BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON THE PROPOSED CHANGES TO THE CAP AND TRADE REGULATION

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SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON THE PROPOSED CHANGES TO THE CAP AND TRADE REGULATION

The Southern California Public Power Authority ("SCPPA") [1] respectfully submits this comment on the proposed changes to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms regulation ("Regulation") released by the California Air Resources Board ("ARB") for 15-day public comment on July 25, 2011 ("Proposed Changes").

SCPPA appreciates that many of the Proposed Changes improve the Regulation and address issues raised by SCPPA in previous comments to the ARB. However, SCPPA recommends further revisions as discussed below.

I. RESOURCE SHUFFLING PROVISIONS IN SECTION 95802(a)(245) AND SECTION 95852(b)(1) SHOULD BE TEMPORARILY REMOVED FOR FURTHER EVALUATION OR, AT MINIMUM, REVISED.

The proposed 15-day modifications contain an entirely new section 95802(a)(245) (p. 40) defining "Resource Shuffling" and an accompanying entirely new section 95852(b)(1) (p. 80) prohibiting resource shuffling, as defined. There were no equivalent sections in the Regulation that was proposed in the October 28, 2010 Staff Report that was considered at the December 16, 2010 Board hearing. Thus, parties are reviewing and assessing both the definition and the prohibition for the first time, and in a very narrow window of time.

SCPPA fully supports the AB 32 requirement that the ARB's GHG emission reduction program shall "minimize leakage," which AB 32 defines as being "a reduction in emissions of greenhouse gases within the state that is offset by an increase in emissions or greenhouse gases

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

outside the state." H&S Code §§ 38505(j), 38562(b)(8). However, the inclusion of the new resource shuffling provisions requires a thorough review. The ARB staff and stakeholders should be allowed to have a reasonable opportunity to better understand the intent of the provisions and to properly assess the potential implications for the electricity sector. The proposed resource shuffling provisions could cripple the competitive wholesale electricity market and have other counterproductive and unintended consequences as discussed below.

The complex issues that are raised by the new resource shuffling provisions cannot be fully assessed in the time allowed for "15-day" comments, even given that the concepts were broached in a "discussion draft" of the Regulation that was released on July 7, 2011 ("Discussion Draft"). Thus, SCPPA recommends that the resource shuffling provisions be temporarily removed from the Regulation until the full ramifications of the provisions can be evaluated. If the provisions are not temporarily removed, then at minimum, they should be revised as also discussed below.

A. The Impact of the "Resource Shuffling" Provisions on the Wholesale Electricity Market Should Be Fully Evaluated.

The impact of the "Resource Shuffling" provisions on the wholesale electricity market should be fully evaluated before being adopted. The western wholesale electricity market is complex. California is in the Western Interconnection which includes fourteen western states, the provinces of Alberta and British Columbia, and the northern portion of Baja California. There are thousands of transactions that involve millions of NERC e-tags for the movement of electricity in and out of California each year. Those transactions occur without regard for the emissions attributes of the electricity.

It is unclear how a first deliverer would be able to know in advance whether a transaction involved resource shuffling. For example, under subparagraph (B) of the definition, "resource shuffling "would occur if a covered entity received a delivery of electricity to the California grid for which the default emission factor is reported and the electricity "replaces electricity with an emissions factor higher than the default emission factor that previously served load in California…." Many wholesale transactions including daily or hourly trades involve the purchase of system power which would be assigned the default emission factor under the ARB's Regulation for the Mandatory Reporting of Greenhouse Gas Emissions ("MRR"). For a covered entity in California that has gas-fired or other generation resources that have an emissions factor that is higher than the emissions factor of system power, any one of those purchases of system power could result in the replacement of higher emissions factor electricity without the trader having any idea that a replacement would occur.

The uncertainty about whether a transaction would result in a charge of contract shuffling could chill the wholesale market for system power. That would be an unfortunate consequence of the resource shuffling provisions. From the interconnected operations standpoint, system power is more desirable than resource-specific power since in most cases system power is "firm" because it is supported by operating reserves.

The ambiguity of the term "historically served California load" in subparagraph (A) of the definition would likewise make it difficult for covered entities to know if they were engaged in resource shuffling or not. Under subparagraph (A) of the definition, a covered entity would be guilty of resource shuffling if the entity took delivery of electricity from a power plant with a low emissions factor and the plant "has not historically served California load." However, the term "historically served California load" is undefined in the regulation. If electricity purchasers do not know the meaning of the term, they may avoid any purchases from out-of-state power plants with low emission factors regardless of how much the plant has served California to be sure of avoiding a charge of resource shuffling. That could preclude purchases of otherwise available supply, distorting the wholesale market and potentially increasing prices to consumers.

