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December 15, 2010

Chairman Mary D. Nichols
California Air Resources Board
1001 "I" Street
Sacramento, California 95812

Subject: Los Angeles Department of Water and Power - Comments on the California Air Resources Board Proposed Regulation to Implement the California Cap-and-Trade Program Under AB 32 (October 28, 2010)

Dear Chairman Nichols:

The Los Angeles Department of Water and Power (LADWP) commends the California Air Resources Board (ARB) for its outstanding leadership on addressing climate change and work to develop an economy-wide California cap-and-trade program. The LADWP respectfully submits these written comments on the Proposed Regulation for your consideration. The City of Los Angeles and the LADWP reaffirm their strong support for AB 32 and the goal of reducing GHG emissions back to statewide 1990 levels through a set of measures outlined in the ARB's Scoping Plan, including the implementation of a cap-and-trade program that is well designed and easy to understand. The cap-and-trade program must be designed to enable LADWP and other southern California public utilities to continue major capital investments in real and permanent emission reductions. To meet the significant program goals, it is critical that the cap-and-trade program support the transformation of California's energy supply. The LADWP remains fully committed to working with the ARB and other stakeholders to further refine the cap-and-trade regulation during the 15-day language process.

LADWP Is Making Progress In Reducing Its Greenhouse Gas Emissions

The LADWP embraces its responsibility to continue to make portfolio-wide emission reductions on behalf of its customers and service community, and has set a goal of reducing carbon emissions to 35 percent below 1990 levels by 2020. It plans to accomplish that goal by moving away from coal, expanding energy conservation and efficiency, investing in renewable energy resources and transmission, replacing and upgrading its in-basin natural gas generation, and using smart grid technology and dynamic scheduling. The LADWP continues to make great strides in reducing its

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emissions as illustrated by its early actions well ahead of the 2012 start date, which have resulted in a 25 percent drop below its 1990 system carbon intensity level (lbs/MWh) as of 2009 despite an overall 10 percent increase in generation (MWh) over the same timeframe.[1] The LADWP has increased its investments in renewable energy from just 3 percent in 2003 and is on the way to achieving 20 percent in 2010.

California's Cap-and-Trade Must Keep California Businesses Competitive
In light of the current economic recession and need for a focus on recovery, the LADWP fully supports the Governor's sentiments as highlighted in his letter, dated March 24, 2010.[2] The LADWP supports an approach to AB 32 cap-and-trade that gives businesses in California sufficient time to reduce their emissions in a cost-effective manner without unnecessary short-term costs. California businesses should be allowed to remain competitive and positioned to fully reap the benefits of a federal climate program. As such, the LADWP strongly supports policies that have been incorporated into the Proposed Regulation intended to help contain compliance costs, including administrative allocation of allowances to electric distribution utilities on behalf of their retail customers, banking of allowances, three year compliance periods, an allowance reserve, and use of emission offsets.

Allowance Allocation to the Electric Sector
The LADWP supports the administrative allocation of allowances to the electric sector and appreciates that ARB recognizes that electricity distribution utilities are best situated to utilize allowance value for their ratepayers, and recognizes the considerable investment required to reduce emissions within the sector. For that reason, the LADWP also supports the policy to allocate allowances to distribution utilities to 1) support policies and programs that are reducing GHG emissions from the electricity sector, and 2) ensure that electricity ratepayers do not experience sudden increases in their electricity bills associated with the pricing of carbon emissions in the cap-and-trade program. The allocation must also balance the desire to reward early actions to reduce emissions without penalizing electric utilities for geographic or historical circumstances that dictate the emissions of their current generation portfolio.

The LADWP appreciates the ARB's proposal to administratively allocate allowances to the electric sector as a whole in an amount that is expected to cover the sector's native load compliance burden while the electric distribution companies expand their renewable energy portfolios and pursue aggressive energy efficiency standards. It is important for the electric sector's emissions budget to be set at the start of the program in order to provide regulatory certainty. However, should there be major shifts in emissions that result from an earlier than expected economic recovery, increase in load

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[1] CO2 reduction from 1990 to 2009 of LADWP's total system CO2 carbon intensity (lbs/MWh) from owned and purchased generation, and change in total owned and purchased generation (MWh) from 1990-2009.
[2] http://www.climatechange.ca.gov/eaac/documents/2010-03-24_GOVERNOR_LETTER.PDF

associated with electric transportation or multi-year droughts, the LADWP supports an overall reevaluation of the electric sector's allowance budget and upward adjustments as appropriate to ensure that the electric ratepayers are protected from undue economic harm.

