**August 11, 2011**

**Comments of the Independent Energy Producers Association**

**On CARB’s Proposed Regulation to Implement the California Cap-and-Trade Program**

**[Release Date: July 27, 2011]**

The Independent Energy Producers Association (“IEP”) submits these comments on the California Air Resources Board (“CARB”) Proposed Regulation to Implement the California Cap-and-Trade (“C&T”) Program (released July 27, 2011). IEP represents over 26,000 MWs of installed non-utility, independently owned generation resources in California. IEP supports the goals of AB 32 and offers these comments in conjunction with previous comments on the Cap-and-Trade Regulation.[[1]](#footnote-1) IEP looks forward to working with staff to discuss our concerns as detailed below.

IEP encourages CARB to make certain changes to the regulation to better preserve the competitive and efficient nature of California’s electricity markets. At the highest level, IEP’s comments focus on:

 (1) Eliminating potential discriminatory effects of certain aspects of the proposed C&T program, including the dissimilar treatment between independent power producers (“IPPs”) and Utility Owned Generation (“UOG”);

(2) Encouraging stability in the cap-and-trade auctions; and,

(3) Providing certainty to regulated entities as to the effect and application of the cap-and-trade program.

These concerns remain our top priorities as CARB moves forward in designing the cap-and-trade Program. Accordingly, IEP has both general and specific comments related to the cap-and-trade proposed 15-day changes.

1. **General Comments**

IEP thanks staff for their attentiveness to stakeholder input during this rulemaking, and notes there are important improvements in the July 27th version of the Cap-and-Trade regulation. First, IEP appreciates the amendments CARB has made to Section 95852.2, which will aid in encouraging Municipal Solid Waste conversion projects. However, we do request that waste to energy technologies be evaluated on a life-cycle assessment basis in order to address the GHG life-cycle benefits of waste to energy technologies and avoid the unintended consequences of increasing greenhouse gas emissions. Second, IEP supports the change to the compliance periods, so that the first compliance period only contains the 2013 and 2014 emission years. This will allow more time to test the auctions and auction software, and better evaluate market stability concerns. Finally, IEP is pleased to see CARB’s treatment of allowance auction revenue, such that auction proceeds shall be used exclusively for the benefit of retail ratepayers of each electrical distribution utility consistent with the goals of AB32, while also requiring that each electrical distribution utility report on the use of auction proceeds and allowance value.

1. **Specific Comments on the Cap and Trade Regulation:**

**1. The proposed 15-Day Language fails to treat all obligated entities equally as regards access to GHG compliance instruments.**

Currently, obligated entities under the C&T program are to be allocated free allowances to compensate them for the negative impacts of the GHG program on their market position(s). Thus, the industrial entities, the publicly-owned municipal utilities, and the investor-owned utilities are targeted for free allocation of allowances. As a practical matter, therefore, irrespective of whether the obligated entities have a market in which they can pass along to consumers the costs of GHG allowances (e.g. cement, refineries, transportation sector, glass, etc.), these entities are to receive free allowances to compensate them for their trade exposure in the marketplace.

The only exception to this rule is the treatment of independent power producers (“IPPs”). All IPPs are required to obtain their allowances via an auction.[[2]](#footnote-2) No free allowances are to be allocated, irrespective of the market/trade exposure faced by the individual generator. For the vast bulk of IPPs, this approach is palatable as they have mechanisms available to recover the costs of GHG allowances in the market, either via new contracts or various market structures (e.g. CAISO markets). However, for a small subset of IPPs operating under existing, long-term contracts, currently no viable mechanisms exist within their contract structures to recover the cost of the GHG allowances they are obligated to obtain under the C&T program. This limited set of IPPs and combined-heat and power facilities (“CHP”) operate under long term contracts. The lack of specific consideration in the cap-and-trade regulation regarding generators caught in these circumstances raises serious equity and consistency concerns.

Specifically, three different categories of IPPs operate under existing, long-term contract structures for which the pass-through of GHG costs to end-use customers is not likely available: (1) a very limited number of IPPs selling to utilities; (2) a relatively larger number of IPP/CHP facilities selling to a thermal host (e.g. steam sales); and (3) a very limited number of IPPs selling to marketers. CARB, thus far, has insisted that these entities renegotiate their contracts with their counterparties in order to account for unrecoverable GHG allowance costs. IEP encourages this outcome. However, renegotiations in which one party has little if no incentive to re-negotiate makes this solution unworkable in most instances.