Given the harsh penalties that the ARB would impose for "resource shuffling," the proposed resource shuffling provisions could remove liquidity from the wholesale electricity market, reducing the potential for cost-effective trades as well as for trades that enhance system reliability while increasing electricity prices. That would be a negative and counterproductive consequence of having an overly broad and ambiguous resource shuffling rule.

B. The Potential for the Resource Shuffling Provisions to Discourage Emission Reductions Should Be Fully Evaluated.

Subparagraph (B) of the definition could have another counterproductive consequence. A covered entity may desire to permanently retire a power plant that has an emissions factor that is higher than the default emissions factor and replace the output of the plant with unspecified system power. The consequence of retiring the high-emitting plant would be to reduce GHG emissions, but the retirement would be precluded by the fact that the replacement of the output of the plant with unspecified system power would be penalized as resource shuffling.

Perversely, under subparagraph (B) the covered entity could avoid a resource shuffling charge if the covered entity replaced the output of the plant with electricity that has an emissions factor that is *higher* than the default emissions factor. The result could be higher net emissions after retiring the power plant in comparison to the prohibited retirement combined with replacement at the default emissions factor.

Even more perversely, subparagraph (B) would allow the plant to be retired and replaced with system power if the retirement were the result of the SB 1368 Emissions Performance Standard ("EPS") being applied to the plant, effectively requiring the covered entity to continue operating the plant and emitting GHG at a higher level until shut-down is required under the EPS.

The ultimate irony is that subparagraph (B) would apply even if the high emissions plant were fully retired and replaced with a new zero emissions renewable resource before retirement was required by the EPS. Subparagraph (A) contains an exception for deliveries of low emission electricity from "new or expanded" low emission resources, but there is no such exception in subparagraph (B).

The definition of "Resource Shuffling" is replete with problems that could have substantial negative consequences. The definition and the related provisions should be deleted from the "15-day" Regulation and reserved for consideration in a separate proceeding in which the provisions can be refined to achieve the proper objectives of AB 32 without having so great a potential for negative outcomes.

C. If Not Deleted, the Definition of "Resource Shuffling" Should Be Revised.

If the resource shuffling provisions are not deleted and held for future consideration, at bare minimum they should be revised. The revisions would not eliminate all of the potential for the negative and counterproductive consequences that are discussed above, particularly, the adverse impact on the wholesale electricity market, but they would eliminate at least some of the counterproductive consequences.

First, the first sentence of the definition should be revised to make it clear that the definition applies only to deliveries to the California grid from a jurisdiction that is not linked with the California cap-and-trade program:

> **§ 95802. Definitions.**
>
> (a)(245) "Resource Shuffling" means any plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity generated outside California and in a

jurisdiction where a GHG emissions trading system has not been approved for linkage by the Board pursuant to subarticle 12 to the California grid, for which:

Second, the definition in § 95802(a)(245)(A) should be revised to refer to a new defined term, "historically consumed in California" and to make other changes to conform to the use of the new defined term:

§ 95802. Definitions.

(a)(245) "Resource Shuffling" means ...

(A) An emission factor below the default emission factor is reported pursuant to MRR for electricity generated at a generation source that is~~has~~ not electricity historically consumed in~~served~~ California, as defined in section 95802(a) ~~load~~ (excluding electricity from new or expanded capacity) (such electricity being "Relevant Electricity"). And, during the same interval(s), electricity with ~~higher~~ emissions equal to or higher than the default emission factor was delivered to serve load located outside California and in a jurisdiction that is not linked with California's Cap-and-Trade Program which was previously served by the Relevant Electricity now used to serve load in California.~~; or~~

The definition of the new defined term, "historically consumed in California," should be based on § 95111(g)(4)(A) of the Mandatory Reporting Regulation. SCPPA recommends the following definition of "historically consumed in California:"

§ 95802. Definitions.

(a)(X) "Electricity Historically Consumed in California" means electricity from a specified source of electricity located outside California that was reported in a 2009 verified data report and either:

(A) The electricity is claimed for the current data year by the same electricity importer that imported electricity from that specified source in 2009, based on a written power contract or status as a generation providing entity (as defined in MRR) in effect prior to January 1, 2010 that remains in effect, or that has been renegotiated for the same facility or generating unit for up to the same share or quantity of net generation within 12 months following prior expiration; or

(B) The electricity is claimed for the current data year by a different electricity importer than the entity that imported electricity from that specified source in 2009, but at least the same share or quantity of net generation from that specified source was imported into California in 2009 (as reported in a 2009 verified data report).

Third, subparagraph (B) of the definition of "Resource Shuffling" should be deleted in its entirety. As discussed above, subparagraph (B) would have the potential for consequences that are contrary to the purpose of AB 32. The subparagraph would have the potential to discourage a covered entity from permanently retiring a power plant before being required to do so under the EPS. The covered entity could only avoid a resource shuffling charge only by replacing the output of the retired plant with electricity within an emission factor higher than the default emissions factor. The subparagraph would discourage a covered entity from retiring a high emissions plant and replacing the plant with a renewable resource before retirement as required by the EPS.

