the annual cap on emissions for sectors within the cap-and-trade program will be set.[9] CARB provides a spreadsheet illustrating how it plans to derive these caps, with example base budget numbers "for illustrative purposes" and stakeholder comment.[10] The annual numbers represent base-year emission values,[11]

---

[8] PDR at 29.
[9] *Id.* at 31.
[10] *See id.* at 31-32; *see also* http://www.arb.ca.gov/cc/capandtrade/meetings/121409/capcalc.xls.

annually declining to equal the cap-and-trade sectors' capped emissions value of 365 million metric tons in 2020. The annual rate of decline from the respective 2012 and 2015 base year emission values is calculated to reflect a levelized decline through 2020.

The example numbers in the PDR show that CARB is currently planning to establish straight-line trajectories to the 2020 cap for both Broad Scope and Narrow Scope sources.[12] SCE agrees that any trajectory should have an end point that meets AB 32's goal of 1990 emission levels by 2020. However, SCE recommends that the first compliance period be viewed as a transition period, with a reduced reduction trajectory in order to allow a period of adjustment for new technologies to develop and reductions from other emission reduction measures to materialize, as well as to reduce the economic burden of emission reductions.

It will take time for new low-carbon technologies that will reduce emissions to develop. Moreover, the reductions from other emission reduction measures are not likely to occur on a straight-line trajectory. For example, the need to build transmission to interconnect new renewable resources and the time required to construct such transmission makes it more likely that emission reductions from new renewables will be back-loaded.

Additionally, it is not clear that renewables will provide an additional avenue by which cap-and-trade entities can meet their GHG reduction goals. Since the RES will require cap-and-trade entities to obtain renewables to comply with a specific RES program, there is a very low likelihood that additional renewables will be available to entities hoping to reduce their GHG emissions. Accordingly, the design of the cap-and-trade system is fundamentally flawed because the hoped-for drive for low-carbon technology induced by the cap-and-trade carbon price is virtually eliminated by the insistence that renewables development be driven by a RES, regardless of the price of reductions attributable to renewables.

Furthermore, it is well known that prices will increase as a consequence of GHG reduction measures. To a certain extent, moderate price increases are not only inevitable but

---

Continued from the previous page

[11] There will be an adjustment in base numbers in 2015 to include the additional emissions from the newly-added broad-scope entities.

[12] PDR at 31-32.; *see also* http://www.arb.ca.gov/cc/capandtrade/meetings/121409/capcalc.xls.

desired, since consistent and accurate price signals will help drive investment to low-emitting technologies and reward obligated entities and consumers for taking actions that reduce GHG emissions. However, even moderate price increases may cause a significant economic burden. It takes time to adjust to a carbon-constrained world that features higher energy prices. Individuals and businesses need time to adjust their behavior and make investments to reduce their energy and fuel use. Moreover, experiences such as the California electricity crisis of 2001 show that rapid increases in prices of critically-needed commodities result in regulatory exceptions that threaten the integrity of emission reductions systems. During the California electricity crisis, the South Coast Air Quality Management District's nitrogen oxide declining cap RECLAIM program was effectively temporarily abandoned to assure existing power plants could continue to operate.

Consequently, the trajectory of cap should begin with moderate emission reductions in the first compliance period, and then "ramp up" with greater reductions in the second and third compliance periods. The cap trajectory should not be a straight line. Instead, the first period should have a relatively moderate slope, and the second and third periods a relatively steeper slope. This trajectory will allow time for adjustments to GHG pricing and reduce the economic burden of the new GHG reduction program, while still meeting the 2020 AB 32 goals.

VII.

SUBARTICLE 6, SECTION 95910: THE INITIAL 2012 CAP LEVELS SHOULD BE ADJUSTED UPWARDS TO REFLECT EARLY EMISSION REDUCTION EFFORTS

SCE encourages CARB to consider adjusting base budget numbers upwards to account for GHG emissions displaced by voluntary early actions or investments. Specifically, SCE is concerned with an earlier suggestion from CARB staff that emission reductions as a result of any early actions would reduce the need to acquire emissions allowances under the cap-and-trade program, and consequently that CARB might not explicitly recognize and reward voluntary early

actions.[13] SCE believes that CARB's allowance caps should reflect an adjustment similar to the Western Climate Iniative's ("WCI") proposed Early Reduction Allowance adjustment.[14]