Importantly, from the perspective of achieving GHG objectives while fostering a clean-tech economy, the current C&T proposal to “re-negotiate” is very counter-productive absent proper incentives to foster successful re-negotiation. Absent re-negotiation, for example, economic principles suggest that electric generators that are unable to recover their full operating costs will eventually shut down. In the context of achieving a 7,000 MW goal of operational CHP by 2020 [i.e. 4000MWs of additional CHP + 3000MWs of existing], an outcome in which CHP is incented to discontinue operations only undermines this goal. Similarly, in the context of an electric generator selling to a utility under an existing contract for which GHG costs are not recoverable, the utility will have the incentive to operate this unit more often than would occur otherwise, regardless of the units’ efficiencies, thereby hiding the true cost of carbon that the cap and trade program is attempting to illustrate. Furthermore, this outcome contradicts CARB’s policy rationale for allocating free allowances to distribution utilities. The utilities get free allocation under the assumption that ratepayers incur GHG costs when the utility purchases power at wholesale, under bilateral contracts or through the utility’s own compliance obligation for Utility-Owned-Generation. If the utility can avoid the GHG costs for some contracts, then it should not be receiving free allocation to cover the costs of GHG from generation without GHG cost recovery.

Without more affirmative direction from CARB, many counterparties will have no incentive to renegotiate the contracts. In fact, many if not all counterparties will have an incentive toavoid renegotiation because their counterparties’ ability to avoid these costs enables the Buyer to garner windfall profits from the sale of the electricity in a market where the Market Clearing Price (“MCP”) contains a GHG value. In proposing a solution, IEP wants to create incentives, where there are otherwise none, for renegotiations to occur. Our proposal provides incentives for renegotiations to occur, while also creating incentives for generators to reduce their emissions, as allowances will be scarcer when they come off of their long term contracts.

**IEP Recommendation:** To address this concern, IEP recommends changes to three sections of the proposed regulations.

1. ***Amend Section 95802(a)(150), p. A-25:***

The definition for “Long-Term Contract” should be amended to reflect the date AB 32 was chaptered: September 27, 2006.

***Proposed Language Change***: "Long-Term Contract" means a contract for the delivery of electricity or thermal energy entered into before ~~January 1,~~ September 27, 2006 for the term of five years or more.

1. **Add New Subsection 95834(a)(4), p. A-72:**

CARB should also amend the Disclosure of Beneficial Holding Section [Section 95834] to require a distribution utility to enter into a beneficial holding relationship to cover the emissions obligation of the generator selling to the utility under an existing long-term contract.

*Proposed Language Insertion*:

 (4) In the event there is a Long-Term Contract for the sale of electricity at wholesale which: i) does not directly or indirectly provide or refer to GHG costs either explicitly or through a) a CPUC approved contract or, b) a CPUC authorized pricing basis that includes GHG costs; ii) was fully executed before the final approval of AB 32 (September 27, 2006); and, iii) has not been renegotiated as of January 1, 2012 to address GHG costs, then, a beneficial holding relationship is deemed to exist pursuant to section 95834(a)(1)(A) without further action. The electric distribution utility party to the Long-Term Contract shall purchase and hold allowances for the eventual transfer to the other party to the Long-Term Contract for the sole purpose of supplying the second entity with compliance instruments to cover emissions resulting from satisfaction of the Long-Term Contract.

1. ***Add New Section 95871:***

In order to avoid discriminatory impacts on the other 2 types of existing contracts without a reasonable (i.e. market-based) means of cost recovery, IEP recommends inserting a new section in the regulation to deal with each of these transactions. IEP proposes the following language:

***Proposed Language Insertion***:

This section applies to (1) electric wholesale CHP Facilities, without a means for GHG cost recovery, under a Long-Term Contract to a thermal host; and, (2) Electric wholesale generators, without a means for GHG cost recovery, under a Long-Term Contract with a Marketer.

1. CHP Facilities, without a means for GHG cost recovery, operating under a Long-Term Contract with a thermal host facility:

In the event there is a Long-Term Contract for the sale of thermal energy which: (1) does not directly or indirectly provide or refer to GHG costs; (2) was fully executed before the final approval of AB 32 (September 27, 2006); (3) has not been renegotiated as of January 1, 2012 to address GHG costs; and, (4) the CHP Facility has provided an annual attestation, backed by reporting data and a commercially binding agreement between the CHP Facility and the thermal host, that the agreement between the CHP Facility and the thermal host does not contemplate any compliance obligation by the thermal host, then:

* + 1. The thermal host becomes the responsible entity for the GHG compliance costs associated with that contract until either (a) the contract term expires; or (b) the contract is renegotiated.
		2. The CHP Facility is relieved of its GHG compliance obligation associated with the emissions from that contract until (a) the contract term expires; or, (b) the contract is renegotiated between counterparties.
1. Electric wholesale generators, without a means for GHG cost recovery, under Long-Term Contract with a Marketer:

In the event there is a Long-Term Contract for the sale of electricity at wholesale which: (1) does not directly or indirectly provide or refer to GHG costs explicitly or alternatively through a CPUC approved contract or a CPUC authorized pricing basis that includes GHG costs; (2) was fully executed before the final approval of AB 32 (September 27, 2006); (3) has not been renegotiated as of January 1, 2012 to address GHG costs; and, (4) the electric wholesale generator has provided an annual attestation that there is a commercially binding agreement between the electric wholesale generator and the marketer, that does not contemplate any compliance obligation by the marketer, then:

1. The marketer in the transaction shall become the first deliverer, with a compliance obligation to CARB for the GHG allowance costs associated with that particular contract until either (a) the contract term expires; or, (b) the contract is renegotiated.
2. The electric generator is relieved of its GHG compliance obligation associated with the emissions from that contract, until (a) the contract term expires; or, (b) the contract is renegotiated between counterparties.

**2. Exclude from the definition of “resource shuffling” legitimate transactions that do not constitute fraud.**

Fraud is a criminal violation that exists when a regulated entity intentionally or knowingly misrepresents the truth. Presently, the definition for “resource shuffling” could incorporate legitimate transactions where there is no intent to misrepresent a specified source’s emissions. For example, the regulation does not make clear whether an out-of-state power plant could fall within the definition of “resource shuffling” if the facility reported a portion of its output “historically serving” California, but then enters into a new contract for the remaining capacity. The definition appears to impute a dedication of a resource to California loads simply by historical operation of a contract. Thus, in addition to IEP’s concern that the definition does not recognize an “intent to mislead,” such a presumptive determination solely based on a historical contract ignores the situation of merchant facilities as well as assets coming off of term contracts that will require flexibility in entering new contracts. In other words, the resource shuffling provisions impose a significant impediment to the ability of resources “historically serving” California from entering into new contractual arrangements.

**IEP Recommendation:**

The definition for resource shuffling should be clarified to exclude legitimate transactions and only apply to situations where an entity knowingly and intentionally misrepresents its emissions for purposes of avoiding the compliance obligation. Reference to “fraud” should be deleted.

***Amend Section 95802(a)(245), p. A-40:***

“Resource Shuffling” means any plan, scheme, or artifice to intentionally misstate or mislead regarding the ~~receive credit based on~~ emissions rate ~~reductions that have not occurred,~~ involving the delivery of electricity to the California grid~~,~~ by an entity that has not already registered under the Mandatory Reporting Regulation as a specified importer for which:

(A) An emission factor below the default emission factor is reported pursuant to MRR for a generation source that has not ~~historically~~ served California load (excluding new or expanded capacity)~~. A~~ and, during the same interval(s), electricity with higher emissions was delivered to serve load located within ~~outside~~ California. ~~and in a jurisdiction that is not linked with California’s Cap-and-Trade Program; or~~

~~(B) The default emission factor or a lower emissions factor is reported pursuant to MRR, for electricity that replaces electricity with an emissions factor higher than the default emission factor that previously served load in California; except when the replaced electricity no longer serves California load as a result of compliance with the Emission Performance Standards adopted by the California Energy Commission and the California Public Utilities Commission pursuant to Senate Bill 1368 (Perata, Chapter 598, Statutes of 2006~~).

***Amend Section 95852(b)(1), p. A-80:***

1. Resource shuffling is prohibited and is a violation of this article. ~~and is a form of fraud.~~ ARB will not accept a claim that emissions attributed to electricity delivered to the California grid are at or below the default emissions factor for unspecified electricity specified pursuant to MRR section 95111 if that delivery involves resource shuffling, unless the resource has been registered as a specified import. The following attestations must be submitted to ARB annually in writing, by certified mail only:
2. “I certify under penalty of perjury of the laws of the State of California that [facility or company name] has not intentionally engaged in the activity of resource shuffling to reduce compliance obligation for emissions, based on emission reductions that have not occurred

(B)       “I understand I am participating in the Cap-and-Trade Program under title 17, California Code of Regulations, Article 5, and by doing so, I am now subject to all regulatory requirements and enforcement mechanisms of this program and subject myself to the jurisdiction of California as provided in title 17, California Code of Regulations, article 5, as the exclusive venue to resolve dispute brought pursuant to this Article.

**3.** **The definition regarding imported electricity improperly relies on electronic tagging (e-tags) to determine when an entity owns imported power.**

Currently, the cap-and-trade definitions provide that the “electricity importer” is the purchasing and selling entity (“PSE”) on the physical path where the delivery point is in California. (95802(a)(84). However, instances may arise when the PSE on the e-tag does not correctly identify the entity that owns power as it crosses the State’s borders.