Subparagraph (A) achieves the objectives of a prohibition against resource shuffling under AB 32 without subparagraph (B). Insofar as subparagraph (B) is unnecessary and, worse yet, counterproductive, it should be deleted in its entirety:

§ 95802. Definitions.

(a)(245) "Resource Shuffling" means ...

~~(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).~~

D. If Not Deleted, Section 95852(b)(1) Regarding Resource Shuffling Should Be Revised.

Section 95852(b)(1) (p. 80) is a new section that prohibits resource shuffling, states that resource shuffling is "fraud," and requires certifications. As discussed above, this section and the new definition of "resource shuffling" require a significantly more thorough review process to allow the ARB staff and stakeholders with a reasonable opportunity to better understand the intent of the language and to properly assess the potential implications for the electricity sector. The complex issues that are raised by the new resource shuffling provisions cannot be fully assessed in the time allowed for "15-day" comments. Thus, § 95852(b)(1) should be deleted from the Regulation until its full ramifications can be evaluated.

However, if the provisions are not deleted, then at bare minimum they should be revised. First, the conclusive statement that resource shuffling is "fraud" should be eliminated. Section 95852(b)(1) prohibits resource shuffling. The statement that resource shuffling is "fraud" adds nothing to the force or effect of the prohibition. However, as pointed out at the July 15, 2011 workshop on the Discussion Draft, "fraud" is a shrill term that suggests that the Board is biased and intemperate. The term is inappropriate and should be deleted.

Second, the certifications that are required by § 95852(b)(1) should be modified to recognize that the signatory, an individual, is certifying as agent for the covered entity and to avoid the absurdity of requiring the signatory to certify that the signatory himself or herself is participating in the cap-and-trade program. These certifications are not strictly necessary because certifications are required under the MRR for the whole of an entity's emissions report, as well as independent verification.

These minimal revisions to § 95852(b)(1) are as follows:

> **§ 95852. Emission Categories Used to Calculate Compliance Obligations.**
>
> (b)(1) Resource shuffling is prohibited, <u>and </u>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. The following

attestations must be submitted to ARB annually in writing, by certified mail only:

(A) "I certify under penalty of perjury of the laws of the State of California that [facility or company name], for which I am an agent, has not knowingly engaged in the activity of resource shuffling to reduce compliance obligation for emissions, based on emission reductions that have not occurred."

(B) "I understand [facility or company name], for which I am an agent, is~~I am~~ participating in the Cap-and-Trade Program under title 17, California Code of Regulations, article 5, and by doing so, it is~~I am~~ now subject to all regulatory requirements and enforcement mechanisms of this program and subjects it~~my~~self to the jurisdiction of California as the exclusive venue to resolve disputes."

II. CERTAIN DEFINITIONS SHOULD BE REVISED.

A. Section 95802(a)(145), the Definition of "Limited Use Holding Account," Should Be Revised.

Section 95802(a)(145) (p. 24) defines "Limited Use Holding Account" as meaning "an account in which allowances are placed after an entity qualifies for a direct allocation under section 95890(b)." However, § 95892(b)(2) (p. 121) permits Publicly Owned Utilities ("POUs") to direct the Executive Officer to place all or a portion of their directly allocated allowances in the POU's compliance account instead of its limited use holding account. Thus, the definition of "limited use holding account" should be revised as follows:

§ 95802. Definitions.

(a) (145) "Limited Use Holding Account" means an account in which allowances are placed after an entity qualifies for a direct allocation under section 95890(b) unless the entity elects to have its directly allocated allowances deposited into its compliance account pursuant to section 95892(b)(2). Allowances placed in this account can only be removed for consignment to the auction pursuant to section 95831(a)(3).

B. Section 95802(a)(237), the Definition of "Replacement Energy," Should Be Revised.

Section 95802(a)(237) (p. 39) defines "Replacement Electricity." The definition is too restrictive. First, the definition restricts Replacement Electricity to being energy that replaces renewable energy that meets the narrow definition of "Variable Renewable Resources." Section 95802 (a)(272) (p. 44) defines "Variable Renewable Resources" as meaning "run-of-river hydroelectric, solar, or wind energy that requires firming and shaping to meet load requirements." That definition excludes many sources of renewable energy such as small hydroelectric projects at impoundments, geothermal projects, biomass projects, and biogas combustion. The production of renewable energy from those excluded sources may vary over time even though the sources may not be traditionally classified as variable or intermittent. Although those excluded renewable resources may have relatively stable output given current technologies, the purchaser may need to obtain replacement energy to accommodate transmission constraints or to shape the renewable energy, for example, to meet seasonal load requirements. Thus, the definition of "Replacement Electricity" should be broadened by deleting the word "variable" from the definition and severing any tie to the restrictive definition of "Variable Renewable Resources" in § 95802(a)(272).