At least since the passage of AB 32, stakeholders have been taking concrete and quantifiable steps to reduce their emissions. A business-as-usual projection of estimated actual emissions in 2012 would likely include the emission reductions from these early actions as part of the reference or base case. Should CARB rely on such a projection to set the 2012 cap, the cap would be set below what it would have been had the voluntary early reductions not occurred. In an *actual* business-as-usual scenario, not only would the cap and the allowance allocation be greater, but the compliance entities could have fully monetized their reductions. By not acknowledging these early actions, CARB would penalize those entities who decided not to wait for the cap-and-trade program and preemptively reduced their GHG emissions. This is inconsistent with AB 32's requirement that CARB "[e]nsure that entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions."[15] Although CARB should determine its best estimate of actual emissions in 2012, adjusting the 2012 cap upward by the amount of GHG reductions due to voluntary early actions would avoid penalizing those entities that already reduced their emissions and would be consistent with the WCI's proposed cap-and-trade regulations.

---

[13] November 16, 2009 Public Meeting; *see* Comments of Southern California Edison Company to the California Air Resources Board on Cap Setting and Data Review: Establishing Surrender Obligation and Examining Historical GHG Data Trends (December 14, 2009).

[14] Design Recommendations for the WCI Regional Cap-and-Trade Program, September 23, 2008, Corrected March 13, 2009. section 8.11.

[15] Cal. Health & Safety Code § 38562(b)(3).

VIII.

SUBARTICLE 7, SECTION 95930: SCE SUPPORTS THREE-YEAR COMPLIANCE PERIODS

Section 95930 of the PDR outlines the duration of the three compliance periods for covered entities.[16] Compliance time periods should be consistently administered. Accurate GHG compliance planning requires strict adherence to preset and stated compliance cycles. CARB should maintain the current three-year compliance periods, as shortening the time periods would reduce compliance flexibility. Such flexibility is essential to achieving the most cost-effective and efficient emissions reductions.

IX.

SUBARTICLE 7, SECTION 95950: CARB'S BIOMASS POLICY SHOULD ALIGN WITH STATE GOALS, AND CARB SHOULD MAKE CONSISTENCY ACROSS SECTORS A PREFERRED GOAL

Section 95950 of the PDR excludes from the calculation of surrender obligation certain types of biomass.[17] However, the provisions listing specific exceptions are yet to be developed.[18] Although SCE does not suggest specific language here, it notes that this section must be carefully crafted in order to align State policies as they relate to GHG emissions reductions and other goals, such as increasing of the use of biomass among other renewable resources.[19] Significant limits on exclusions could discourage the use of biomass and threaten the State's renewable energy goals, while too many exclusions might threaten the State's GHG emissions reduction goals. The exclusion language must balance the State's definition of renewable biomass resources, along with the reality that biomass resources are not all created equal and that some of those resources do not reduce GHG emissions.

---

[16] PDR at 37, Section 95930.
[17] *Id.* at 38, Section 95950(a)(2).
[18] *Id.*
[19] *See* Executive Order S-06-06 (April 25, 2006).

In crafting its provisions on fuel deliverers, CARB staff seek stakeholder input on the relative importance on fuel-switching incentives, consistency across sectors and end uses, scalability to a broader program, and reporting and administrative complexity.[20] Consistency across sectors and end uses is the most important consideration. Consistent treatment between the various fuels in the cap-and-trade and LCFS rules will create a level playing field for the program participants and allow for fair implementation of the rules. While reporting and administrative complexity is an important consideration, the utilities have been collecting reporting data for the LCFS program and CARB should be able to use that data for the cap-and-trade program. In addition, while SCE supports CARB in considering an incentive to encourage fuel switching to low-carbon fuels such as electricity and hydrogen, more information about the various options is needed.

X.

SUBARTICLE 7, SECTION 95960: TO ADDRESS THE POTENTIAL BANKRUPTCY OF COVERED ENTITIES, CARB SHOULD DESIGN COMPLIANCE RULES SPECIFICALLY FOR THOSE ENTITIES WITH HIGH DEFAULT RISK

Section 95960 of the PDR summarizes the timing for calculation of a covered entity's surrender obligation.[21] CARB staff have expressed concern that covered entities may default on their obligation to retire allowances and that this default risk could increase if the cap-and-trade program utilizes multi-year compliance periods. The PDR includes a discussion concept to address the bankruptcy of covered entities, and asks stakeholders to comment on two policy options.[22] The first option would require covered entities to cover a portion of their annually-reported emission by retiring compliance instruments at specific periodic intervals. The second option would shorten the compliance period to one year.