Allocation to the Electric Distribution Utilities
The LADWP generally supports a forecasted emissions-based methodology to allocate allowances in a manner that: 1) reflects the forecasted emissions cost burden for each load serving utility, and 2) incorporates the expected benefits of energy efficiency investments, so that energy efficiency accomplishments are rewarded. The LADWP supports an allocation methodology that does not leave any electric utility "short" of emission allowances so long as that utility continues to make emission reductions in alignment with the State's renewable energy and energy efficiency requirements.

The LADWP firmly rejects any methodology that would incorporate a retail sales-based allocation, in that such allocation fails to acknowledge the cost burden associated with the cap-and-trade program and introduces disparate and discriminatory treatment between electric distribution utilities. The LADWP does not support updating of the intra-sector allocation between electric utilities between 2012 and 2020, since this is a fairly short period and any shifting of allowances between utilities could cause unnecessary disruptions to investments. If any reassessment of the sector's allowance budget results in an increase to the sector's overall allocation, such increase should be equitably applied to all electric distribution utilities.

Administrative Allocation to Publicly Owned Electric Distribution Utilities
The LADWP strongly supports the provision that allows a publicly owned electric distribution utility (POU) to deposit administratively allocated allowances directly into its compliance account. All entities should have a reasonable means to comply with the cap-and-trade regulation in a manner that accommodates their respective business models and compliance strategies. By including this provision, the ARB has correctly acknowledged that the electric sector remains only partially deregulated after AB 1890, Chapter 854, Statutes of 1996 – the legislation that was originally intended to introduce competition to California's electricity sector.

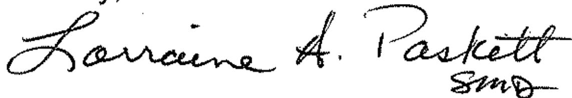
The ARB has been sensitive to the diversity of the electric distribution utilities, many of which are publicly owned utilities that 1) operate for the exclusive benefit of their retail ratepayers, 2) provide the sole source of electric service within their service territories, 3) own their generation assets on behalf of their retail ratepayers, and 4) finance their investments in a manner entirely different from investor-owned utilities. As such, imposing auction design features on vertically integrated POUs is an unnecessary additional step that does not provide any value to POU electric ratepayers, nor to California overall. Many utilities, such as LADWP, own and operate generation to meet all of the load requirements. It does not make sense for LADWP to receive administratively allocated allowances, sell them in an auction, only to turn around and

buy them back again. This is not, in LADWP's view, a "carve out" or "exemption" for POUs. Instead, it is a fundamental and critical need, due to the business structure. The cap-and-trade program must be designed to work for all participants, including POUs, even if that means the regulation includes provisions like this one that efficiently accommodate different business models and compliance strategies.

Conclusion

The LADWP congratulates the ARB for reaching a major milestone for AB 32 with the adoption of this regulation and thanks the ARB for this opportunity to provide comments on the cap-and-trade regulation. The LADWP stands ready to do its part to reduce emissions and help California achieve its emission reduction goal. LADWP's technical comments on the Proposed Regulation are included as an attachment to this cover letter. The LADWP looks forward to working with ARB staff, other utilities, and stakeholders during the coming year to refine the regulation during the 15-day comment period. If you have any questions, please do not hesitate to contact me at 213-367-0926.

Sincerely,



Lorraine A. Paskett
Senior Assistant General Manager
Sustainability Programs and External Affairs

LJK:nsh
Attachment
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Attachment

Los Angeles Department of Water and Power
Technical Comments On The California Air Resources Board's October 28, 2010 Proposed Regulation to Implement The California AB 32 Cap-and-Trade Program

SUBARTICLE 2: PURPOSE AND DEFINITIONS

§ 95802. DEFINITIONS

1. ***Comment: The Definition of "First Deliverer of Electricity" Should Be Clarified to Apply to the Operator of An In-State Electricity Generating Facility, Page A-17***

The first deliverer of electricity is currently defined either as the "*owner or operator*" of an electricity generating facility in California or an electricity importer. Because the point of regulation for the electricity sector is the first deliverer, it is critical that the definition be certain and unambiguous. In the majority of cases, the operator is also the owner, but there are cases where the owner may include multiple parties and the operator may be one of those owners acting on behalf of all the owners. The LADWP recommends that this be corrected for consistency with Subarticle 3, Section 95811, such that for an in-state electricity generating facility *only* the operator is the first deliverer, and *not* the owner of the facility.

