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Mr. Steven Cliff  
Chief - Climate Change Markets Branch  
California Air Resources Board  
1001 I Street  
Sacramento, CA 95812-2828

**Re: Pacific Gas and Electric Company's Comments on the Draft Amendments to the California Cap-and-Trade Regulations to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions**

Dear Mr. Cliff:

Pacific Gas and Electric Company ("PG&E") welcomes the opportunity to submit these comments on the Air Resources Board's ("ARB") draft amendments to the California Greenhouse Gas ("GHG") cap-and-trade regulations. PG&E supports ARB's efforts to link its cap-and-trade program with other jurisdictions, and we view linkage with Quebec as an important first step. We appreciate ARB's efforts to ensure that linkage occurs in a manner that does not adversely affect covered entities in California. We encourage ARB to continue to coordinate cross-market rules so as not to limit compliance flexibility and cost-containment measures ARB has included as part of its program.

**I. INTRODUCTION**

PG&E's detailed comments on the proposed amendments are set forth in Section II below. The following summarizes the key issues:

**A. Modify Several Holding Limit Provisions**

**A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))**

**A2. Clarify Intent in Conduct of Trade (Section 95921(f))**

**A3. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))**

**A4. Clarify Intent and Language for Holding Limit for Future Vintage Allowances (Section 95920(e))**

**A5. Clarify Implementation Timeline for Limited Exemption Petition (Section 95920(d)(3))**

**B. Ensure Linkage Does Not Adversely Affect Covered Entities in California**

**B1. Ensure Permanence of Compliance Instruments Purchased from Linked Jurisdiction**

**B2. Approve Additional Offset Protocols and Adjust to Quantitative Usage Limit**

**B3. Modify Determination of Auction Reserve Prices (Section 95911(c)(3)(D))**

**B4. Make Bid Guarantees for Linked Jurisdiction Equivalent to Those Required for California Auction Participants (Section 95912(i)(1)(D))**

**B5. Compute Common APCR Tier Prices in the Same Manner as the Auction Reserve Price (Section 95913(e))**

**B6. Harmonize Annual Compliance Showings Across Linked Jurisdictions (Section 95855)**

**C. Revise and Refine Provisions Regarding Auction and the Allowance Price Containment Reserve (APCR), the Registration Process, and Conduct of Trade**

**C1. Clarify Calculation of Bid Guarantee for Auction (Section 95912)**

**C2. Modify Auction Administration to Ensure that All Potential Bid Scenarios are Appropriately Addressed, Revise Process to Sell Consigned Allowances, and Return Unsold Allowances to their Respective Source Account (Section 95911 (e) & Section 95911 (f))**

**C3. Modify APCR Sale Administration to Clarify Calculation of Bid Guarantee and Ensure Sale is Conducted in Line with Market Efficiency Principles (Section 95913)**

**C4. Other Recommended Changes and Clarifications for Attestations, Corporate Association Requirements, and Conduct of Trade. (Sections 95830, 95832, 95921)**

**D. Modify the Know-Your-Customer Requirements (Section 95834)**

**II. DISCUSSION.**

**A. Modify Several Holding Limit Provisions**

PG&E recognizes that the Cap-and-Trade Regulation adopted in 2011 included regulatory language regarding Beneficial Holdings that contained challenging information disclosure and trade conduct requirements. As such, PG&E supports the deletion of this regulatory language and the associated requirements.

However, the current Holding Limit calculation continues to unfairly constrain PG&E and other entities with a large portfolio due to the nature of our electric portfolio, which includes both utility owned generation and contracted electric generation with third parties through "Tolling Agreements." As such, PG&E recommends the changes to the Holding Limit and Limited Exemption described in A1 below.

**A1. Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))**

The current Holding Limit unfairly disadvantages both large entities and entities such as PG&E with an electric portfolio of both owned and contracted resources through "Tolling Agreements". To address this, PG&E recommends modifications to the regulatory language pertaining to the limited exemption, which would provide greater flexibility to large compliance entities who are constrained by the current Holding Limit calculation.