E-tags were designed to address and track compliance with the Western Electricity Coordinating Council’s reliability standards, and do not necessarily track energy ownership. Presently, the CAISO’s convention for the completion of E-tags require an entity delivering at an out-of-state node to identify itself as if it is making a physical delivery into the state when that may not be the case. If CARB relies on that potentially incorrect information to impose an obligation, CARB may misrepresent the nature of the property rights and associated liabilities (such as risk of loss) transferred at the delivery point. Accordingly, in the case of sales into the CAISO markets delivered at an out-of-state node, the CAISO’s e-tagging convention may identify the out-of-state selling entity as the entity holding title into California when in fact delivery was made outside California. CARB’s reliance on E-tags in the electricity importer definition as evidence of ownership when power crosses the California border creates two problems. First, CARB may effectively assign a cap-and-trade compliance obligation to an entity that is not subject to California state jurisdiction as it did not own the power when it crossed the state border. This creates the potential for a legal challenge on an interstate commerce clause claim, which should be avoided to provide greater certainty to the market and credibility for the cap-and-trade program design.

Second, if the regulation misidentifies the first jurisdictional deliverer in some instances, that dissimilar treatment will have a discriminatory effect that is contrary to the stated intent of CARB. The discrimination occurs where certain importers delivering to an out-of-state CAISO node but not identified as the PSE on the E-tag may avoid the carbon compliance burden and other entities delivering to a CAISO market at the out-of-state node but not holding title across state lines are incorrectly identified as the owner by the operation of the CAISO E-tag notational convention.

IEP seeks assurances that the entity with the compliance obligation is the entity that has title to the power as it crosses the state’s border. Currently, IEP is not aware of a single precise method or tool to reliably and definitively track the proper entity with title to the power as it is delivered across California’s political borders. It may be the case that this concern arises only in the context of transactions to the CAISO market delivered at out-of-state nodes. CARB should therefore work with the CAISO and stakeholders to identify the scope of potential transactions where this issue arises and develop an appropriate tool or methodology. If E-tags are revised to serve this purpose, that effort must be open to public comment and the method must not result in a unilateral alteration of commercial terms without the principle parties’ consent. Applying new ownership rules to e-tags will place new uses and requirements that were not contemplated when the e-tagging concept was originally developed.

**IEP Recommendation:**

Amend the definition for “Electricity Importer” so that it does not rely in all cases on the E-tag to designate ownership of the electricity at the time it crosses the California border when the transaction is a sale to a CAISO market (as opposed to a bilateral arrangement).

***Amend Section 95802(a)(84), p. A-15:***

“Electricity Importers” are marketers and retail providers that hold title to imported electricity. For electricity delivered between balancing authority areas, the entity that holds title to delivered electricity ~~is~~ may be identified on the NERC E-tag as the purchasing-selling entity (PSE) on the tag’s physical path, with the point of receipt located outside the state of California, and the point of delivery located inside the state of California. Federal and state agencies are subject to the regulatory authority of ARB under this article, and include Western Area Power Administration (WAPA), Bonneville Power Administration (BPA) and California Department of Water Resources (DWR). When PSEs are not subject to the regulatory authority of ARB, including tribal nations, the electricity importer is the immediate downstream purchaser or recipient that is subject to the regulatory authority of ARB.

**4**. **The definition for “replacement electricity” inappropriately requires deliveries of energy to derive from resources physically located in the same balancing authority area as the renewable resource. CARB should link its definition of “replacement power” to that employed by CA energy agencies (e.g. CPUC, CEC)**

CARB’s policy supporting the balancing authority (“BA”) area restriction in the definition of replacement electricity is unclear and raises numerous concerns. IEP notes that the CPUC and CEC are currently considering how to deal with these types of transactions for compliance with the 33% RPS. As a result, CARB’s Cap-and-Trade regulatory language should be drafted in a manner such that it can be linked with the language of the CPUC and flexible enough so that ultimately, it will be compatible with the CPUC’s conclusion in the RPS proceeding [R.11-05-005]. To the extent that the cap-and-trade and RPS programs are not coordinated, the energy markets will be less efficient and costs will increase for California’s energy users.