2. ***Comment: The Definition of "Imported Electricity" Should Exclude Emissions Attributed and Regulated By Another Linked External Emissions Trading System, Page A-20***

The definition of imported electricity does not address potential linkages to other external emissions trading systems (ETS). The LADWP understands that next year the ARB will commence a separate proceeding to address such linkages. The emissions attributed to another linked jurisdiction are already regulated by the other jurisdiction and therefore should be netted out from any compliance obligation that results from the reporting of emissions under AB 32. To avoid double-counting emissions, LADWP recommends that the definition of imported electricity be revised to include the following:

> *"Imported electricity" means electricity generated outside the state of California and delivered to serve load inside California. Imported electricity includes electricity delivered from a point of receipt located outside the state of California, to the first point of delivery inside the state of California, having a final point of delivery in California. Imported electricity includes electricity imported into California over a multi-jurisdictional retail provider's transmission and distribution system, or electricity imported into California over a balancing authority's transmission and distribution system. Imported electricity includes electricity that is a result of cogeneration outside of California. Imported electricity does*

> *not include electricity wheeled through California, which is electricity that is delivered into California with final point of delivery outside California. <u>Imported electricity does not include electricity that is imported from a source in an approved external ETS where emissions associated with that electricity are attributed to and regulated by the other linked external emissions trading system.</u>*

3. ***Comment: The Definition of Imported Electricity Should Exclude Wheeled Power, Page A-20***

The definition of imported electricity excludes electricity wheeled through California, which is electricity that is delivered into California with final point of delivery outside California." The LADWP recommends that this definition also be revised as follows to remain consistent with treatment of simultaneous energy exchanges under the AB 32 fee regulation:

> *"Imported electricity does not include electricity wheeled through California, including simultaneous exchanges, which is electricity that is delivered into California with final point of delivery outside California<u>, including simultaneous energy exchanges in which the point of receipt and point of delivery are outside California."</u>*

<u>SUBARTICLE 7:</u>
<u>COMPLIANCE REQUIREMENTS FOR COVERED ENTITIES</u>

<u>§ 95852. EMISSION CATEGORIES USED TO CALCULATE COMPLIANCE OBLIGATIONS</u>

4. ***Comment: The Compliance Obligation For First Deliverers of Electricity Under The Cap-and-Trade Regulation Should Be Amended To Account For Emission Reductions Associated With The Retirement of Renewable Energy Certificates Under the California Renewable Electricity Standard Regulation, Page A-62 Subparagraph (b)***

The draft regulation states that a deliverer of electricity covered under sections 95811(b) and 95812(b)(2) has a compliance obligation for *"every metric ton of CO2e emissions for which a positive verification statement or qualified positive verification statement is issued"* and every metric ton of CO2e of stationary source combustion emissions, or emissions associated with electricity imported into California from a source in a jurisdiction where a GHG emissions trading system has not been approved for linkage by the Board pursuant to Subarticle 12.

The cap-and-trade regulation is not a stand alone regulation; rather it is one piece of a larger program to achieve the state's emission reduction goal, and needs to dovetail with the other complementary emission reduction measures identified in the AB 32

Scoping Plan. As such, the cap-and-trade regulation should recognize emission reductions achieved under other AB 32 regulations such as the Renewable Electricity Standard (RES). The RES environmental analysis suggests that increasing renewable energy from 20% to 33% will result in 11-12 MMT in GHG emission benefits (MMTCO2e/yr) by 2020. The RES also acknowledges that emission benefits are "WECC-wide" insofar as compliance can be achieved through the purchase and retirement of renewable energy certificates (RECs) generated within the WECC without actual delivery of the green energy to California.

This reduction in WECC-wide emissions due to the RES should be recognized under the cap-and-trade regulation, and a first deliverer's compliance obligation under the cap-and-trade regulation should be adjusted to reflect the emission reduction associated with the RECs that entity has retired to comply with the RES. However, as currently drafted, the compliance obligation under the cap-and-trade regulation will be calculated based on emissions reported and verified under the mandatory reporting regulation (MRR). Except to the extent that delivered renewable energy reduces emissions by displacing fossil generation, the MRR does not quantify emissions reduced as a result of purchasing and retiring unbundled RECs.

The LADWP recommends that ARB fully acknowledge the WECC-wide emission reductions that will result from the RES. Without alignment between the RES, MRR, and cap-and-trade regulations, entities will only be credited with renewable energy that is physically imported into California. Any RES compliance using unbundled RECs would result in a double-burden insofar as entities would pay the cost of purchasing the RECs as well as the cost of emission allowances for energy used to serve load in California. It would be inconsistent to count the emission reductions from the RES toward the AB 32 emission reduction target without also attributing those emission reduction benefits to the entities that are purchasing and retiring the RECs.