The current limited exemption contemplates that entities only buy allowances equivalent to the emissions from their owned generating units or from electricity imports. The determination of the ARB annual allowance allocation, however, correctly contemplated that GHG exposure for some entities may extend beyond an entity's direct compliance obligations. With this in mind, PG&E proposes the following modifications to the Holding Limit calculation:

- 1) Currently, the limited exemption only applies to credits in an entity's Compliance Account. However, PG&E requests further flexibility to allow the limited exemption to apply to credits in both the Holding Account and Compliance Account.
- 2) The limited exemption equals the greater of, the amount permitted in the current regulation section 95920(d)(2) (i.e. the most recent emissions data report that has received a positive or qualified positive emissions data verification statement), or a percentage of the entity's annual allowance allocation from ARB for the prompt year. Specific percentage of the entity's annual allowance allocation to be applicable for limited exemption should be determined through more discussion on this topic with stakeholders and ARB.

**A2. Clarify Application and Intent of General Prohibitions on Trading Provision (Section 95921 (f))**

PG&E requests clarification on ARB's intent with respect to section 95921(f)(1): "An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." PG&E seeks clarity on whether this statement precludes PG&E (and other utilities) from purchasing allowances as part of contractual arrangements with counterparties with which we have tolling agreements.

**A3. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B))**

PG&E acknowledges the need to address Holding Limit violations not discovered until after a transfer request is recorded; or if the Holding Limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage Holding Limit. However, the 5 business day cure period is too stringent and may be unworkable for some entities with internal governance processes and/or additional regulatory oversight.

If a Holding Limit violation occurs, one method to cure could be via sale of allowances. Currently, the California Public Utilities Commission's ("CPUC") Proposed Decision on Tracks I and III of the 2010 Long Term Procurement Plan states that utilities may only resell greenhouse gas Compliance Instruments with prior Commission approval via a Tier 2 advice letter, and after consultation with their Procurement Review Group (Proposed Decision Before The California Public Utilities Commission, Rulemaking 10-05-006, February 21, 2012). Given this constraint, PG&E and other Investor Owned Utilities would not be able to obtain the CPUC authority to sell allowances within 5 business days. Even if PG&E were allowed to sell Compliance Instruments without an advice letter, the process to cure a violation within a large entity like PG&E requires more time due to the need to obtain approvals, execute sales, conduct transfers, etc. As such, PG&E requests that the entity in violation have 30 business days to cure.

**A4. Clarify Intent and Language for Holding Limit for Future Vintage Allowances (Section 95920(e))**

PG&E believes the intent of the Holding Limit for Future Vintage allowances is to calculate the future vintage Holding Limit based on the annual allowance budget for the year in which the future allowances are issued. We suggest the following revision to confirm this is the case:

"Annual Allowance Budget" is the number of allowances issued for the current ~~budget~~ year. It is calculated as the sum for the ~~current~~ budget year of the compliance budgets of California and all ETS programs to which California has linked pursuant to section 95940.

#### **A5. Clarify Implementation Timeline for Limited Exemption Petition (Section 95920(d)(3))**

PG&E supports the process which permits entities to petition to adjust the limited exemption. However, PG&E requests that ARB define the time frame for the Executive Officer to approve or deny the limited exemption petition after being submitted. This clarification is needed as market participants need to have a clear understanding of their current and future applicable limited exemption in order to properly manage positions and Compliance Instrument procurement and avoid Holding Limit violations.

#### **B. Ensure Linkage Does Not Adversely Affect Covered Entities in California**

##### **B1. Ensure Permanence of Compliance Instruments Issued from Linked Jurisdiction**

PG&E recommends that ARB amend the Cap-and-Trade regulation to specify that Compliance Instruments purchased from a linked jurisdiction are fully fungible for compliance purposes even if a linked jurisdiction subsequently modifies its program or ceases to be linked with California. Market participants need assurance that Compliance Instruments will be given "full faith and credit" by California provided that the issuing jurisdiction was linked with California when the instrument was originally issued.

##### **B2. Approve Additional Offset Protocols and Adjust Quantitative Usage Limit**

PG&E believes that the use of high quality offsets is an effective cost containment tool and an essential part of a successful cap-and-trade program. However, as stated in PG&E's February 17, 2012 comments on linkage, without the approval of additional protocols and adjustment to the implementation of the quantitative usage limit, the cost containment objectives with respect to the use of offsets in the cap-and-trade program will not be realized.

PG&E recommends that the ARB and Quebec adopt the Climate Action Reserve's Nitric Acid Production and Coal Mine Methane protocols, as well as the American Carbon Registry's Protocol for Conversion of High-Bleed Pneumatic Controllers in Oil & Natural Gas Systems. These protocols show the greatest potential of quickly delivering high quality reductions. PG&E also encourages Quebec to quickly adopt the ARB protocols as written.