Requiring the replacement energy to derive from a resource physically located in the same balancing authority area as the renewable resource may create a number of unintended consequences. For example, presently, 11 different balancing authorities exist in the Pacific Northwest. Some are very small (e.g. publicly owned utility service areas) and some are quite large (e.g. the Bonneville Power Administration). What is true, however, is that BAs are dynamic and can change over time. However, the contractual relations that provide for the delivery of replacement power from one resource in support of another renewable resource needs to assume some certainty over time even in instances where the geographic boundaries of BAs change. In addition, many transactions with out-of-state renewables do not identify the source or the balancing authority area for the ancillary services needed to support the renewable generation. Thus, there could be renewable transactions that will face significant GHG compliance costs simply because their contract does not specify the location of the ancillary services. Consequently, there will be disparate treatment of similarly situated contracts.

**IEP Recommendation:**

CARB should remove the restriction in the definition for Replacement Electricity that requires replacement electricity and the renewable energy to be generated in the same balancing authority area. Link the CARB definition of “replacement energy” to the concepts that will emerge from the CPUC and CEC 33% RPS proceedings.

***Amend Section 95802(a)(237), p. A-39:***

“Replacement Electricity” means electricity delivered to a first point of delivery in California to replace electricity from variable renewable resources in order to meet hourly load requirements. The electricity generated by the variable renewable energy facility and purchased by the first deliverer is not required to meet direct delivery requirements. ~~The physical location of the variable renewable energy facility busbar and the first point of receipt on the NERC E-tag for the replacement electricity must be located in the same Balancing Authority Area.~~

**5. The purchase limit on allowances discriminates against IPPs in favor of UOGs. In addition, the purchase limit should be modified to reflect individual Covered Entities compliance obligations.**

The purchase limit on allowances applies to all regulated entities, except electrical distribution utilities. Distribution utilities that purchase allowances to cover their own compliance obligation should be treated the same as any other entity subject to a compliance obligation. Specifically, independent generators directly compete with utility owned generation, and this preferential provision could place them at an unfair advantage, especially as allowances become scarcer in the later years of the program. Specifically, this limitation could create a skewed competitive level playing field where utility distribution companies can obtain more allowances than they need for their own compliance obligation, only to sell back to their IPP competitors when prices are high. In addition, these utility distribution companies could potentially use these additional allowances to advance bids for their own generation.

When applying the purchase limit to Covered Entities in a non-discriminatory manner, the purchase limit must be established such that *all* Covered Entities face equivalent opportunities to buy (or not buy) allowances out of the auction necessary to meet their compliance obligations. Currently, the Purchase Limit establishes a ceiling of 10 percent of the allowances offered per auction. While this proposal would have little, if any, impact on relatively small emitters of GHG, such a proposal for relatively larger emitters or those with corporate associations may create constraints on their ability to choose which auctions to enter, when to purchase allowances from the auction, etc. In recognition of these disparate impacts on Covered Entities, the Purchase Limit should generally remain at 10% of the allowances offered for auction; however, for large covered entities or a group of covered entities with a corporate association, CARB should set the Purchase Limit for these entities such that it recognizes different magnitudes of compliance obligations. IEP believes that this adjustment may only apply to a very small subset of covered entities or a group of covered entities with a corporate association.

**IEP Recommendation:**

The utilities’ exemption from the purchase limit should be deleted [Section 95911(c)(4)(B)]. In addition, section 95911(c)(4)(A) should be modified to set a large covered entities purchase limit based on its compliance obligation.

***Amend Section 95911(c)(4)(A) and Section 95911(c)(4)(B), p. A-135:***

1. For the auction of current vintage allowances:
2. The purchase limit for covered entities and opt-in covered entities will be 10 percent of the allowances offered for auction. Upon an application by a covered entity, CARB may determine that the established Purchase Limit disadvantages the covered entity unreasonably, and CARB may establish a unique purchase limit for the covered entity scaled to the appropriate magnitude of the covered entity’s compliance obligation.
3. ~~The purchase limit does not apply to electrical distribution utilities receiving a direct allocation of allowances pursuant to section 95892(b) and subject to the monetization requirement pursuant to section 95892(c). This provision shall not be interpreted to exempt said electrical distribution utilities from any other requirements of this article; and~~The purchase limit for all other auction participants is four percent of the allowances offered for auction.

**6.** **The Holding limit on allowances should be modified to reflect individual Covered Entities compliance obligations.**

Along the same lines as the purchase limits discussed above, the holding limit must be established such that all Covered Entities have an equal opportunity to hold allowances in their holding account, before transferring these allowances to their compliance account. The holding limit is the maximum number of California GHG allowances that may be held by an entity or jointly held by a group of entities with a corporate association at any point in time. For some large covered entities, the holding limit, as currently proposed, may limit their ability to use the flexible compliance mechanisms provided by CARB, including unlimited banking of allowances and the three year compliance periods. As a result of this limitation, some large entities will have to surrender enough allowances to meet their total annual emissions, rather than using the flexible 3 year compliance period to decide when to submit their allowances, in order to avoid exceeding the holding limit.