The LADWP recommends the following be included in this section under section (b):

> *"First Deliverers of Electricity. A deliverer of electricity covered under sections 95811(b) and 95812(b)(2) has a compliance obligation for every metric ton of CO_2e emissions for which a positive verification statement or qualified positive verification statement is issued, and every metric ton of CO_2e of stationary combustion emissions, or emissions associated with electricity imported into California from a source in a jurisdiction where a GHG emissions trading system has not been approved for linkage by the Board pursuant to Subarticle 12. <u>This compliance obligation shall be adjusted for implementation of the Renewable Electricity Standard for the purchase and retirement of unbundled or tradable renewable energy certificates purchased and retired by the entity to comply with the Renewable Electricity Standard."</u>*

5. *Comment: The Compliance Obligation For First Deliverers of Electricity Under The Cap-and-Trade Regulation Should Not Include Electricity That Is Generated Out-Of-State and Sold Outside California*

As currently drafted, it appears that the cap-and-trade regulation may inadvertently place a compliance burden on electricity that is generated out-of-state that does not enter California. The regulation must clarify this issue to ensure that electricity that is generated outside of California by a California load serving entity, that is not imported into California is not a California greenhouse gas emission. The legislation did not provide ARB jurisdiction under AB 32 to consider external generation not imported, and therefore not subject to emissions reporting under Section 38530 of the mandatory reporting regulation. The language proposed in Section 95111(g)(5) of the mandatory reporting regulation should be deleted to ensure that such electricity is not treated as having an emissions compliance burden under section 95852 of the cap-and-trade regulation.

6. *Comment: Two-Way Border Adjustment Needed To Prevent Leakage In Electricity Sector*

The LADWP supports ARB's efforts to address emissions leakage, which negatively affects California's economy and erodes the environmental integrity of the cap-and-trade program. While the first deliverer approach addresses the competitive advantage of *importers* of power into California, an additional mechanism is needed to address the competitive disadvantage faced by *exporters* of power generated in California The proposed cap-and-trade regulation requires California power generators to acquire compliance instruments to cover their greenhouse gas emissions, whether that power is consumed within California or exported. If the exporter is not the generator, the exporter will nonetheless be liable for the costs of the compliance instruments as the generator will incorporate the cost into the price of the power. To remain whole, the exporter would need to pass the cost of the compliance instruments through to the out-of-state buyer, putting California exporters at a competitive disadvantage compared to out-of-state generators that serve load in jurisdictions where there is no cap-and-trade program. This may lead to emissions leakage, as power that was formerly generated within California becomes uncompetitive and is replaced with power generated outside California.

From an operational standpoint, not reimbursing exporters for the compliance cost of California power could have a negative impact on reliability of the electrical grid, especially as utilities must comply with pending regulations being promulgated by the Federal Energy Regulatory Commission (FERC) to provide regulation services every fifteen minutes for interconnected intermittent renewable resources like wind and solar. This regulation service is critical with regard to overall reliability of the WECC-wide (Western Electricity Coordinating Council) grid. If one utility is getting less output than expected from an interconnected intermittent renewable resource like wind, then other utilities may be required to provide energy to help meet that load, regardless of whether that need is in California or somewhere else within the WECC region. If electricity

generated in California is exported to support load elsewhere within the WECC, the exporting entity should receive credit for the compliance obligation associated with the California power. If not, the higher cost of California power would be a disincentive to exporting power when it is needed to support reliability of the grid and the regulation conflicts with the comprehensive regulatory structure established by FERC.

§ 95852.2. EMISSIONS WITHOUT A COMPLIANCE OBLIGATION

7. *Comment: Biogas Emissions From Digesters Should Not Hold A Compliance Obligation, Page A-64 Subparagraph (a)*

Subparagraph (a) indicates emissions from biomass-derived fuels (except biogas from digesters) count toward applicable reporting thresholds, but do not count toward a covered entity's compliance obligation. First, the exclusion of digester biogas from this provision suggests that it *is* counted toward a covered entity's compliance obligation. This appears to be inconsistent with subparagraph (e) on page A-66 that indicates biomethane from all animal and other organic waste, or landfill gas and wastewater are categories *without* a compliance obligation under the cap-and-trade program. Subarticle 3 (Applicability) correctly does not include publicly owned treatment works (POTWs) or sewage treatment plants as a category of covered entities. However, it appears that if that digester gas, whether from municipal sewage or livestock, is captured and flared it does not create a surrender obligation, yet if that same digester gas is combusted to generate electricity instead of being flared, the same gas will have GHG emissions that would then count toward an allowance surrender obligation for a covered entity, such as an electric utility.

