

COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY
TO THE CALIFORNIA AIR RESOURCES BOARD ON THE CAP-AND-TRADE
WORKSHOP: REGULATION FOR LINKING CALIFORNIA'S AND
QUEBEC'S CAP-AND-TRADE PROGRAMS

JENNIFER TSAO SHIGEKAWA
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: 626-302-6962
E-mail: Nancy.Allred@sce.com

Dated: [February 17, 2012](#)

I.

INTRODUCTION

Southern California Edison Company (“SCE”) respectfully submits these comments to the California Air Resources Board (“ARB”) on the Cap-and-Trade Workshop: Regulation for Linking California’s and Quebec’s Cap-and-Trade Programs (“Linkage Workshop”), held on February 3, 2012. At the Linkage Workshop, ARB staff presented a basic outline for linking California’s cap-and-trade program to Quebec’s cap-and-trade program, and discussed the possibility of holding a joint allowance auction as early as August of this year.

SCE has consistently indicated during the cap-and-trade rulemaking process that it prefers a broader market-based program, such as a regional or national program, rather than a California-only cap-and-trade program.¹ Given the lack of meaningful action at the national level, linking California’s cap-and-trade program to Western Climate Initiative (“WCI”) partners’ cap-and-trade programs, or other programs such as the Regional Greenhouse Gas Initiative (“RGGI”) or the European Union Emissions Trading Scheme (“EU-ETS”), would be an important step towards developing a broad market. There are a number of ways to link cap-and-trade programs, and ARB should carefully consider how to do so to minimize the need for harmonization. SCE is concerned, however, that ARB’s proposal to link with Quebec this year is unnecessarily diverting ARB’s focus and resources, as well as stakeholder resources, from the critical task at hand: successfully implementing California’s cap-and-trade program by developing the requisite framework, systems, and processes, as well as addressing issues in the current regulation that were identified at the time of Board approval and remain unresolved. A well-functioning market is a prerequisite to linking successfully with any other jurisdiction. SCE therefore, respectfully, recommends that ARB focus on the timely and successful implementation of a California-only cap-and-

¹ SCE encouraged ARB to begin the cap-and-trade program only if key readiness criteria were fully achieved. To that end, SCE supported ARB’s June 2011 decision to institute a delay. SCE continues to see significant challenges ahead; given the numerous implementation tasks left undone, SCE feels that much is yet to be achieved in the short time before the first allowance auction in August 2012.

trade program. After the recent national debate, cap-and-trade programs currently have little or no support in the Congress; a solid success in California should be ARB's first aim. ARB can explore the various ways to link to other jurisdictions after successfully implementing California's program.

SCE also believes that far more analysis is needed before ARB makes the important step to link to Quebec. ARB staff indicated that they plan to address linkage issues in a rulemaking this Spring. In these comments, SCE posits a number of initial questions and potential challenges with the linkage process as proposed in the Linkage Workshop. SCE also reiterates the key implementation steps that ARB has yet to take in California. Even if the California market is to be built with linkage to partner jurisdictions in mind, ensuring that the market and allowance tracking infrastructure, the allowance auction, and market monitoring processes have been carefully designed, tested, and implemented will be key to the success of California's cap-and-trade program. For this reason, SCE urges ARB to allocate sufficient time and resources to market implementation efforts to ensure the success of its program, rather than attempting to link with Quebec from the beginning.

II.

ARB SHOULD EXPLORE ALL POSSIBLE WAYS TO LINK IN ORDER TO MINIMIZE THE NEED FOR HARMONIZATION

California has multiple options for linking to Quebec's cap-and-trade program. Currently, ARB seems to be considering the development of a "common program" with a single joint auction, auction administrator, common tracking system, common holding limits, and common compliance calendars. Executing this sort of linkage will likely prove to be logistically infeasible within the short time frame before the first auction. Moreover, the proposal represents a greater degree of program harmonization than that needed to realize the environmental and economic benefits of a robust linked program. SCE recommends that ARB identify a set of minimum conditions required for a linked cap-and-trade program. Doing so will enable ARB and other potential partners to establish linking agreements with greater ease and simplicity. ARB must evaluate any harmonization efforts with an eye toward market impacts, readiness, and the minimum conditions for linking. For example, ARB could consider allowing

the two programs to be deployed separately but allow the compliance instruments to be fully fungible between programs. Doing so would prevent some of the implementation concerns of linking two jurisdictions in two separate countries, with different currencies and program rules. This approach would also greatly reduce the amount of time and effort that ARB staff must expend focusing on linkage with Quebec when its attention is needed elsewhere. Such a linkage would maintain the most critical element of a regional program – that one compliance instrument represents one ton of emissions, no matter where it was issued.

