BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON REGULATION FOR LINKING CALIFORNIA AND QUEBEC CAP-AND-TRADE PROGRAMS

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I. INTRODUCTION.

The Southern California Public Power Authority ("SCPPA") [1] respectfully submits this comment on issues discussed at the February 3, 2012 workshop on the regulation for linking California and Quebec cap-and-trade programs.

SCPPA supports linking California's cap-and-trade program to cap-and-trade programs in other jurisdictions in general and to Quebec's program in particular to the extent that linkage can help to contain the costs of the linked programs. In theory a larger market for allowances would be a more liquid market, and having a larger market would make available more lower-cost opportunities to reduce greenhouse gas ("GHG") emissions. However, the Air Resources Board ("ARB") should perform an economic evaluation to assure that any program that is proposed for linkage to California's program would not be so short of opportunities to reduce GHG emissions that covered entities in the linked jurisdiction would rely on California disproportionately to generate emissions reductions, potentially causing allowance prices to be higher than they would be if California were not linked to the other program.

The ARB should also be careful to assure that any program that is linked to California's program will not contain features that would counterproductively result in an increase in the cost of allowances, thereby negating the principal benefit–cost containment– that can be obtained through linkage.

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[1] SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, the Imperial Irrigation District, Pasadena, Riverside, and Vernon.

Some features of programs in other jurisdictions that should be watched to assure that linking those programs to California would not result in exacerbating rather than mitigating allowance prices are the following:

Cap Setting: California should be careful to assure that the cap set by a linked jurisdiction is not more stringent than California's cap. Linking to jurisdictions with more stringent caps would tighten the market for allowances in the linked jurisdictions, driving up allowance prices.

Withdrawal of Allowances to Create a Cost Containment Reserve: While the creation of a cost containment reserve is in itself laudable, attention should be given to how the cost containment reserve is populated with compliance instruments. If the reserve is populated by withdrawing allowances from the allowance budgets for various years, the withdrawal of allowances should not be greater in percentage terms than under the California program. It appears that Quebec's withdrawal of allowances parallels the withdrawal under the California program. Under section 95870 of California's regulation, the Executive Officer shall transfer allowances to the allowance price containment reserve as follows:

(1) One percent of the allowances from budget years 2013-2014;

(2) Four percent of the allowances from budget years 2015-2017; and

(3) Seven percent of the allowances from budget years 2018-2020.

Section 38 of Quebec's regulation will create a Quebec reserve in the same manner. Thus, Quebec's creation of a cost containment reserve would harmonize with California's creation of a cost containment reserve.

Cost Containment Reserve Prices: If the administratively established prices for allowances in a linked jurisdiction's cost containment reserve escalate more rapidly than the

administratively established prices for allowances in California's reserve, the linked jurisdiction could put pressure on prices in the unified allowance market, forcing more reliance by California covered entities on the California cost containment reserve than would occur otherwise. This could occur even if, as proposed by the staff at the February 3, 2012 workshop, entities in the linked jurisdiction were unable to access California's reserve directly. Thus, the rate of escalation of the prices for reserve allowances should be harmonized. Section 95913(d)(2) of California regulation specifies reserve tier prices for 2013 ($40 per allowance for allowances from the first tier, $45 per allowance for allowances from the second tier, and $50 per allowance for allowances from the third tier) with the rate of escalation of allowance prices being set in Section 95913(d)(3) at five percent annually plus the rate of inflation as measured by the Consumer Price Index for all consumers. Section 58 of Quebec's regulation sets prices and a rate of inflation that appear to approximate California's prices and rate of inflation, although there is no adjustment for differences in currency valuation.

Allowance Price Floor: The linked jurisdiction should not have a floor on prices that is any higher than the California floor. For California, Section 95911(b)(6) sets a floor price at $10 per metric ton for allowances auctioned in calendar years 2012 and 2013 with an annual escalation thereafter by 5 percent plus the rate of inflation as measured by the Consumer Price Index for all of customers. Section 49 of Quebec's regulation appears parallel to California's regulation, although there is no provision for how adjustments would be made for differences in currency valuation.

Offset Limits: Section 95854 of California's regulation establishes a quantitative usage limit on the use of offset credits to meet compliance obligations. The limit is set at 8 percent of an entity's compliance obligation for a compliance period. If a linked jurisdiction elects to set a

limit on the use of offsets, the quantitative limit should not be more restrictive than the limit established under the California program. A more restrictive limit in the linked jurisdiction would put more pressure on the price of allowances that are available in the unified market, thereby raising allowance prices. Quebec's limit as specified in section 20 of Quebec's regulation appears to be consistent with California's quantitative limit.

Offset Supply: In addition to allowing the use of offsets, a linked program should facilitate the availability of offsets. However, Quebec's regulation does not appear to provide for protocols that would result in the generation of offsets in proportion to or exceeding the rate of generation of offsets under California's offset protocols. Accordingly, SCPPA urges California and Quebec to work to harmonize protocols so that opportunities for the generation of offset credits under the Quebec program will, at a minimum, be no less than under the California program.

Penalty Allowances: If a failure to surrender compliance instruments in a timely fashion is penalized by assessing an additional amount of allowances that must be surrendered, the additional amount of allowances that is obtained from a penalized entity should be placed in the respective jurisdiction's auction account for subsequent auctioning instead of being retired. If the penalty allowances were retired, the market for allowances would be tightened. Quebec's program appears to be consistent with California's program in this regard. Under both section 95857 of the California program and Section 22 of the Quebec program, the sanction for untimely surrender of allowances would be three allowances in addition to the allowance that was not timely surrendered, with the three penalty allowances being placed in the auction account for auction at a later date rather than being retired.

This listing of elements that should be harmonized to prevent linkage from counterproductively tightening the market for allowances is intended to be heuristic rather than exhaustive or exclusionary. In determining whether to link to a jurisdiction such as Quebec, the ARB should carefully analyze each element of the potentially linked jurisdiction's program to assure an absence of provisions that would result in linkage making California's cap-and-trade programs more costly rather than less.

The staff explained at the February 3, 2012 workshop that linkage with Quebec would be pursued through a formal rulemaking under California's Administrative Procedure Act. The staff will include an economic analysis of linkage with Quebec in the staff's Initial Statement of Reasons ("ISOR") for the proposed regulation linking the California and Quebec programs. That economic analysis should focus on the degree of symmetry between the California and Quebec jurisdictions to generate GHG emissions reductions and on whether there are aspects of Quebec's regulation that would have an adverse economic impact on California if the Quebec and California programs were linked. It would not be in California's interest to link with Quebec if linkage would tighten the market for compliance instruments and make the linked cap-and-trade markets more expensive for California than an unlinked market.

SCPPA appreciates this opportunity to present these comments on the staff's initial informal workshop on linking the California and Quebec programs. SCPPA looks forward to both further informal workshops and opportunities for informal comment as well as for the

formal opportunities for comment that will be provided to stakeholders under the Administrative Procedure Act after release of the ISOR.

Respectfully submitted,

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