Second, the definition restricts replacement energy to being energy from the balancing authority in which the renewable resource is located. The last sentence of the definition provides: "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." That sentence should be deleted. There should be no requirement for the replacement electricity to come from the same Balancing Authority Area as the renewable energy. The restriction would unreasonably reduce the flexibility that utilities require to cost-effectively obtain renewable energy and will unnecessarily drive up the cost of meeting policy objectives. For example, when the import of renewable electricity from the Bonneville Power Administration Balancing Area in the Pacific Northwest is inhibited by transmission constraints, the acquiring utility should be allowed to use replacement energy from another Balancing Authority.

To eliminate the two undue restrictions in the definition of "Replacement Electricity," the definition should be revised as follows:

> **§ 95802. Definitions.**
>
> (a) (237) "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.~~

C. Section 95802(a)(258), the Definition of "Specified Source," Should Be Revised to Refer to a Definition of "Contract."

The definition of "Specified Source" in § 95802(a)(258) (p. 42) requires a "written contract" in the absence of ownership to claim a facility as a specified source of electricity: "The electricity importer must have either full or partial ownership in the facility/unit or a written contract to procure electricity generated by that facility/unit." However, in power trading, a binding sale and purchase agreement may be made orally with only a taped or recorded memorialization, for example by software such as Instant Messenger. The ARB should develop a definition of "contract" so that covered entities can have certainty that their agreements for electricity from specified sources will be accepted by the ARB.

D. Section 95802(a)(272), the Definition of "Variable Renewable Resource," Should Be Deleted.

The definition of "Variable Renewable Resources" should be deleted. The term appears in only two sections of the Regulation: § 95802(a)(237) (p. 39) defining "Replacement Electricity" and § 95852(b) (p. 80) regarding the calculation of the compliance obligation for replacement electricity. In its comment above on § 95802(a)(237) and in its comment below on § 95852(b)(3), SCPPA recommends removing the word "variable." If the ARB adopts SCPPA's recommendation, the term variable renewable resources will not appear anywhere in the Regulation. Accordingly, the definition of "Variable Renewable Resources" in § 95802(a)(272) would be surplus and should be deleted.

> **§ 95802. Definitions.**
>
> (a) ~~(272) "Variable Renewable Resource" means run-of-river hydroelectric, solar, or wind energy that requires firming and shaping to meet load requirements.~~

III. THE CHANGE TO THE DISPOSITION OF PENALTY ALLOWANCES SHOULD BE REFLECTED IN SECTION 95831(b).

Section 95831(b)(4)(C) (p. 61) provides for allowances "submitted to fulfill an entity's excess emissions obligation pursuant to section 95857(d)" to be placed into the Allowance Price Containment Reserve Account. However, as a very welcome change from the Discussion Draft, § 95857(d)(1)(A) (p. 101) now provides for three fourths of those allowances to be transferred to the Auction Holding Account. Accordingly, Section 95831(b) should be revised as follows to reflect this change in the disposition of penalty allowances:

> **§ 95831. Account Types.**
>
> (b) Accounts under the Control of the Executive Officer. The accounts administrator will create and maintain the following accounts under the control of the Executive Officer: ...
>
> (2) A holding account to be known as the Auction Holding Account into which allowances are transferred to be sold at auction from: ...
>
> <u>(D) The Executive Officer pursuant to section 95857(d)(1)(A), being three fourths of the allowances submitted to fulfill an entity's excess emissions obligation. ...</u>
>
> (4) A holding account to be known as the Allowance Price Containment Reserve Account:

(A) Into which the serial numbers of allowances allocated by ARB for auction that remain unsold at auction will be transferred;

(B) Into which the serial numbers of allowances directly allocated to the Allowance Price Containment Reserve pursuant to section 95870(a) will be transferred; and

~~(C) Into which the serial numbers of allowances submitted to fulfill an entity's excess emissions obligation pursuant to section 95857(d) will be transferred; and~~

(C~~D~~) From which the Executive Officer will authorize the withdrawal of allowances for sale to covered entities pursuant to section 95913.

IV. VAGUE AND AMBIGUOUS CRITERIA IN SECTION 95833(a) FOR BEING A CORPORATE ASSOCIATION SHOULD BE DELETED.

Two provisions in section 95833(a) (p. 69-70) should be deleted. First, § 95833(a)(1)(D) (p. 69) should be deleted. That section provides that an entity has a "direct corporate association" with another entity if any one of the entities "controls more than 20 percent of the other entity's affairs through some other means." The phrase "controls more than 20 percent of the other entity's affairs through some other means" is too vague to have any practical application. How would an entity or the ARB know if that entity controls 20 percent of another entity's affairs through "some other means"?