Second, the cross reference to the MRR [section 95131(i)(2)A)(2)] unnecessarily restricts biomass-derived fuel to 1) contracts in effect prior to January 1, 2010 and that remain in effect or 2) fuel provided under a contract dated after January 1, 2010 only for the amount of fuel that is associated with an increase in the biomass-based fuel producer's capacity. The MRR ISOR indicates that this provision is to prevent contract shuffling. Undue restrictions to address contract shuffling will result in increased costs for compliance with the RES regulation and the cap-and-trade regulation.

The LADWP supports the use of biomass-derived fuels for meeting compliance with the 33% RES as they play a critical role in the ability of utilities to meet the standard at the lowest cost. Use of digester gas or other biogas that is upgraded to pipeline quality – in lieu of natural gas to generate electricity – is a beneficial use of waste gas and should be both encouraged and supported by the ARB. The LADWP recommends that the ARB recognize the displacement of fossil fuels and treat biomass-derived fuels that are RES-compliant as having zero GHG emissions compliance obligation under the cap-and-trade program when used in the generation of electricity. The LADWP recommends that ARB reassess how it addresses contract shuffling to make sure that it does not hinder the beneficial displacement of fossil fuels for generating electricity.

§ 95855. ANNUAL COMPLIANCE OBLIGATION

8. Comment: The Deadline For Annual Surrender Should Be Aligned With The 3-Year Compliance Period Surrender Deadline, Page A-70

Subparagraph (b) on page A-69 indicates the annual compliance obligation equals thirty percent of a positive verification statement or qualified positive verification statement from the previous year. The LADWP supports this annual surrender obligation as a reasonable balance between providing needed flexibility and identifying entities at risk of default. The LADWP recommends further streamlining of the surrender deadline to a single date of November 1 of the following calendar year, rather than two separate dates of May 15 and July 15. Vertically integrated electric utilities have two reporting deadlines, one for facility-level reporting and another for entity-level reporting. A single annual surrender deadline that occurs after these two dates provides for less complexity. As such, the annual surrender is proposed as follows:

"Compliance Period 1 Annual Surrender Deadlines:
1) *Thirty percent of 2012 emissions are due November 1, 2013*
2) *Thirty percent of 2013 emissions are due November 1, 2014*
3) *Remaining emissions for 2012-2014 are due November 1, 2015*

Compliance Period 2 Annual Surrender Deadlines:
4) *Thirty percent of 2015 emissions are due November 1, 2016*
5) *Thirty percent of 2016 emissions are due November 1, 2017*
6) *Remaining emissions for 2015-2017 are due November 1, 2018*

Compliance Period 3 Annual Surrender Deadlines:
7) *Thirty percent of 2018 emissions are due November 1, 2019*
8) *Thirty percent of 2019 emissions are due November 1, 2020*
9) *Remaining emissions for 2018-2020 are due November 1, 2021"*

§ 95856. TIMELY SURRENDER OF COMPLIANCE INSTRUMENTS BY A COVERED ENTITY

9. Comment: The Regulation Should Include An Appeal Process To Address Technical Reporting Issues Affecting the Timely Surrender Of Compliance Instruments, Page A-69

Section 95865 outlines the provisions for the surrender of compliance instruments, including data review and determination of a covered entity's triennial obligation and final retirement of the compliance instruments by the ARB Executive Officer. It is unclear if and when a covered entity may appeal the Executive Officer's final determination of a compliance obligation. It is possible that there may be technical differences of opinion between the covered entity and the verifier as to the calculation of emissions that are subject to a compliance obligation. The LADWP recommends that an additional subparagraph be added to this section as follows:

(h) Appeal Process.
(1) The covered entity may appeal its triennial compliance obligation within 15 days of receiving the final determination.

(2) An appeal must be submitted in writing to the Executive Officer and must include a detailed explanation of what is being contested. Additional new information may be submitted in support of the appeal.

(3) The covered entity must surrender compliance instruments equivalent to the emissions not subject to the appeal, and hold the balance of compliance instruments in its compliance account to cover the remaining emissions as identified in the Executive Officer's final determination while the appeal is reviewed.

(4) Upon final review and resolution, a written notification shall be sent to the covered entity that includes any findings of the Executive Officer in response to the appeal as well as any necessary adjustments to the covered entity's final triennial compliance obligation.

(5) The Executive Officer shall retire the compliance instruments in the compliance account equivalent to the emissions identified in the written notification. Any remaining allowances deemed not subject to a surrender obligation shall remain in the compliance account for future surrender obligations.