III.

LINKING ARB’S CAP-AND-TRADE PROGRAM TO QUEBEC’S PROGRAM RAISES A NUMBER OF SIGNIFICANT ISSUES THAT MAY NOT BE SUFFICIENTLY RESOLVED BEFORE THE FIRST AUCTION IN 2012

At the Linkage Workshop, ARB staff and participating stakeholders presented a number of issues relating to “harmonizing” the two cap-and-trade programs. Below, SCE discusses some of these issues and outlines further concerns that warrant additional review and discussion based on the proposals at the Linkage Workshop.

- Auctions –ARB envisions that a joint auction would enable bids in both currencies, establish a common floor price, harmonize tie-breaking requirements, and allow purchased allowances to be a bundle of California and Quebec allowances. This vision of a joint auction requires significant rule changes in both cap-and-trade regulations and raises a number of important questions, including how compliance entities will submit bids in two currencies² or how collateral will be returned to auction participants.³ Many such questions remain unresolved. The extensive effort required to successfully harmonize the auctions would detract from other necessary implementation activities, is unnecessary for initial linkage, and should not be viewed as a higher priority than general California market readiness.

² To the extent the currency value fluctuates between the time bids were submitted and the auction clears, it is not clear how such fluctuations will influence the auction results.

³ For example, how will ARB account for such fluctuations when the collateral is to be returned? Will collateral be held only in the denomination in which it was submitted? Or will it be converted to a common currency? If the latter, how will ARB refund the amount if the currency values have changed between the time collateral was posted and the time it was returned?

- Future Changes to Either Program –ARB should clearly outline its processes for addressing potential changes to either cap-and-trade program. The more elements that ARB decides to harmonize, the more complicated this task will be. Although the two programs could be “harmonized” in 2012, either jurisdiction could further make a change to its program that might disrupt this harmony. By establishing a minimum set of characteristics that require harmonization, ARB can increase the freedom and autonomy of individual programs, which will invite additional linked partners.
- Disconnecting the Linkage – ARB should also consider how it could disconnect the two jurisdictions should the need arise. For example, one program could be suspended due to litigation or superseded by a national program. In these situations, the value of allowances for the original program could dramatically change, or fall to zero, which would severely affect large compliance entities like SCE. SCE remains concerned that ARB is not establishing sufficient provisions to separate if the need arises; rather, it appears that linkage will be very difficult, if not impossible, to reverse.
- Holding Limits – At the Linkage Workshop, ARB staff indicated that the Holding Limit would change to reflect the addition of Quebec allowances to the allowance baseline. Although an increased baseline will increase the Holding Limits for California entities by a small amount, Quebec entities will be able to hold a greater number of compliance instruments out of the market than Quebec brings to the market. This creates a situation where Quebec compliance entities could reduce the number of allowances committed to California compliance entities. Although this might be expected with linkage to a smaller trading partner, the true problem is rooted in the Holding Limit calculation. The current Holding Limit unfairly restricts the market options available to compliance entities with a larger emissions exposure. SCE has consistently advocated for Holding Limits to be consistent with the emissions exposure of the regulated entity.⁴
- Offsets – At the Linkage Workshop, ARB staff stated that a linked jurisdiction must adopt all of another linked jurisdiction’s offset protocols. SCE supports this approach and encourages Quebec and other potential linking partners to move quickly to establish comparable offset protocols in order to enable the most efficient and low-cost means of achieving emissions reduction goals. However, ARB staff also noted that Quebec’s offset protocols were still in the preparation stage, which could create problems once linkage is established. ARB’s regulation should explicitly state that all compliance instruments, allowances, and emissions reductions achieved under a linked jurisdiction’s protocols are eligible for compliance under California’s cap-and-trade program.
- Regulatory Oversight and WCI, Inc. –ARB has stated that a non-profit corporation, Western Climate Initiative, Inc., was established to provide administrative and technical support to the participating jurisdictions’ programs and will be funded in part from the AB 32 administrative fee. It is unclear what sort of oversight this body will have over either jurisdiction’s “bad

⁴ The limited exemption to the Holding Limit inadequately addresses SCE’s concerns, considering the prohibition against transferring allowances between the compliance accounts owned by a single regulated entity.

actors.” In addition, the California program may be subject to commodities or securities trading regulators in the United States, and it is unclear how ARB will ensure that these agencies coordinate with their Canadian counterparts.