---

[20] PDR at 40-41, Section 95950(c).
[21] *Id.* at 41-42, Section 95860.
[22] *Id.*

Shortening the compliance period is not the solution to mitigating the default risk. SCE favors multi-year compliance periods and opposes periodic true-ups as a means to address default risk. CARB staff should investigate some new process or financial instrument to cover this default risk. For example, an insurance instrument that would cover default risk could be developed. The pricing for such an instrument would need to be actuarially fair, meaning that lower-risk entities pay lower premiums per unit of exposure. CARB staff could also consider creating an exchange or clearing house where members could self-insure against a single-member default by paying to participate in the exchange.

CARB should not change the compliance rules for all entities to address the default risk for certain higher-risk entities. Creditworthy covered entities with low default risk should not be burdened with onerous compliance rules designed to address the default risk of less reliable entities. If CARB chooses to mandate periodic true-ups to reduce default risk, it should only utilize such true-ups for recognized high-risk entities. Covered entities with low default risk should not be forced to retire compliance certificates in advance of the end of the compliance period.

XI.

SUBARTICLE 9, SECTIONS 96030-96040: CARB SHOULD DESIGN AN AUCTION THAT IS TRANSPARENT AND SIMPLE

SCE understands that any questions regarding allowance auction design may be premature as the question of whether to utilize an auction has not been determined. However, should CARB choose to utilize an auction to distribute allowances, SCE recommends an auction design that is transparent, straightforward, and minimizes the opportunity for manipulating the outcome. The PDR addresses auction design in general and references the anticipated final report of the Economic and Allocation Advisory Committee ("EAAC").[23] The Draft EAAC

[23] PDR Overview at 8; PDR at 49-50, Sections 96030-96040.

Report recommends using a uniform price sealed bid auction. SCE agrees that a uniform price sealed bid auction is the simplest design and most straightforward for auction participants.

XII.

SUBARTICLE 10: CARB SHOULD CREATE AN ALLOCATION PROCESS THAT WILL MINIMIZE THE ECONOMIC BURDEN OF IMPLEMENTING A CAP-AND-TRADE PROGRAM

The PDR does not address allowance allocation in any detail, opting instead to wait for the EAAC Final Report.[24] The Draft EAAC Report recommends that no allowances or allowance value be allocated to electricity load-serving entities ("LSEs") for benefit of electricity customers.[25] Specifically, the Draft EAAC Report recommends returning allowance value to electricity customers by way of either a tax reduction or a fixed dividend.[26] These two options are needlessly complicated, offer no assurance that the amount returned would be a fair and equitable representation of actual economic harm, and would require additional legislative action to implement. Further, it is clear from reading the Draft EAAC Report that the EAAC has not sufficiently evaluated the regulatory and ratemaking processes in the electric sector. For example, the Draft EAAC Report expresses concern that returning allowance value via LSEs would reduce electricity rates and not expose customers to the rate impact that would result from including the cost of carbon. However, as SCE has stated in previous comments, the regulated ratemaking process offers a mechanism to return this value to customers in a non-volumetric way to maintain the integrity of the carbon price signal. The allowance value can be returned to ratepayers via fixed rebates. These rebates can be included in monthly, quarterly or annual rebates to customers, and are particularly important early in the transition period.

Additionally, SCE encourages CARB to consider the economic burden of implementing the complementary measures recommended in the Scoping Plan. The Draft EAAC Report

---

[24] PDR Overview at 8.

[25] Economic and Allocation Advisory Committee Report Draft, November 4, 2009, at 2-3 (available at http://www.climatechange.ca.gov/eaac/documents/eaac_reports/2009-11-04_Allocation_Report_Draft.pdf).

[26] *Id.* at 29.

recommends that a significant share of allowance value be used to promote investments in low emission technology, energy efficiency, and renewable energy procurement. However, the Draft EAAC Report fails to recognize the existing LSE expenditures in these areas and the additional costly complementary measures that are imposed on LSEs in the Scoping Plan. Allowance value could be used to offset the higher costs of these direct measures without impacting the integrity of the carbon price in retail rates.

Returning allowance value to ratepayers via LSEs allows for a relatively straightforward application of existing regulatory processes to ensure that a fair and appropriate amount is distributed to electricity customers. This can be done in a way that addresses the higher cost of the cap-and-trade and complementary policies while maintaining the carbon price signal. The electricity sector is already being disproportionately burdened with emission reduction mandates greater than its share of emissions. By returning allowance value to electricity customer via regulated LSEs, some of this inequity could be mitigated.

XIII.