While IEP shares CARB’s concerns regarding hoarding, market manipulation, etc, there needs to be a mechanism in place to address the compliance needs of large obligated entities where the current holding limit potentially creates discriminatory impacts, with respect to flexible compliance instruments.

**IEP Recommendation:**

In order to compensate for these disparate impacts on obligated entities, CARB should adjust the holding limit calculation for large obligated entities to reflect the different magnitudes of compliance obligations among obligated entities. Specifically, upon an application by a covered entity, *CARB may determine that the established Holding Limits disadvantage the covered entity unreasonably, and CARB may establish a unique holding limit for that covered entity scaled to the appropriate magnitude of the covered entity’s compliance obligation.*

**7. Buyers of offset credits should not be liable for offset revocation.**

As a general matter, IEP supports offsets as a means for compliance obligated entities (i.e. electric generators) to take advantage of lower-cost reductions that, ultimately, will lower the cost of implementing a GHG reduction program. Accordingly, IEP’s concerns primarily relate to ensuring business and regulatory certainty for obligated entities using certified offsets. Under the proposed regulation, an offset credit once validated by CARB could be invalidated by CARB up to eight years after issuance, and the buyer of that offset would be liable for replacing that offset with another compliance instrument (i.e. either an offset or an allowance) where the offset was used against a compliance obligation.

Once an offset has been certified by the proper authorities and is issued and sold into the market, the use of the offset credit for purposes of regulatory compliance ought not to be subject to revocation. All parties agree that every certified credit is supported by an emission reduction that is real, additional, permanent, and verifiable. This is the whole purpose of the rigorous certification process which specifies that an offset must be permanent. The value of taking this approach is that it allows the offset certificates to be traded without concern that the certificate may be revoked.

In addition, this approach ensures that a party, who in good faith enters into an arrangement to buy offsets for a compliance obligation, is not held accountable for replacing the offset certificates for which they had no fraudulent involvement. A buyer who purchases offsets that have been certified and issued according to the appropriate protocols, and who reasonably and in good faith relies on the jurisdiction’s representations that the offset certificate can be used to meet the buyer’s compliance obligation should be held harmless and should not have to purchase additional offsets or incur penalties if the certificate is later revoked. Moreover, if a jurisdiction in the United States certifies offsets but later revokes the offset certificates, it may be subject to claims that its actions constitute a taking of property without just compensation, in violation of the due process clause of the United States Constitution and similar provisions in many state constitutions.

Accordingly, IEP recommends that the CARB pursue an offset program in which credits, once certified, are non-revocable. Alternatively, if CARB continues to pursue a program where certified and verified offset credits are revocable, all invalidated offsets should be treated similar to the requirements for forest offset projects [section 95895(g)] in which the forest owner must replace each invalidated ARB offset credit with a valid ARB offset credit or another approved compliance instrument. This approach, which holds the project owner responsible, provides a remedy for replacing the invalid offset without punishing obligated entities that in good faith purchased what they thought was a legitimate offset credit validated by CARB. In essence, this approach allows the offset certificate to remain in circulation while the reduction underlying the certificate is replaced by project proponents.

**IEP Recommendation:**

Offset credits, once issued, should not be revocable by CARB. Alternatively, CARB should remove provisions that make the buyer liable for invalidation, and instead place the liability to replace the offset credit on the offset project operator. Also, revise the regulation so that an offset credit can only be invalidated within one year after the offset is issued.

1. ***Delete Section 95985: Invalidation of ARB Offset Credits, p. A-242 through A-246.***
2. ***Alternatively, Amend Section 95985(f), p. A-245:***

(f) Requirements for Non-Sequestration Offset Projects. If an ARB offset credit is found to be invalid pursuant to sections 95985(b) and (d) the party identified in section 95985(c)~~(2)~~ (3) must replace each ARB offset credit with a valid ARB offset credit or another approved compliance instrument pursuant to subarticle 4, within 90 calendar days of notification by ARB pursuant to section 95985(e). If the party identified in section 95985(c)~~(2)~~ (3) does not replace each invalid ARB offset credit within 90 calendar days of the notice of invalidation pursuant to section 95985(e), each outstanding ARB offset credit will constitute a violation pursuant to section 96014. ~~If the party identified in section 95985(c)(2) is no longer in business~~ ~~ARB will require the Offset Project Operator or Authorized Project Designee to replace each invalidated ARB offset credit and will notify the Offset Project Operator or Authorized Project Designee that they must replace them. The Offset Project Operator or Authorized Project Designee must replace each ARB offset credit with a valid ARB offset credit or another approved compliance instrument pursuant to subarticle 4, within 90 calendar days of notification by ARB pursuant to section 95985(e). If the Offset Project Operator or Authorized Project Designee does not replace each invalid ARB offset credit within 90 calendar days of notification by ARB pursuant to section 95985(e), each outstanding ARB offset credit will constitute a violation pursuant to section 96014.~~