§ 95857. UNTIMELY SURRENDER OF COMPLIANCE INSTRUMENTS BY A COVERED ENTITY

10. Comment: Applicability of The Untimely Surrender Obligation Should Not Apply To Emissions Subject to Appeal and Under Review By The Executive Officer, Page A-72 Subparagraph (a)

The LADWP recommends that an appeal process be included in the regulation for cases where there may be a difference of opinion between the covered entity and the verifier related to the technical calculation of a compliance obligation. In order to avoid undue penalties while an appeal is being reviewed by the Executive Officer, the LADWP recommends adding the following exclusion under subparagraph (a) Applicability on page A-72:

(3) The compliance obligation for untimely surrender shall not apply to a covered entity or opt-in covered entity for emissions that are the subject of a written appeal submitted

to the Executive Officer while that appeal is under review and consideration.

11. Comment: The Excess Emissions Obligation Is Excessive And Should Be Made Consistent With Other Trading Programs, Page A-72 Subparagraph (b)(2)

The draft regulation indicates "The covered entity's compliance obligation for untimely surrender is calculated as four times the entity's excess emissions" (4:1 ratio). This compliance penalty is excessive in comparison to other existing emissions trading programs and may have the unintended consequence of limiting the market further than necessary or appropriate.

The RECLAIM and Acid Rain programs require that the amount that the allocation is exceeded be deducted from the next year's allocation on a 1:1 ratio. CARB audits may reveal that some entities need to apply conservative CEMS missing data procedures, which may result in a calculated surrender obligation that is above the entities' actual emissions. Such approach ensures the environmental integrity of the program is not compromised, but does not go so far as to take out of circulation additional allowances that are needed by covered entities in general for compliance. This occurs when ARB transfers three fourths of surrendered allowances to the highest-priced tier in the Allowance Price Containment Reserve Account [the other one fourth is retired].

This approach works against other cost containment provisions in the regulation and essentially penalizes all covered entities by restricting allowance supply and driving up the allowances prices. This provision is in addition to financial penalties proposed under 1) section 96013 where penalties may be assessed for *any* violation, and 2) section 96014 (b) where a separate violation is defined for *each day* or portion thereof after the compliance date that each required compliance instrument has not been surrendered. If a covered entity has excess emissions of 500 MT for 10 days, it must then surrender 20,000 MT of California allowances [500 MT of GHG emissions x 4 California GHG allowances x 10 days = 20,000 MT of California GHG allowances].

The LADWP strongly recommends that the untimely surrender obligation for excess emissions remain consistent with other emissions trading programs with a 1:1 surrender obligation in which the replaced compliance instrument is permanently retired. The LADWP recommends that this subparagraph (b)(2) be revised to read as follows:

"A covered entity's compliance obligation for untimely surrender is calculated as equal to the entity's excess emissions."

12. Comment: Any Approved Compliance Instrument Should Be Eligible For Untimely Surrender Obligation, Not Just California GHG Allowances, Page A-72 Subparagraph (b)(3)

The draft regulation indicates that *only* California GHG allowances may be used to fulfill a covered entity's compliance obligation for untimely surrender. The LADWP

recommends that such provision be deleted as it is unnecessarily restrictive. Any approved allowance or offset credit that is eligible for use in the California cap-and-trade program overall should also be eligible for use to fulfill any surrender obligation. Otherwise, divergent treatment of compliance instruments available through ARB-approved offset protocols or ARB-approved external trading programs sends incorrect signals to investors that such compliance instruments are inferior and less valuable than California GHG emission allowances. The LADWP recommends that this subparagraph (b)(3) be revised to read as follows:

> *"A covered entity's compliance obligation for untimely surrender may be fulfilled with compliance instruments issued pursuant to Subarticle 4."*

13. Comment: Covered Entities Should Be Given Adequate Time To Purchase Allowances At Auction For Excess Emissions, Page A-73 Subparagraph (c)(6)

The draft regulation indicates that the obligation to surrender allowances for excess emissions is immediately due, and the Executive Officer may pursue enforcement activities if a covered entity does not surrender sufficient allowances equal to this untimely surrender obligation by the end of the 30-day period. The LADWP recommends that ARB provide covered entities with the opportunity to purchase allowances at the next quarterly auction. This timeframe could be less than 30 days or up to 3 months, but it offers the covered entity a more reasonable opportunity to purchase allowances without going to the secondary market or allowance reserve. Additionally, the LADWP recommends that this section be revised such that it is clear that the covered entity has a set period of time - until the next quarterly auction - to true up its compliance obligation for untimely surrender before the Executive Officer pursues enforcement activities. In other words, the Executive Officer shall not impose penalties pursuant to Subarticle 15 unless the covered entity has failed to secure adequate allowances by the time the next quarterly auction is completed and auctioned allowances are transferred into the covered entity's compliance account.