SUBARTICLE 11, SECTIONS 96080-96090: SCE SUPPORTS BROAD, INCLUSIVE MARKETS SUBJECT TO REGULAR REPORTING AND REGULATORY TRANSPARENCY

In Sections 96080 and 96090 of the PDR, CARB staff provide an overview of principles for trading and banking of compliance instruments and offsets.[27] SCE generally agrees with the proposed language of the PDR. However, two overarching principles merit repetition. First, broader, more inclusive markets are better for liquidity and in the long run will provide the most efficient trade instrument pricing. Second, both the financial and physical transactions of all market participants should be subject to regular reporting and regulatory transparency. The combination of these principles should help to ensure well-functioning markets within the cap-and-trade program.

---

[27] PDR at 51-54, Sections 96080-96090.

XIV.

SUBARTICLE 13: CARB SHOULD SERVE AS OFFSETS ADMINISTRATOR AS PART OF THE CAP-AND-TRADE PROGRAM IMPLEMENTATION

The PDR proposes several roles for CARB as the administrator of an offset system and seeks stakeholder input on whether CARB should become a credit issuing body for offset credits, approve offset credits issued by external programs, or some combination of the two.[28] CARB cannot and should not delegate responsibility for design and implementation of the cap-and-trade and offsets program. As the PDR notes, a credit issuing body is tasked with many complicated assignments, including approving quantification methodologies, reviewing and approving offset programs, overseeing the monitoring and recordkeeping of project activities, and reviewing verification statements. As part of this function, CARB should implement clear and transparent standards for offset projects. Managing the offset system internally will allow CARB to better manage its credit issuing responsibilities.

XV.

SUBARTICLE 13, SECTION 96260: THERE SHOULD BE NO GEOGRAPHIC LIMITS ON CARB-ISSUED OFFSET CREDITS

SCE supports CARB's determination during the Scoping Plan process that it would not place geographic limits on the origins of offset credits.[29] However, the PDR indicates that CARB is now considering whether CARB issuance of offset credits should be limited to California, the United States, North America, or not at all.[30] SCE has consistently advocated that the supply of offsets should not be artificially constrained. CARB should not place geographic limits on its issuance of offset credits. Although it is true that limiting the geographic area for CARB-issued credits would not preclude credits from other parts of the world, it would create additional administrative burdens in terms of qualifying and approving the external programs.

---

[28] *Id.* at 61.
[29] Scoping Plan at 38.
[30] PDR at 67, Section 96260.

XVI.

SUBARTICLE 13, SECTION 96390: CARB SHOULD ALLOW THE CREATION OF FINANCIAL INSURANCE INSTRUMENTS TO REPLACE REVERSED OR CANCELLED OFFSETS

The PDR discusses the reversals of offset credits and the point of enforcement and assessment of penalties if an offset credit is reversed or found invalid.[31] The PDR notes that the CARB's preferred approach would be to require the covered entity using the flawed offset credit to meet its surrender obligation by making the system whole and replacing the lost tons. SCE supports the creation of a financial insurance instrument that would fund the purchase of offsets or other compliance instruments if a previously used instrument was deemed to be invalid or otherwise nonperforming.

XVII.

SUBARTICLE 13, SECTION 96400: CARB SHOULD ALLOW ENTITIES TO USE EXISTING INTERNATIONAL OFFSETS

AB 32 directs CARB to design GHG emission reduction measures to meet statewide emission limits in a manner that minimizes costs and maximizes benefits for California's economy.[32] Both domestic and international offsets are key to containing the costs of emissions abatement. As noted previously, there should be no geographic limits on offsets and the supply should not be subject to artificial constraints. Instead, CARB should ensure that all offsets meet the high quality standards specified in AB 32.

Both standardized and project-specific methodologies should be utilized for approving offsets and specifying monitoring, reporting, and verification requirements. Standardized assessments may streamline the process but will likely not be applicable to all projects. Project-specific tests should also be available. Moreover, while sector-based crediting may be a long-

---

[31] *Id.* at 76, Section 96400.
[32] Cal. Health & Safety Code § 38562(b)(1).

term option for international offsets, sector-based crediting systems are not yet in place. CARB should use existing international offsets at the outset of California's cap-and-trade program to ensure an adequate supply of offsets and allow offsets to help contain the costs of the AB 32 program.

Finally, in order to ensure enforcement of international offsets and the environmental integrity of California's system, CARB should utilize contractual agreements for implementation of monitoring, reporting, and verification requirements, and other provisions.

XVIII.