Second, § 95833(a)(2) (p. 70) should be deleted. The section provides that an entity has a "direct corporate association" when it holds "allowances in its holding account in which another entity has an ownership interest." It is unclear what possible ownership interest a second party could have in instruments in a first party's account, given that:

- the instruments exist only to the extent that they are recorded in an account – they have no independent existence in the way that physical goods do; and

- section 95820(c) (p. 55) explicitly provides that allowances do not constitute property rights: "A compliance instrument issued by the Executive Officer does not constitute property or a property right."

In addition, the wording of § 95833(a)(2) provides that a corporate association only arises under this provision if an entity has attested that its relationship constitutes a corporate association. It would appear, then, that if an entity does not attest to a corporate association, and § 95833(a)(1) does not apply, that entity will not have a corporate association, making this provision essentially voluntary in nature.

For these reasons, § 95833(a) should be revised as follows:

§ 95833. Disclosure of Direct and Indirect Corporate Associations.

(a) Entities registered pursuant to section 95830 must disclose direct and indirect corporate associations with other registered entities.

(1) An entity has a "direct corporate association" with another entity if any one of these entities:

(A) Holds more than 20 percent of any class of listed shares, the right to acquire such shares, or any option to purchase such shares of the other entity;

(B) Holds or can appoint more than 20 percent of common directors of the other entity; or

(C) Holds more than 20 percent of the voting power of the other entity.~~; or~~

~~(D) Controls more than 20 percent of the other entity's affairs through some other means.~~

~~(2) An entity has a "direct corporate association" with another registered entity when it holds compliance instruments in its own holding account in which another entity has an ownership interest and the entity has attested to the Executive Officer that its relationships with the other entities constitute a corporate association.~~

V. SECTION 95852(b) REGARDING COMPLIANCE OBLIGATIONS FOR FIRST DELIVERERS OF ELECTRICITY SHOULD BE AMENDED.

Section 95852(b) (p. 80-84) provides for the calculation of the compliance burden of first deliverers of electricity. The opening provision in the section should be revised as follows to make it clear that the compliance obligation will be calculated in accordance with all of the paragraphs of § 95852(b), not just the first paragraph.

> **§ 95852. Emission Categories Used to Calculate Compliance Obligations.**
>
> (b) First Deliverers of Electricity. A first deliverer of electricity covered under sections 95811(b) and 95812(c)(2) has a compliance obligation for every metric ton of CO_2e of emissions, subject to sections 95852(b)(1) to (b)(7) inclusive, from a source in California or in a jurisdiction where a GHG emissions trading system has not been approved for linkage by the Board pursuant to subarticle 12. And, where the thresholds set out in section 95812 have been reached and for which a positive or qualified positive emissions data verification statement is issued or there are assigned emissions.

A. Section 95852(b)(2) Regarding Calculating Compliance Obligation on the Basis of Facility-Specific Emission Factors Should Be Revised.

Section 95852(b)(2) (p. 81) contains criteria that must be met by importers who want to calculate their compliance obligation using facility-specific emission factor rather than the default emission factor. The section should be revised to make it clear rather than implied that the criteria apply to imports from a jurisdiction that is not linked to the California cap-and-trade program. Also, § 95852(b)(2)(D) should be revised to eliminate the requirement that when there is a chain of custody for the electricity from the specified source the importer must identify the amount that was to be delivered under the original contract with the facility. It would be difficult if not impossible for the importer to know the original *amount* in a complex chain of contracts unless the importer were a party to the original contract. Thus, § 95852(b)(2) should be revised as follows:

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

(b)(2) The following criteria must be met for first deliverers of electricity generated outside California in jurisdictions where a GHG emissions trading system has not been approved for linkage by the Board pursuant to subarticle 12~~deliveries~~ to calculate their compliance obligations based on an ARB facility specific emission factor specified pursuant to MRR section 95111 less than the default emission factor for unspecified electricity specified pursuant to MRR section 95111:

(A) Electricity deliveries must be reported to ARB pursuant to MRR section 95111;

(B) The first deliverer must be the facility operator or have ownership or contract rights to electricity generated by the facility or unit claimed;

(C) First deliverers must report electricity from specified sources to ARB using the ARB specified source identification number assigned to the source pursuant to MRR; and

(D) If there are other parties within the contract chain of custody, then the original source of generation ~~and quantity of MWhs to be delivered under the original contract~~ must be identified within the entire contract chain. The quantity of electricity delivered, and for which an ARB facility specific emission factor specified pursuant to MRR section 95111 is claimed, cannot exceed the ~~original~~ amount under ownership or contract rights reported pursuant to section 95852(b)(2)(A).