In addition, given the time required to approve additional protocols and the current limited supply of offsets, PG&E also requests that the quantitative usage limit apply to a complying entity's total compliance obligation from January 1, 2013 through the current compliance period. This will allow time for the offset market to develop projects while maintaining the current cap on the use of offset credits.

**B3. Modify Determination of Auction Reserve Prices (Section 95911(c)(3)(D))**

The auction administrator uses a specified exchange rate to convert the Auction Reserve Prices calculated separately in U.S. and Canadian dollars to a common currency, and then uses a formula to set a single Reserve Price to apply in both currencies and for both jurisdictions. While PG&E supports the use of a single Reserve Price that applies to both currencies for each auction, we do not support using the maximum of the two separate prices, as it will provide an upward bias on the reserve price for both jurisdictions, compared to the reserve price used in earlier versions. Instead, PG&E proposes using the average of these two prices, with the following proposed modification to section 95911(c)(3)(D):

The auction administrator will use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated separately in U.S. and Canadian dollars. The auction administrator will set the Auction Reserve Price equal to the higher average of the two values.

**B4. Make Bid Guarantees for Linked Jurisdiction Equivalent to Those Required for California Auction Participants (Section 95912(i)(1)(D))**

In the event of a joint auction, section 95912(i)(1)(D) would allow entities from a linked jurisdiction to use “any financial instruments” accepted by that linked jurisdiction. We believe ARB should revise this section to require participants from linked jurisdictions to provide bid guarantees with an equivalent level of financial assurance to that provided in section 95912(i)(1). We therefore propose that the language proposed in section 95912(i)(1)(D) of the draft regulation be revised as follows:

If California participates in a joint auction with one or more external GHG ETS programs to which it has linked, and entities from all linked programs are eligible to purchase from the auction, then the auction administrator will accept any financial instruments accepted by any linked external GHG ETS for allowance purchases, provided such instruments are equivalent to the bid guarantees authorized in subsection 95912(i)(1).

**B5. Compute Common APCR Tier Prices in the Same Manner as the Auction Reserve Price (Section 95913(e)(5))**

While the Auction Reserve Price is set equal in the two working currencies, the California and Quebec Allowance Price Containment Reserve (APCR) tier prices are not and may diverge after 2013. This could lead to market distortions if the “marginal price” for the APCR in California (i.e. the price for the lowest tier with available credits) is less than an expected Auction price but the lowest reserve tier price in Quebec is greater than the expected Auction price. The reverse situation could likewise lead to market distortions. In the former case, entities in California may choose to purchase from their APCR while entities in Quebec would not, if all entities were

attempting to minimize their current compliance costs. This would lead to lower demand for auctioned allowances for all entities, potentially reducing the Auction price for both California and Quebec entities, while only the California APCR would be drawn down.

To maintain a level playing field between California and Quebec entities, PG&E recommends computing common Reserve Tier Prices for each tier in the same manner as the Auction Reserve Price in section 95911. PG&E proposes the following language for new subsection 95913(e)(5):

The auction administrator will calculate each Reserve Tier Price using the following procedure:

(A) The Reserve Tier Price in U.S. dollars shall be the U.S. dollar Reserve Tier Price for the previous calendar year increased annually by 5 percent plus the rate of inflation as measured by the most recently available twelve months of the Consumer Price Index for All Urban Consumers.

(B) The Reserve Tier Price in Canadian dollars shall be the Canadian dollar Reserve Tier Price for the previous calendar year increased annually by 5 percent plus adjusted in the manner provided for in section 83.3 of the Financial Administration Act (R.S.Q., c. A-6.001) of Quebec.

(C) At 0900 Pacific Standard Time on the day of the Reserve Sale, the Auction Administrator shall announce the exchange rate to be used to determine the Reserve Tier Prices. The exchange rate shall be the most recently available at 1200 Pacific Standard Time daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada.

(D) The auction administrator will use the announced exchange rate to convert to a common currency the Reserve Tier Price previously calculated separately in U.S. and Canadian dollars. The auction administrator will set each Reserve Tier Price equal to the average of the two values.

#### **B6. Harmonize Annual Compliance Showings Across Linked Jurisdictions (Section 95855)**

Under the ARB regulations, entities have an annual compliance obligation equal to 30% of the previous year's reported emissions; there is no such obligation under the rules published by Quebec's MDDEP. The annual compliance obligation is an important tool to reduce the likelihood of market volatility close to the triennial compliance deadlines. For these reasons, and to create a level playing field, PG&E urges ARB to work with MDDEP to harmonize the two regulations, particularly with respect to annual compliance limits.