SUBARTICLE 9: DIRECT ALLOCATIONS OF CALIFORNIA GHG ALLOWANCES

§ 95890. GENERAL PROVISIONS FOR DIRECT ALLOCATIONS

14. Comment: Correct Reference to Positive or Qualified Positive Verification Statement of Emissions, Page A-77 Subparagraph (b)

The eligibility requirements for electric distribution utilities in subparagraph (b) reflects an omission of the word "allowances" and an error that incorrectly makes reference to a "positive or qualified positive verification statement on *its sales number* for the prior year pursuant to the MRR." The LADWP recommends that this subparagraph be revised to read as follows:

> *"(b) Eligibility Requirements for Electrical Distribution Utilities. An electrical distribution utility shall be eligible for direct allocation of California allowances if it has complied with the requirements of the MRR and has obtained a positive or qualified positive verification statement ~~on its sales number~~ of emissions for the prior year pursuant to the MRR."*

§ 95892. ALLOCATION TO ELECTRICAL DISTRIBUTION UTILITIES FOR PROTECTION OF ELECTRICITY RATEPAYERS

Allocation to Electrical Distribution Utilities

15. *Comment: Publicly Owned Utility Allocation Provision Correctly Recognizes Diverse Electric Distribution Utility Business Models, Page A-83 Subparagraph (b)(2)*

The LADWP appreciates that the ARB proposes an administrative allocation to electrical distribution utilities for the protection of electricity ratepayers that recognizes the different business models of the utilities. As a direct result of AB 1890, the investor owned utilities (IOUs), for the most part, divested of their fossil generation assets, and today have an indirect compliance obligation that is based primarily on power purchased from other generators. On the other hand, publicly owned utilities follow a different business model in which they continue to remain mostly vertically integrated utilities owning the majority of their generation assets on behalf of their customers. As a result, POUs maintain a direct compliance obligation for the electricity that they directly generate to serve native load. This is a fundamental difference that makes it imperative that the ARB maintain a cap-and-trade program that accommodates these different business models in a way that maintains the environmental integrity of the program, while giving the utilities the flexibility they need to continue to make the necessary emission reduction investments in renewables and energy efficiency that will help transform the electric sector to low- and non-emitting generation resources.

There are circumstances in which allowances should be allowed to be transferred directly from a compliance account of one entity to the compliance account of another covered entity. These include the following:

1. energy purchases to make up for emergency outages affecting owned generation (fire, earthquake, equipment failure)
2. energy purchases to make up for planned outages affecting owned generation (maintenance, upgrades, repowering)
3. energy purchases to make up for under-production from intermittent renewables (renewable energy project is not delivering projected output for native load)
4. energy received from a jointly owned facility for retail sales where allowances are held by the joint owners in their capacity as electric distribution utilities, and the operator of the facility may be a joint owner operating the facility on behalf of the owners overall.

The LADWP recommends that ARB revised the regulation to allow for these direct transfers of allowances from one compliance account to another compliance account.

SUBARTICLE 10: AUCTION AND SALE OF CALIFORNIA GREENHOUSE GAS ALLOWANCES

§ 95912. AUCTION ADMINISTRATION AND REGISTRATION

16. *Comment: Creditworthiness As Demonstrated by A High Bond Rating From A Rating Agency Should Be Allowed In Lieu Of A Bid Guarantee, Page A-92 Subparagraph (i)*

The cap-and-trade regulation requires that registrants of an auction provide a bid guarantee to the auction administrator at least one week prior to auction. The bid guarantee must be in one or a combination of the following forms: 1) a bond, 2) cash in the form of a wire transfer or certified funds, 3) an irrevocable letter of credit.

Most municipal utilities carry bond covenants and restrictions that limit their ability to post assets as collateral, plus the cost for a letter of credit is significant. For electric distribution utilities, the LADWP's preferred alternative to the ARB's bid guarantee requirements is to rely on a high bond rating as the basis for creditworthiness, such as "AA" or above to qualify an entity to participate in a quarterly auction. There are also creditworthiness provisions outlined in master agreements such as those available through the Western Systems Power Pool (WSPP) or Edison Electric Institute (EEI) that could be used as the basis for participation by utilities in a quarterly auction.