B. Section 95852(b)(3) Regarding Replacement Energy Should Be Revised.

Section 95852(b)(3) (p. 82) contains provisions governing the calculation of the compliance obligation for replacement electricity. For the reasons discussed above regarding the definition of "replacement electricity" in § 95802(a)(145) (p. 24), the restriction to electricity from a "variable" renewable resource should be eliminated because replacement energy may be required to substitute for deliveries from renewable resources such as small hydroelectric projects at impoundments, geothermal projects, biomass projects, and biogas combustion even though those resources are not usually considered to be intermittent. Section 95852(b)(3) should be revised as follows:

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

(b)(3) Replacement electricity that substitutes for electricity from a ~~variable~~ renewable resource qualifies for the ARB facility specific emission factor specified pursuant to MRR section 95111 of the ~~variable~~ renewable resource under the following conditions:

(A) First deliverers of replacement electricity have a contract, or ownership relationship, with the supplier of the replacement electricity, in addition to ~~a~~ contract <u>or ownership rights to electricity generated by</u>~~with~~ the ~~variable~~ renewable resource; and

(B) The amount of the reported replacement electricity does not exceed the amount for the reported annual ~~variable~~ renewable resource.

(C) Replacement electricity with an emission factor greater than the default emission factor for unspecified electricity specified pursuant to MRR section 95111 is not eligible to receive an emission factor of zero metric tons CO_2e/MWh. For contracts that use replacement electricity for which the emission factor is greater than the default emission factor for unspecified electricity, the difference between the emission factor from the replacement electricity and the default emission factor for unspecified electricity will be used to calculate emissions with a compliance obligation.

C. Section 95852(b)(4) Regarding Resources with Zero Direct Emissions Should Be Revised.

Section 95852(b)(4) (p. 82) addresses claims to resources that have zero direct emissions. The section should be revised as follows, to conform to the elimination (discussed above) of the distinction between "variable" renewable resources and renewable resources that are not generally considered to be "variable."

§ 95852. Emission Categories Used to Calculate Compliance Obligations.

(b)(4) Claims to resources with zero direct emissions, emissions without a compliance obligation, or emissions calcula<u>t</u>~~l~~ed using a lower emissions factor than the default emissions factor for unspecified electricity specified pursuant to MRR section 95111~~, including renewable resources other than variable renewable resources~~ must demonstrate, pursuant to MRR, direct delivery of electricity as defined in section 95802.

D. **Section 95852(b)(5) Regarding Electricity Generated from "Biomethane" Should Be Revised.**

Please see the separate SCPPA comment on the biomass-derived fuel provisions in the Regulation and the MRR.

E. **Section 95852(b)(7) Regarding Imported Electricity Should Be Revised.**

Section 95852(b)(7) (p. 83) determines the compliance obligation for electricity that is imported from unlinked jurisdictions. The section paraphrases the provisions of MRR § 95111(b)(5) but does not replicate those provisions. The use of paraphrases instead of the precise provisions of MRR § 95111(b)(5) could lead to confusion. Any summary paraphrasing is likely to be somewhat inaccurate. Instead of trying to paraphrase MRR § 95111(b)(5) in § 95852(b)(7), the section should be revised to refer to MRR § 95111(b)(5) as follows:

> **§ 95852. Emission Categories Used to Calculate Compliance Obligations.**
>
> (b)(7) The compliance obligation for ~~(CO2e covered) is calculation based on the~~ emissions from electricity deliveries from jurisdictions that are not approved for linkage pursuant to subarticle 12 is calculated in accordance with MRR section 95111(b)(5).~~:~~
>
> ~~(A) 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);~~
>
> ~~1. Specified deliveries meeting the requirements of section 95852(b)(2);~~
>
> ~~2. The adjustment for replacement electricity associated with the variable renewable electricity pursuant to section 95852(b)(3);~~
>
> ~~3. The specified electricity meeting direct delivery requirements pursuant to section 95852(b)(4); and~~
>
> ~~4. The specified electricity generated from the use of biomethane which meets the requirements pursuant to section 95852.2.~~
>
> ~~(B) All deliveries of electricity not meeting the requirements of section 95852(b)(2) through (5) will have emissions calculated using the~~

~~default emission factor for unspecified electricity pursuant to section 95111 of MRR (CO2e unspecified).~~

~~(C) Emissions resulting from qualified exports (CO2e qualified exports) will be subtracted from the compliance obligation pursuant to section 95852(b)(6).~~

~~Compliance Obligation in~~ $\cancel{CO2e_{covered} = CO2e_{specified} + CO2e_{unspecified} - CO2e_{qualified\ export}}$

VI. SECTIONS 95852.1 AND 95852.1.1 REGARDING BIOMASS-DERIVED FUELS SHOULD BE REVISED.

SCPPA appreciates the efforts made by ARB staff to accommodate our concerns with the provisions on biomass-derived fuel in the Regulation and the MRR. As biomass-derived fuel provisions are included in both regulations, SCPPA's remaining concerns about those provisions are presented in a separate comment that addresses biomass-derived fuel provisions only.