**C. Revise and Refine Provisions Regarding Sale of Allowances from Auction and the Allowance Price Containment Reserve (APCR), the Registration Process, and Conduct of Trade**

**C1. Clarify Calculation of Bid Guarantee for Auction (Section 95912)**

PG&E appreciates ARB's revisions to the language in section 95912(i)(2) to clarify the bid guarantee calculation. PG&E suggests the following language modifications to further clarify this approach:

(2) The amount of the bid guarantee must be greater than or equal to the maximum value of the bids submitted from the set of notional values calculated.

(A) ~~The value of a set of bids, evaluated at any potential auction settlement price, equals the quantity of bids submitted at or above that price times the price.~~ To determine set of notional values, calculate the notional value of each bid point, where the notional value is the bid point price multiplied by the allowance quantity to be awarded at that bid point price.

~~(B) The maximum value of a set of bids is the highest value of a set of bids calculated at any potential auction settlement price.~~

**C2. Modify Auction Administration to Ensure that All Potential Bid Scenarios are Appropriately Addressed, Revise Process to Sell Consigned Allowances, and Return Unsold Allowances to their Respective Source Account (Section 95911 (e) & Section 95911 (f))**

**Section 95911(e) - Ensure that All Potential Bid Scenarios are Appropriately Addressed**

PG&E appreciates the added clarity on resolution of tie bids in the new draft language in 95911(e)(5). In addition, PG&E suggests the following modifications to Section 95911(e) to ensure that each potential bid situation is addressed:

(e)(3) Beginning with the highest bid price, bids from each bidder will be considered in declining order by price and entities submitting bids at that price will be sold allowances until either the auction operator shall reject a bid:

\* \* \*

(e)(4)(A) The next lower bid price is less than the auction reserve price, or there are no additional bids, in which case the ~~current price~~ Auction Reserve Price becomes the auction settlement price; or

(e)(4)(B) The total quantity of allowances contained in the bids at the next lower bid price is greater than or equal to the number of



allowances yet to be sold, in which instance, the next lower bid price becomes the auction settlement price and the procedure for resolution of tie bids in section 95911(e)(5) shall apply.

Further, we note the need for two additional clarifications in section 95911(e)(5)(B). First, the cross reference to section 95912(e)(4)(A) needs to be corrected as 95912(e)(4)(A) does not exist. Second, the reference to “the number of allowances in the tier” appears to be incorrect. We expect the intent is to say “number of allowances at that price point” given this section refers to the auction and not the APCR.

**Section 95911(f)(2) - Revise Process to Sell Consigned Allowances**

The new draft language would require the auction operator to sell an “equal proportion” of allowances from each consigning entity when there are insufficient winning bids to exhaust the allowances. PG&E suggests the following changes to clarify that the proportion would be based on the quantity of allowances consigned by each entity. For example, suppose there are two entities consigning allowances in a given auction: Entity A consigns 10 MMT and Entity B consigns 5 MMT. A total of 12 MMT of consigned allowances are sold through this auction. Rather than each entity selling an “equal proportion” of 6 allowances each, Entity A should sell 8 Allowances and Entity B 4 Allowances, since Entity A consigned more allowances than Entity B:

When there are insufficient winning bids to exhaust the allowances from a consignment source in section 95911(b)(3)(A), the auction operator will sell allowances an-in equal proportion to the number of allowances consigned from each consigning entity in that source rounded down. If, as a result of rounding down, there are fewer allowances sold than demanded, the auction operator will assign a random number to each unsold bundle of 1,000 metric tons of CO<sub>2</sub>e from a consignment source in section 95911(b)(3)(A). Beginning with the lowest random number assigned and working in increasing order of the random numbers assigned, the auction operator shall sell allowances assigned the random number until the quantity of allowances sold equals the quantity of allowances demanded.

