

COMMENTS OF SOUTHERN CALIFORNIA EDISON COMPANY TO THE
CALIFORNIA AIR RESOURCES BOARD ON THE JANUARY 25, 2013
INFORMATION SHARING WORKSHOP

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Southern California Edison Company (“SCE”) respectfully submits its comments to the California Air Resources Board (“ARB”) on the January 25, 2013 Information Sharing Workshop (“January 25 Workshop”). SCE actively participated in the January 25 Workshop and offers its comments on both the written presentation slides as well as verbal comments from ARB staff.

I.

EXECUTIVE SUMMARY

SCE appreciates the ARB’s willingness to work with stakeholders to ensure the appropriate release of public information. Proper information release is essential to provide market transparency, deter market manipulation, and increase market efficiency. Still, certain data, such as entity-specific compliance account balance information, is not appropriate for release as it contains sensitive information that would unfairly harm certain market players.

The ARB has indicated that a primary purpose for publicizing compliance account balances is to confirm the compliance status of regulated parties. To achieve this policy goal, the ARB should consider alternatives to releasing market-sensitive data. Such alternatives include (1) releasing a compliance report, indicating the compliance status of regulated parties, and (2) releasing entity-specific compliance account balances only after a sufficient time lag (for example, after the compliance date for a full compliance period). Both alternatives would achieve the same goal without unfairly and unjustly exposing the positions of compliance entities to other market participants.

SCE also suggests that the ARB should:

- Commit to, along with its Independent Market Monitor, a regular schedule for the release of public reports;

- Require entities to report the types of transactions resulting in compliance instrument transfers as a means to collect meaningful data;
- Classify its list of qualified bidders by entity type; and
- Allow CITSS users the ability to search for account numbers and entity reference codes.

Data release policies must strike the right balance between market conditions, potential adverse impacts, and alternative options. SCE's suggested modifications to the ARB's information sharing policy seek to achieve that balance.

II.

THE PREMATURE RELEASE OF INDIVIDUAL ACCOUNT BALANCE INFORMATION WILL UNFAIRLY EXPOSE SENSITIVE POSITION INFORMATION

SCE opposes the ARB's stated intent¹ to release information on individual account balances, until and unless doing so will not expose sensitive position information. While SCE supports the ARB's proposal to maintain the confidentiality of holding account balances and limited use holding account balances, SCE encourages the ARB to also maintain the confidentiality of compliance account balances.

A. Market Conditions Must be Considered When Evaluating Information Policy

With a few exceptions, the ARB has maintained that more public information is better. SCE agrees that appropriate information release is necessary to provide market transparency, but the idea that perfect information² will necessarily improve market efficiency only applies in the context of a perfectly competitive market. Regulated parties under the California cap-and-trade

¹ "Public Information Sharing in California's Cap-and-Trade Program," ARB Information Sharing Workshop ("ARB Workshop Presentation"), 25 Jan 2013, at 11, *available at* <http://www.arb.ca.gov/cc/capandtrade/meetings/01252013/presentation.pdf>.

² Perfect information is defined as "the possession by market participants in a competitive economy of complete knowledge and foresight with regard to the array of present and future prices, as well as the location of goods and services." The MIT Dictionary of Modern Economics, 3rd ed.

program face an imperfect market for various reasons, including costly entry and exit to the underlying product markets,³ lack of full substitution of resources in the allowance market,⁴ a fixed supply of allowances,⁵ and restrictions on the purchase and sale of compliance instruments.⁶ Increasing public information in an otherwise imperfectly competitive market will not necessarily move the market towards greater competitive balance.⁷ In the case of California’s cap-and-trade program, market imperfections could cause compliance entities to face a competitive disadvantage if market-makers are able to identify the entities’ need to buy or sell allowances. Because of the existing market imperfections, entities must be protected against the public release of their net short or long position in the allowance market. Providing excessive public information, such as entity-specific compliance account balances, will put compliance entities at a competitive disadvantage and will likely harm rather than improve the efficiency of the allowance market.

B. Prematurely Releasing Individual Compliance Account Balance Information Exposes the Sensitive Position Information of Compliance Entities and Especially Harms Large Compliance Entities.

Before making a policy decision on the release of information, the ARB must be fully informed of the costs, benefits, and impacts of such a decision. Releasing entity-specific compliance account balances will burden compliance entities because market-makers can better estimate their net short or long position. Compliance entities can expect to be placed at a

³ Covered industries do not have capital or labor that can be costlessly redirected to other productive uses, as is assumed in perfectly competitive models.

⁴ There are limited types of acceptable offsets, which are in essence the only allowable allowance “substitutions.”

⁵ While the fixed supply of allowances is necessitated by the regulatory design of cap-and-trade programs, it leads to an imperfectly competitive market.

⁶ Entities’ ability to purchase compliance instruments and then subsequently sell those instruments is restricted by the quantity allowed in the holding account.