VII. SECTIONS 95853 AND 95855 SHOULD BE REVISED TO REFER TO SECTION 95852 WHEN CALCULATING COMPLIANCE OBLIGATIONS.

The wording in § 95853 (p. 93) and § 95855 (p. 96) on the calculation of a covered entity's triennial or annual compliance obligation does not accurately describe the covered emissions for electric sector entities. Not all of the emissions that an electric sector entity must report will form part of its compliance obligation. For example, biofuel emissions must be reported and verified but do not lead to a compliance obligation. Section 95852 sets out the details of the calculation of covered emissions for each covered sector. This section should be referred to whenever an entity's compliance obligation is being calculated.

§ 95853. Calculation of Covered Entity's Triennial Compliance Obligation.

A covered entity that exceeds the threshold in section 95812 in any of the three data years preceding the start of a compliance period is a covered entity for the entire compliance period. The covered entity's triennial compliance obligation in this situation is calculated as the total of the emissions ~~that received a positive or qualified positive emissions data verification statement, or were assigned emissions pursuant to section~~

~~95131 of MRR~~ calculated in accordance with section 95852 from all data years of the compliance period.

Furthermore, § 95855(a) should be revised to include reference to § 95856(d)(3) (p. 97). Section 95855(a) refers to years in which an entity does not have an annual compliance obligation, and § 95856(d)(3) states that there is no annual compliance obligation in 2015, 2018, and 2021 for the preceding years, only a triennial compliance obligation.

§ 95855. Annual Compliance Obligation.

(a) An entity has an annual compliance obligation for any year when the entity is a covered entity except for the conditions specified in sections 95853(d) and 95856(d)(3); and

(b) The annual compliance obligation for a covered entity equals 30 percent of emissions ~~reported~~ from the previous data year ~~that received a positive or qualified positive emissions data verification statement, or were assigned emissions pursuant to section 95131 of MRR~~calculated in accordance with section 95852.

VIII. SECTION 95854 SHOULD BE REVISED SO THAT THE 8 PERCENT OFFSET LIMIT WILL APPLY CUMULATIVELY.

For the most efficient use of the offset limit, all offsets submitted by the entity since the start of the cap and trade program should be included in the calculation of the offset limit, not just the offsets submitted in a particular compliance period. The total compliance obligation of the entity since the start of the cap and trade program should also be included in this formula, not just the compliance obligation in a particular compliance period.

§ 95854. Quantitative Usage Limit on Designated Compliance Instruments – Including Offset Credits.

(a) Compliance instruments identified in section 95820(b) and sections 95821 (b), (c), and (d) are subject to a quantitative usage limit when used to meet a compliance obligation.

(b) The total number of compliance instruments identified in section 95854(a) that each covered entity may surrender to fulfill the entity's compliance obligation ~~for a compliance period~~ must conform to the following limit:

O_O/S must be less than or equal to L_O

In which:

O_O = Total number of compliance instruments identified in section 95854(a) submitted since January 1, 2013 to fulfill the entity's total compliance obligation ~~for the compliance period~~ through the current compliance year.

S = Covered entity's total compliance obligation beginning January 1, 2013 through the current compliance year.

L_O = Quantitative usage limit on compliance instruments identified in section 95854(a), set at 0.08.

(c) The number of sector-based offset credits that each covered entity may surrender to meet the entity's compliance obligation for a compliance period must not be greater than 0.25 of the L_O for the first compliance period and not more than 0.50 of the L_O for subsequent compliance periods.

IX. SECTION 95856(b) SHOULD BE REVISED TO ELIMINATE UNDUE RESTRICTIONS ON THE COMPLIANCE INSTRUMENTS THAT MAY BE USED TO MEET A SURRENDER OBLIGATION.

Section 95856(b)(2) (p. 96) appears to allow entities to use for compliance only allowances issued in or before the year in which the relevant emissions were emitted. This is too restrictive and diminishes the value of having triennial rather than annual compliance periods. The flexibility associated with a three year compliance period should be retained.

Additionally, entities should be permitted to use compliance instruments issued during the year in which the compliance obligation is calculated, i.e., the year immediately following the end of the compliance period. That would mitigate the potential for sellers of allowances to demand an extortionate price for vintage allowances when an entity gets past the end of a compliance period and finds that he does not have enough compliance instruments to cover his compliance obligation. To meet a compliance obligation, entities should be allowed to use allowances that were issued during the compliance period in which the emissions occurred, during any previous years, and during the year in which the surrender is due. For example, for the annual compliance obligation due in November 2014 for 30 percent of 2013 emissions, an entity should be able to use allowances issued in 2013 or 2014. For the triennial compliance obligation due in November 2018 for emissions in 2015, 2016, and 2017, an entity should be able to use allowances issued in 2013, 2014, 2015, 2016, 2017, and 2018.