***Amend Section 95985(b), p. A-243:***

1. ARB may determine within ~~8~~1 year~~s~~ of issuance, ~~except as provided in section 95985(b)(5) and (6),~~ that an ARB offset credit is invalid for the following reasons:

 (1) ARB determines that information provided to ARB for an Offset Project Data Report or Offset Verification Statement by offset verifiers, verification bodies, Offset Project Operators, Authorized Project Designees, or Offset Project Registries, related to an offset project was not true, accurate, or complete; or

1. The Offset Project Data Report contains errors that overstate the amount of GHG reductions or GHG removal enhancements by more than 5 percent; or
2. The offset project did not meet all local, state, or national regulatory requirements during the time covered by an Offset Project Data Report; or
3. ARB determines that offset credits have been issued in any other voluntary or mandatory program within the same offset project boundary or for the same GHG reductions or GHG removal enhancements covered by an Offset Project Data Report.
4. If an offset project is developed under Compliance Offset Protocol U.S.

Ozone Depleting Substances Projects, ARB may invalidate within ~~five~~ one year~~s~~ of issuance of the ARB offset credits covered by an Offset Project Data Report.

1. If an offset project is verified after three years of ARB offset credit issuance by a different offset verifier, ARB may invalidate within ~~five~~ one year~~s~~ of issuance of the ARB offset credits covered by an Offset Project Data Report.
2. An update to a Compliance Offset Protocol in itself, will not result in an invalidation of ARB offset credits issued under a previous version of the Compliance Offset Protocol.

**8. The threshold for applying a cap-and-trade compliance obligation to imports is unclear.**

The cap-and-trade proposed regulation applies to electricity importers of specified sources when the source emits 25,000 metric tons (“MT”) of CO2(e) or more per year. The proposed regulation also provides that an entity’s compliance obligation is based on the CO2(e) calculated under the verification requirements for the Mandatory Reporting Regulation. The proposed regulation does not make clear whether an out-of-state facility will have a cap-and-trade compliance obligation when its total emissions exceed 25,000 MT, but it imports only part of its capacity, and the import into California accounts for less than 25,000 MT of GHG emissions associated with the importer’s total capacity.

**IEP Recommendation:**

Clarify that the importer’s compliance obligation applies to emissions associated with delivery of power into California.

***Amend Section 95812(c)(2)(b), p. A-50:***

1. Electricity importers of specified sources of electricity. The applicability threshold for an electricity importer from specified sources is based on the total annual emissions of the electricity generating facility from which the imported electricity originated. The applicability threshold for an electricity importer from a specified source which emits 25,000 metric tons or more of CO2e per year is zero metric tons.

***Amend Section 95852(b)(7), p. A-83:***

1. The compliance obligation (CO2e covered) is calculation based on the emissions from electricity deliveries into California from jurisdictions that are not approved for linkage pursuant to subarticle 12:
2. Emissions which result from specified electricity deliveries (CO2e specified) will be assigned the facility emission factor, determined by ARB, for electricity deliveries meeting the requirements of section 95852(b)(2) through (5);
3. Specified deliveries meeting the requirements of section

95852(b)(2);

1. The adjustment for replacement electricity associated with the variable renewable electricity pursuant to section 95852(b)(3)
2. The specified electricity meeting direct delivery requirements pursuant to section 95852(b)(4); and
3. The specified electricity generated from the use of biomethane which meets the requirements pursuant to section 95852.2.

**9. The excess emissions obligation will penalize entities that are in compliance with the cap-and-trade by creating allowance supply constraints in the auction and reserve sale following the surrender deadlines for the triennial compliance obligations.**

Currently, the cap-and-trade proposed regulation requires that covered entities that do not retire the requisite number of allowances for their triennial compliance obligation will be subject to an “excess emissions obligation” for the shortfall. The excess emissions obligation is four times the shortfall and must be satisfied by purchasing allowances from the auction or allowance reserve sale following the due date of the triennial compliance obligation. Most entities will attempt to satisfy this compliance obligation by obtaining allowances through the auction, which means there will be significantly more demand, creating price volatility. Under this approach, however, due to *the high allowance prices resulting from this heightened demand in the auction(s), covered entities that are in compliance with the cap-and-trade program will inappropriately be penalized for the actions of others.*

**IEP Recommendation:**

To protect against the inappropriate penalizing of covered entities meeting their obligations in a timely manner, CARB should not remove all of the allowances needed to satisfy the excess emissions obligation from the auction or price containment reserve. Instead, CARB should require the entity subject to the shortfall to obtain the allowances that it is short for meeting its compliance obligation (i.e. 1/4 of the excess emissions obligation), thereby maintaining the integrity of the “cap.” On the other hand, the same entity should be required to meet the rest of the penalty (i.e. 3/4 of its excess emissions obligation) via a financial payment, based on the auction clearing price, yet disconnected from direct participation in an auction per se.