⁷ Hong Lui and Yajun Wang demonstrate that imperfect markets with asymmetric information demonstrate more competitive trading environment than markets with symmetric information. “Asymmetric Information, Endogenous Illiquidity, and Asset Pricing With Imperfect Competition,” Hong, L., Y. Wang, Olin Business School, Washington University in St. Louis, 2012.

competitive disadvantage in procurement activities in the greenhouse gas emissions markets. This disadvantage will increasingly harm large compliance entities whose positions are most easily gauged with information about their individual compliance account holdings. Additionally, this disadvantage will be exacerbated for highly regulated entities, like investor-owned utilities, that are restricted in the financial positions they may take in the secondary market.⁸ Revealing this information can lead to less competitive offers and therefore inefficient and higher-priced compliance instruments, which will result in higher long-term compliance costs passed along to California customers. The ARB should not force California customers to bear the risk of this outcome.

C. The Regulation Does Not Require the Release of Information on Individual Compliance Account Balances; the ARB Could Instead Release Information on Aggregate Compliance Account Balances.

At the January 25 Workshop, ARB staff stated that the cap-and-trade regulation requires them to release information on individual compliance account balances.² ARB staff appeared to be referencing Section 95921(e)(4) of the cap-and-trade regulation, which states, “The Executive Officer will protect confidential information to the extent permitted by law by ensuring that the accounts administrator: ... Releases information on the quantity and serial numbers of compliance instruments contained in compliance accounts in a timely manner.”¹⁰ However, this section does *not* refer to “individual” or “entity-specific” compliance account balances. The ARB has the freedom to choose what form of compliance account information it believes is appropriate for release.

To better protect the market-sensitive data of compliance entities, the ARB could release the aggregate quantity of compliance instruments contained in all compliance accounts. This

⁸ CPUC 2010 LTPP Track III, D-12-04-046, 19 Apr 2012, at 51-58.

² ARB Workshop Presentation, at 11.

¹⁰ Section 95921(e), ARB cap-and-trade regulation, 1 Sept 2012, at 155-156.

information will allow the market to determine the overall supply of available tradable instruments. The market can simply calculate the total number of allowances held in holding accounts (that can be resold) by subtracting the total number of compliance instruments in compliance accounts from the total number of compliance instruments issued and consigned to date. In this way, the ARB can provide useful compliance account balance information to the market without exposing sensitive position information.

D. The ARB Should Consider Alternative Methods to Provide the Public with Assurance that Entities are Complying With the Regulation

At the January 25 Workshop, ARB Staff indicated that it intends to publicize compliance account balances in large part to confirm the compliance status of regulated parties. The ARB should consider alternative methods for achieving this goal. For example, the ARB could simply release a compliance report indicating the compliance status of regulated parties, without placing regulated parties at a disadvantage in the compliance instrument markets. Alternatively, the ARB could release the market-sensitive information, including entity-specific compliance account balances, after a sufficient time lag (for example, following the triennial compliance obligation date)¹¹ without unfairly or unjustly exposing compliance entities' positions to counterparties.

E. Any Release of Individual Compliance Account Balances Must Wait Until After the Surrender Date for Compliance Instruments

As noted above, SCE strongly urges the ARB not to release entity-specific compliance account balance information, or to wait until after the triennial compliance obligation surrender date. If, however, the ARB decides to release the information more frequently, it should do so no more than annually. If the ARB releases account balances annually, it should wait to do so

¹¹ Section 95856(d), ARB cap-and-trade regulation, 1 Sept 2012, at 93.

until immediately after the November 1 surrender deadline for the annual compliance obligation.¹² This will allow compliance entities to keep sensitive position information confidential for a full year.

III.

OPTIONAL PRICE INFORMATION WILL NOT PROVIDE COMPLETE OR MEANINGFUL DATA; THE ARB SHOULD REQUIRE ENTITIES TO SPECIFY THE TYPE OF TRANSACTIONS THAT RESULT IN TRANSFERS

Section 95921(b)(6) of the cap-and-trade regulation requires entities to report the *price* of compliance instruments transferred between CITSS accounts.¹³ However, the regulation does not require entities to report the *type* of contract that resulted in a CITSS transfer. As SCE has explained in past comments, failing to distinguish between different types of transactions will lead to inconclusive data, which is not effective for market monitoring purposes.¹⁴ SCE appreciates the ARB's recognition of this concern and its subsequent provision of the optional "trading venue" and "contract type" fields in CITSS.

Unfortunately, *optional* price information will not provide complete or meaningful data either. For example, some entities may properly utilize the contract-type field when transferring allowances to fulfill a tolling contract at \$0 by appropriately selecting the "other" drop-down box. Other entities, however, may not bother selecting any option for contract type, which would result in the \$0 price being associated with prices for spot and other contracts.