AMENDMENTS TO REGULATION FOR MANDATORY REPORTING OF GREENHOUSE GAS EMISSIONS (SECTIONS 95100-95199)

The PDR includes a list of proposed amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions ("Mandatory Reporting Regulation"), approved by CARB in December 2007 and effective January 2009.[33] SCE provides its comments on the proposed amendments below.

A. Attachment 1: Anticipated Changes to Reporting

Attachment 1 discusses anticipated changes to the reporting rules in the Mandatory Reporting Regulation. SCE supports the proposal by CARB staff to modify the reporting threshold to be based on CO_2 equivalent emissions ("CO_2e"), rather than CO_2 only emissions. Including CO_2e emissions will expand the list of entities that will be required to report their emissions. Allowing more players in the cap-and-trade program will create a more robust and effective program.

SCE also supports lowering the reporting threshold to 10,000 metric tons of CO_2e from the current 25,000 metric tons threshold. However, all entities that meet the minimum reporting threshold should be subject to the cap-and-trade program. Further, all entities that are required to report their GHG emissions should be subject to consistent verification requirements. SCE does

[33] *Id.* at 88.

not support differentiating third-party verification requirements based on the amount of reported GHG emissions. Any entity subject to the reporting requirement should also be subject to the verification requirement.

SCE strongly supports CARB staff's proposal to modify requirements developed for a load-based point of regulation to be consistent with the first deliverer approach. SCE looks forward to working with CARB and other stakeholders in shaping these modifications.

CARB staff should not shorten the time period between reporting and certification, as there must be sufficient time for certification.

SCE encourages CARB to continue working with the U.S. Environmental Protection Agency to facilitate a single reporting mechanism to satisfy both state and federal mandatory reporting requirements, as this will reduce duplicative reporting. SCE will offer any assistance as needed.

B. Attachment 3: Preliminary Draft Amendments to Section 95107, Enforcement

Attachment 3 provides preliminary draft amendments to Section 95107 of the Mandatory Reporting Regulation, discussing enforcement. While reasonable enforcement provisions should be in place, consistent with other CARB regulations, these provisions need to be carefully drafted to ensure fairness and equity. CARB needs to develop a compliance pathway that promotes full compliance, with flexible compliance instruments to achieve the State's emission reduction goals. Financial penalties paid into State funds do not guarantee actual emission reductions. Additionally, there are significant compliance risks over which entities may have no control. CARB should identify those circumstances that are reasonably beyond the control of the regulated entities and distinguish those from a situation in which there is a clear intent to avoid compliance. While CARB is concerned about the possibility that some regulated entities will fail to comply, when identifying a compliance failure, CARB must consider reasonable compliance opportunities.

C. Attachment 5: Evaluation of the Relationships between Emissions Quantification, Scope, and Point of Regulation for the Cap-and-Trade Program

Attachment 5 evaluates the relationship between emissions quantification and the point of regulation for a cap-and-trade program. SCE agrees with CARB that emission accounting methodologies should provide an accurate measure of the magnitude of GHG emissions from a source. In order to promote an efficient market, it is paramount that heterogeneous accounting methodologies not create arbitrage opportunities in the allowance market. This is essential to minimize the cost of compliance under a cap-and-trade program for those that buy and sell allowances and offsets.

As CARB notes, it must consider the costs associated with any quantification methodology. Cost-effectiveness needs to be continually addressed as the State proceeds with implementing AB 32.

D. Attachment 6: Detailed Scope Table

Attachment 6 describes CARB staff's preliminary thinking on which emissions generate a surrender obligation. As noted above, SCE supports lowering the reporting threshold to 10,000 metric tons of CO_2e. However, this must be accompanied by a similar reduction to the cap-and-trade inclusion threshold for all facilities with stationary combustion emissions, including the cement, cogeneration, petroleum, and electrical sectors, in addition to fuel deliverers.

XIX.
CONCLUSION

SCE appreciates the opportunity to comment on the PDR and to work with CARB on developing a cap-and-trade regulation that meets the needs of the State and stakeholders.

Respectfully submitted,

MICHAEL D. MONTOYA
CATHY A. KARLSTAD
NANCY CHUNG ALLRED

/s/ Nancy Chung Allred
By: Nancy Chung Allred

Attorneys for
SOUTHERN CALIFORNIA EDISON COMPANY

2244 Walnut Grove Avenue
Post Office Box 800
Rosemead, California 91770
Telephone: (626) 302-3102
Facsimile: (626) 302-1904
E-mail: Nancy.Allred@sce.com

January 11, 2010