- Legal and Jurisdictional Issues – At the Linkage Workshop, questions were raised regarding California’s ability to enter into compacts or agreements with Quebec, as a province of another country, in light of the Compact Clause⁵ or the Contracts Clause⁶ of the United States Constitution. For purposes of market certainty, ARB staff should address these concerns head on and expressly explain its authority to enter into a linking agreement with another state, region, or nation.
- Reserve Sales – ARB proposes operating separate but “consistent” reserves, where a covered entity can only purchase from its own jurisdiction’s reserves. This could become problematic if one jurisdiction within a linked system enables a significantly greater number of allowances to be carved out for use only in its own system. Addressing this problem will require ARB to also preemptively establish a clear mechanism by which the allowance reserve could be replenished.
- Reporting for Sources Below Cap-and-Trade Emissions Threshold – Quebec requires reporting of combustion and process emissions between 10,000 and 25,000 metric tons of carbon dioxide equivalent, while California only requires reporting of combustion emissions. The different reporting requirements are not inherently problematic and likely need not be harmonized. However, ARB should consider potential contradictions in what might constitute a compliance obligation (such as combustion emissions compared to process emissions), and recommends that ARB maintain consistency with existing California requirements to ensure regulatory stability for compliance entities.

These are only some of the significant issues that must be resolved before both cap-and-trade programs “go live” in August 2012.

IV.

ARB SHOULD PRIORITIZE ITS IMPLEMENTATION EFFORTS TO ENSURE SUCCESSFUL EXECUTION OF THE CALIFORNIA CAP-AND-TRADE PROGRAM

SCE has been closely involved in a market implementation working group with other utilities, offering assistance to ARB in developing milestones and a roadmap for implementing the cap-and-trade market. SCE greatly appreciates this opportunity to develop a high-functioning market with ARB staff.

⁵ U.S. CONST. art. I, §10, cl. 3.

⁶ U.S. CONST. art. I, §10, cl. 1.

However, SCE has serious concerns that important implementation activities continue to miss critical targets. These activities include, but are not limited to:

- Designing, deploying, and testing a compliance instrument tracking system;
- Allocating time for program participants – compliance entities and regulators alike – to familiarize themselves with ARB’s systems operations and processes, as well as to build systems and interfaces to ARB’s system;
- Designing, deploying, and testing an auction platform with involvement by market participants;
- Undertaking market simulation efforts to expose, and then address, market flaws that open the program to manipulation or gaming; and
- Opening an organized, ongoing forum for fielding stakeholder questions and concerns and incorporating stakeholder feedback.

In sum, ARB must successfully finalize these milestones to develop California’s cap-and-trade program. SCE strongly urges that ARB resources be focused on these critical market readiness tasks. It will do no good to attempt linkage to Quebec, or any other jurisdiction, if California’s program is not successful. In addition, because of the significant remaining challenges in implementing California’s program, SCE encourages ARB to solicit feedback from stakeholders in the California program and then adopt a simple and straightforward linking process that seeks to harmonize only those minimum conditions needed for a robust linked system with fungible compliance instruments.

V.

CONCLUSION

Establishing a functioning California cap-and-trade program must be the paramount objective of ARB and the California stakeholders. Only then can California preserve the progress it has made in implementing AB 32. Although SCE understands the real and symbolic importance of linkage with the Quebec cap-and-trade program, ensuring the success of California’s program and market is critical to any successful linkage. SCE urges ARB staff to reconsider its current linkage proposals in light of the concerns listed above. SCE appreciates this opportunity to comment on the Linkage Workshop and

looks forward to working with ARB staff on additional market implementation activities to allow for a successful cap-and-trade program.

Respectfully submitted,

JENNIFER TSAO SHIGEKAWA
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: 626-302-6962
E-mail: Nancy.Allred@sce.com

February 17, 2012