***Example of IEP Recommendation:***

To illustrate how this solution would work, assume a regulated entity has a triennial compliance obligation of 200,000 MT, but only retires 100,000 MT worth of compliance instruments. With a 100,000 MT shortfall, the regulated entity will have a 400,000 MT excess emissions obligation (i.e. 4x the shortfall). At the next auction, the entity will submit a bid for 100,000 MT to recover ¼ of the shortfall. These allowances will be retired, consistent with the covered entities original compliance obligation, thereby ensuring that the same amount of allowances are removed from the cap program that would have been removed had the covered entity not been in a position of shortage. In addition, to achieve the penalty aspect of the excess emissions obligation, the entity will have to make a separate payment based on the auction settling price equal to that price times its remaining excess emissions obligation as though it was actually awarded 400,000 MT.

***Amend Section* 95857(b)*, p. A-99*:**

(b) Calculation of the Untimely Surrender Obligation.

(1) The quantity of excess emissions is the difference between the compliance obligation calculated pursuant to this section and any compliance instruments timely surrendered by the entity;

(2) The value of an entity’s compliance obligation for untimely surrender is calculated as four times the entity’s excess emissions;

 (3) An entity’s compliance obligation for untimely surrender may only be fulfilled with CA GHG allowances, ~~or~~ allowances issued by a GHG ETS pursuant to subarticle 12, or through the financial penalty specified in subsection 95857(b)(5) below; and

(4) The untimely surrender obligation is due within five days of the first auction or reserve sale conducted by ARB following the applicable surrender date, whichever is the latter, and for which the registration deadline has not passed when the untimely surrender obligation is assessed.

(5) For each entity with an untimely surrender obligation, the entity shall enter the auction and procure ¼ of the allowances needed to satisfy the untimely surrender obligation. In addition, ¾ of the untimely surrender obligation will be paid to CARB in the form of a financial penalty equal to the auction clearing price and will be allocated to the Air Pollution Control Fund.

**10. CARB should not mandate reductions or efficiency improvements contemplated in the Audit Regulation on top of cap and trade requirements.**

The notice for the July 15th discussion draft requests parties comment on whether and how the Energy Efficiency and Co-benefits Audit Regulation (“Audit Regulation”) should be coordinated with the cap-and-trade to mandate reductions contemplated in the audit process. The July 27th notice for the revisions to the cap-and-trade regulation notes that staff will be opening a separate proceeding this fall to discuss how to mandate improvements contemplated in the Audit Regulation. IEP opposes *mandating* reductions or efficiency improvements contemplated under the audit regulation. The purpose of the cap-and-trade program is to provide a carbon price signal so that companies will make efficiency improvements when they are cost effective to do so. Combining both regulations will thwart that fundamental purpose of the cap-and-trade regulation.

**IEP Recommendation:**

CARB should not mandate reductions or efficiency improvements contemplated in the Audit Regulation on top of cap and trade requirements. If CARB expects regulated entities to undertakeefficiency improvements contemplated in the audit regulation, CARB should coordinate the Audit Regulation with the cap-and-trade by providing some type of transitional assistance to cost effectively integrate efficiency improvements.

**In conclusion**, IEP thanks CARB for the opportunity to comment on the July 27, 2011 Cap and Trade 15-Day Language. We look forward to working with CARB in the final design and implementation of these regulations.

Respectfully Submitted,



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1. See Previous comments at :

<http://www.arb.ca.gov/lispub/comm/bccomdisp.php?listname=capandtrade10&comment_num=123&virt_num=111> [↑](#footnote-ref-1)
2. U**tility-Owned-Generation (“UOG”) also is required to enter the same auction as IPPs to acquire the allowances they need as an Obligated Entity, but UOG’s are guaranteed 100% cost recovery by the CPUC and the revenues from any expenses incurred are circulated back to the customers of the utility to protect against any increase in cost exposure. Thus, not only do UOG’s have full cost-recovery, but customers are insulated from the effects of UOG purchases because all revenues from the auction are to be applied to the benefit of ratepayers and rate relief.** [↑](#footnote-ref-2)