§ 95913. SALE OF ALLOWANCES FROM THE ALLOWANCE PRICE CONTAINMENT RESERVE

17. *Comment: The Allowance Price Containment Reserve Should Not Include Tiers Or Annual Adjustment Beyond Inflation, Page A-96 Subparagraph (d)*

The draft regulation proposes that the Allowance Price Containment Reserve be made available at three price tiers, adjusted annually by 5% plus inflation. Any surplus ARB allowances not sold at auction would be transferred to the reserve and placed in the highest tier ($50/ton). AB 32 workshop discussions have previously focused on an allowance reserve set using allowance prices in the range of $25/ton to $30/ton plus inflation only, without three separate tiers or a 5% annual adjustment. While the intent is to make the reserve the "last resort", extracting higher revenues from the sale of reserve allowances is not the correct policy focus and the LADWP recommends that it be reconsidered. If the allowance reserve is tapped into at some point in the program, it should signal an "emergency" in the program and the ARB should focus on the market factors contributing to the need to purchase allowances from the reserve. An allowance price of $50/ton (plus 5% annually and inflation) for emissions will add significant costs to the price of electricity at a time when such pricing that may not be warranted or publicly supported.

SUBARTICLE 11: TRADING AND BANKING

§ 95920. TRADING

18. Comment: The Holding Limit Conflicts with The Cost Containment Unlimited Banking Provision And Should Better Accommodate The Needs Of Electric Distribution Utilities, Page A-105 Subparagraph (b)

The draft regulation currently proposes a holding limit formula that equals a fixed six million metric ton (MMT) limitation on the holding of emission allowances by any entity or group of associated entities. It also includes a limited exemption for allowances that are transferred into an entity's compliance account equivalent to its annual emissions accumulating annually over the compliance period. The holding limit provision runs contrary to the overall cost containment strategy of "unlimited" banking of emission allowances. The currently proposed holding limit may work well for small covered entities, but is unnecessarily restrictive for larger entities. If a holding limit is applied to electric distribution utilities, the LADWP recommends that the limited exemption be retained for allowances placed in the compliance account. Additionally, the electric distribution utility should be given the option of either the six million metric ton holding limit, or a holding limit equivalent to no less than an entity's previous two years reported emissions associated with serving retail electric load. This would provide electric distribution utilities with much needed flexibility to purchase and bank allowances as needed at auction, while also providing closer alignment to a large electric distribution utility's actual compliance obligation. Additionally, the "group of associated entities" should exclude electric distribution utilities in so far as many electric distribution companies jointly own or have entitlement shares in the same electric generation facilities.

SUBARTICLE 15: ENFORCEMENT AND PENALTIES

§ 96010. JURISDICTION

19. Comment: ARB Should Consult With The CFTC To Ensure The Cap-And-Trade Regulation Is In Full Alignment with CFTC Regulations Originating from the Dodd-Frank Act

The AB 32 cap-and-trade regulation is being established at the same time as regulations for natural gas and power markets are being developed by the Commodity Futures Trading Commission (CFTC) as part of Title VII of the Dodd-Frank Act. On November 26, 2010, the CFTC published in the Federal Register (Vol. 75, No. 227, pg. 72816-17) a solicitation for public input regarding the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets. The LADWP recommends that the ARB consult with the CFTC and review the regulatory proceeding to ensure that the AB 32 cap-and-trade regulation is fully aligned with the CFTC regulations moving forward.

SUBARTICLE 16: OTHER PROVISIONS

20. Comment: Program Evaluation, Market Monitoring and Surveillance Provisions Should Be Added To The Cap-And-Trade Regulation

On page II-56, the staff report states that CARB will evaluate the program every three years and make adjustments as necessary. Evaluation of the program periodically is appropriate, but there are no specifics as to what portions of the program will be evaluated and what situations would trigger adjustments to the regulation. This creates much regulatory uncertainty and makes it difficult for entities to plan for compliance. The LADWP recommends that the ARB include a provision in the regulation related to market monitoring and surveillance, and program evaluation. This provision should provide a full assessment of the cap-and-trade program's performance and market operations. It should also clearly define what would trigger possible amendments to the regulation (e.g. price of allowances reach a certain level during a specified time period, number of offset credits available drops below a specified level). For example, RECLAIM contains backstop provisions that require AQMD to conduct annual program audits. The following are some of the issues that the annual audit assesses:

- Emission reductions
- Job impacts
- Average annual price of credits
- Availability of credits
- Compliance issues
- Emissions associated with equipment breakdowns

AQMD has the right to amend the program if the average price of a credit exceeds a specific price threshold. This determination does not necessarily need to be made via the audit process. The LADWP recommends that such provisions for program evaluation, market monitoring and surveillance be included directly in the regulation and not just in the staff report.