**Section 95911(f)(4) - Return Unsold Allowances to their Respective Source Account**

The proposed language in this section provides that unsold allowances consigned to the auction from Limited Use Holding Accounts are kept in the Auction Holding Account until the next auction. After December 31, 2012, consigning entities have the flexibility to determine quantity of allowances to be consigned in each particular auction, as long as all total annual allocated allowances are consigned within the applicable year. Adding the provision that unsold allowances remain in the Auction Holding Account restrains the flexibility of consigning entities to determine quantity of allowances to be consigned in each auction. PG&E recommends, as was the case prior to the current draft amendments to the regulation, that any unsold consigned

allowances are returned to their respective Limited Use Holding Accounts in order to support the management and timing of receiving revenues to be returned to our customers.

**C3. Modify APCR Sale Administration to Clarify Calculation of Bid Guarantee and Ensure Sale is Conducted in Line with Market Efficiency Principles (Section 95913)**

PG&E supports the proposal that only entities registered in the California GHG Cap-and-Trade program will be eligible to purchase allowances from the APCR. However, we recommend the following modifications.

**Section 95913(f) - Clarify Calculation of Bid Guarantee**

PG&E recommends the following modified language for section 95913(f) to clarify calculation of bid guarantee.

At least twelve days before the scheduled sale an entity intending to participate in a Reserve sale must submit to the financial services administrator a bid guarantee, payable to the financial services administrator, in an amount greater than or equal to the sum of the bid quantity at each tier multiplied by the tier price, summed across the three tiers

~~(1) The maximum value of a set of bids is the quantity bid at each tier times the tier price, summed across the three tiers~~

**Section 95913(g) – Ensure Reserve Sale is Conducted in Line with Market Efficiency Principles**

As PG&E has stated in earlier comments, PG&E requests that ARB revisit the Purchase Determination process to ensure that sale of allowances from the APCR is conducted in line with market efficiency principles. The current process makes it difficult for entities to bid into the Reserve in a manner that reflects their true willingness to pay. For a specific proposal on how Purchase Determinations could better allow participants to bid according to willingness to pay, see PG&E's August 11, 2011, comments, page 26.

**C4. Other Recommended Changes and Clarifications for Attestation, Corporate Association Requirements, and Conduct of Trade. (Sections 95830, 95832, 95921)**

**Section 95832 - Attestations**

PG&E supports the change in 95832(a) of additional alternate authorized account representatives and the addition of account viewing agents. However, with respect to the attestations in the registration section, we suggest the following modification.

In the Final Statement of Reasons posted in October 2011, ARB indicated that the “to the best of my knowledge and belief” language for the attestations associated with registration was inadvertently deleted and this omission would be corrected when the regulation is amended.

PG&E asks that this language be added back into the regulations in sections 959832(a)(3), 959832(a)(6), and 959832(d).

**Section 95833(e) – Consolidation of Accounts for Corporate Associations**

PG&E supports the new approach to enable entities to consolidate accounts that are part of a direct corporate association. This approach will reduce complexity and simplify the compliance process. PG&E seeks clarification as to whether entities that are part of a direct corporate association could opt-in and then at a later point opt-out of having a consolidated account.

**95830(c)(1)(H) – Clarification on Identification of Direct and Indirect Corporate Associations**

Section 95830(c)(1)(H) requires the identification of direct and indirect corporate associations, which is defined in section 95833(a)(5). It is possible that entities may not have enough information to identify all indirect corporate associations because they would need to obtain detailed information regarding third-parties' corporate structure, which is typically considered confidential business information. We recommend that ARB revise this section to require entities to disclose only those indirect associations that are set forth in public filings, such as those made with the Securities and Exchange Commission and other regulatory agencies.

**Section 95921 – Conduct of Trade**

For 95921(a)(1), we recommend that ARB consider translating the time requirements in the regulations from 24 hours or 48 hours to business days, to reflect any potential timing conflicts with holidays and weekends.

**D. Modify the Know-Your-Customer Requirements (Section 95834)**

PG&E recognizes that this section is still under development and appreciates the opportunity to provide ARB with feedback. On a general note, PG&E would like to ensure that if private personal information is collected by ARB, that the proper security measures are in place to ensure that this sensitive data remains private.

PG&E would like to point out that most companies already conduct background checks on their employees before they are hired. As such, PG&E recommends that ARB use the same criteria presently used by the federal government for proof of identity and eligibility to work to include: driver's license, valid passport, and social security number. In addition, while PG&E supports the criminal background check that Staff is considering, we understand that California law does not permit review of criminal history beyond seven years. PG&E recommends that the background check should be limited to that time frame.

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Thank you for the opportunity to submit these comments. We look forward to continuing our work with the ARB and all concerned stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

John W. Busterud

JWB:kp

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