SCE suggests that the ARB take two actions to address these concerns and to provide its market monitor and the public with meaningful data. First, the ARB should add language to

¹² Section 95856(d), ARB cap-and-trade regulation, 1 Sept 2012, at 93.

¹³ Section 95921(b)(6), ARB cap-and-trade regulation, 1 Sept 2012, at 154.

¹⁴ "Comments of the Southern California Edison Company to the California Air Resources Board on the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments in Linked Jurisdictions," 22 July 2012, at 28-29.

Section 95921(b)¹⁵ to require entities to accurately represent transactions that result in a CITSS transfer as a “spot transaction,” a “forward transaction,” a “futures transaction,” or “other.” This requirement is not onerous and will significantly increase the usefulness of the ARB’s data on secondary market transactions.

Second, the ARB should release a guidance document outlining standards for reporting the price and contract type of transfers. Without guidance, different entities may report the same types of transactions in different ways. For example, one entity may report a transfer resulting from a call-option at the strike price of the contract, while the other may report the transfer at a \$0 price (because it is not possible to determine the true price of the transfer given the call-option premium). The ARB and its Independent Market Monitor must collect consistent and meaningful data in order to identify bad actors in the market. While optional contract-type information is an appropriate interim step, the ARB should continue pursuing methods for collecting useful and complete data.

IV.

THE ARB AND ITS INDEPENDENT MARKET MONITOR SHOULD COMMIT TO A REGULAR SCHEDULE FOR THE RELEASE OF PUBLIC REPORTS

The ARB’s Request for Proposal for a market monitor required that the Independent Market Monitor develop three types of public reports: Auction Public Reports, Quarterly Market Public Reports, and Annual Public Reports.¹⁶ While there have yet to be any public reports directly released by the Independent Market Monitor, it is possible that the auction report released by the ARB after the November 14, 2012 first auction was one of those required reports. However, the public has yet to hear when either of the other two reports will be published. The

¹⁵ “Information Requirements for Transfer Requests,” Section 95921(b), ARB cap-and-trade regulation, 1 Sept 2012, at 154.

¹⁶ “Request for Proposal No. 10-111,” California Air Resources Board, 8 Sept 2011, at 11-12, *available at* http://www.arb.ca.gov/cc/capandtrade/contracts/market_monitor_rfp.pdf.

Quarterly Market Report and the Annual Public Report will be particularly important for offering market transparency, as they will provide insight into the transactions occurring in the secondary market. While the Auction Public Report has a natural release schedule, the ARB and its Independent Market Monitor should establish a clear schedule for the release of the Quarterly Market Report and the Annual Public Report.

V.

THE ARB SHOULD CLASSIFY ITS LIST OF AUCTION PARTICIPANTS BY ENTITY TYPE

SCE supports the ARB's decision to release a list of "Qualified Bidders"¹⁷ that participated in the auctions, as this is useful to the market but does not reveal sensitive information. To provide additional useful information to the market, the ARB should classify the list of Qualified Bidders by entity type: compliance entity or non-compliance entity. Although the ARB already releases auction statistics detailing the percentage of allowances purchased by compliance entities, it could add more to those statistics by offering information on the number and names of compliance and non-compliance players in the auctions.

VI.

THE ARB SHOULD ALLOW CITSS USERS THE ABILITY TO SEARCH FOR ACCOUNT NUMBERS AND ENTITY REFERENCE CODES

Currently, entities transferring compliance instruments in CITSS are required to provide the Account Number and Entity Reference Code of their counterparties.¹⁸ However, the ARB should provide a search function within CITSS to allow users to search for Account Numbers

¹⁷ ARB released the list of Qualified Bidders with other auction information in a report after the November 14, 2012 auction. See "California Air Resources Board Quarterly Auction 1," at 2-3, *available at* http://www.arb.ca.gov/cc/capandtrade/auction/november_2012/auction1_results_2012q4nov.pdf.

¹⁸ "Transferring Account Detail, Step 9," CITSS User Guide Volume III, Air Resources Board, Dec 2012, at 24, *available at* <http://www.arb.ca.gov/cc/capandtrade/markettrackingsystem/vol3citssguide-12-20.pdf>.

and Entity Reference Codes of potential counterparties by counterparty name. This added functionality would expedite the compliance instrument transfer process and reduce errors when initiating a transfer request. Other registries, including the Environmental Protection Agency's system for sulfur dioxide allowances and the Western Renewable Energy Generation Information System for renewable energy credits have similar features.

VII.

CONCLUSION

SCE appreciates the ARB's continued engagement with stakeholders to determine the process for public information release. SCE supports the ARB's desire for extensive public information release as a means to increase market transparency, but encourages the ARB to maintain the confidentiality of sensitive position information, especially individual account balances. SCE looks forward to continued work with the ARB in developing appropriate information sharing procedures.

Respectfully submitted,

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