§ 95856. Timely Surrender of Compliance Instruments by a Covered Entity.

(b) Compliance Instruments Valid for Surrender. …

(2) To fulfill any compliance obligation, a compliance instrument must be issued from any allowance budget year up to and including ~~within or before~~ the year in~~for~~ which the compliance obligation is calculated and surrendered, unless: ...

X. SECTION 95857(c)(2) REGARDING A "NEW UNTIMELY SURRENDER OBLIGATION" SHOULD BE CLARIFIED.

Section 95857(c)(2) should be clarified to make it clear that the "new untimely surrender obligation" replaces and is not additional to the previous untimely surrender obligation.

In addition, the purpose of § 95857(c)(3) is unclear. It states that the calculation of the untimely surrender obligation shall only apply once, but the preceding section (2) specifies a second, "new" surrender obligation. If the purpose of section (3) is to clarify that the "new" surrender obligation replaces the previous one, this is more clearly expressed as follows:

§ 95857. Untimely Surrender of Compliance Instruments by a Covered Entity.

(c) If an entity with an untimely surrender obligation fails to satisfy the obligation pursuant to section 95857(b)(4), then:

(1) ARB will determine the number of violations pursuant to section 96014;

(2) If a portion of the untimely surrender obligation is not surrendered as required, the entity will have a new untimely surrender obligation (replacing the previous surrender obligation calculated under section 95857(b)(2)) equal to the amount of the previous untimely surrender obligation which was not satisfied by the deadline stated in section

95857(b)(4) upon which the number of violations will be calculated pursuant to section 96014. The new untimely surrender obligation is due immediately; and

(3) The calculation of the untimely surrender obligation shall only apply once for each untimely surrender of compliance instruments per annual or triennial compliance obligation.

XI. SECTION 95870(d) REGARDING THE DISPOSITION OF ALLOWANCES TO UTILITIES SHOULD BE REVISED.

Section 95870(d) (p. 103) should be revised to correctly identify the accounts into which the Executive Officer will place the allowances that are allocated to electrical distribution utilities. Currently, the section incorrectly states that the Executive Director shall place the allowances that are allocated to electrical distribution utilities in the "holding account" of each utility. The section should be revised to state that the allowances shall be placed either in the utility's limited use holding account in accordance with § 95892(b)(1) (p. 120) or in the utility's compliance account in accordance with § 95892(b)(2) (p. 121).

Additionally, § 95870(d) should be revised to provide that the allowances that are allocated to the electric sector each year shall be allocated among the electrical distribution utilities on the basis of the percentage allocation factors specified for each utility in Table 9-3 (p. 124-129). Currently, the section identifies the total amount of allowances that shall be available for allocation to the electrical distribution utility sector each year but does not take the next step of identifying how the allowances will be allocated among the electrical distribution utilities within the sector.

§ 95870. Disposition of Allowances.

(d) Allocation to Electrical Distribution Utilities. The Executive Officer will place an annual individual allocation either in each eligible electrical distribution utility's limited use holding account in accordance with section 95892(b)(1) or in its compliance account in accordance with section 95892(b)(2)~~in the holding account of each eligible electrical distribution utility~~ on or before January 15 of each calendar year from 2013-2020

> pursuant to section 95892. Allowances available for allocation to electrical distribution utilities each budget year shall be 97.7 million metric tons multiplied by the cap adjustment factor in Table 9~~.~~-2 for each budget year 2013-2020. The allowances allocated to each electrical distribution utility each budget year shall be the amount allocated to the electrical distribution utilities for the budget year multiplied by the percentage allocation factors specified in Table 9-3.

XII. SECTION 95890 ELIGIBILITY REQUIREMENTS FOR DIRECT ALLOCATIONS SHOULD BE DELETED OR REVISED.

Section 95890 (p. 109) states that in order to be eligible for direct allocations an electrical distribution utility must have "complied with the requirements of the MRR" and "obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to the MRR." These provisions should be removed. Table 9-3 entitled "Percentage of Electric Sector Allocation Allocated to Each Utility" identifies by name each utility that will receive a direct allocation of allowances. Being an electrical distribution utility as defined in § 95802(a)(82) and, as a result, being identified in Table 9-3 in itself establishes the eligibility of the utility to receive an allocation of allowances calculated in accordance with § 95870(d) as discussed above. Adding additional conditions that the utility must have "complied with the requirements of the MRR" and "obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to the MRR" would expose the utility to a duplicative and harsh punishment—loss of its allocation of allowances—if it failed to meet those conditions.

The first requirement that the utility must have "complied with the requirements of the MRR" is vague. An entity could be deemed to be non-compliant with the MRR for a variety of reasons, including being late with reports, including inaccurate data in reports, or failure to retain records as required. The MRR already establishes penalties for these infractions. Imposing the additional penalty of denying the utility its allocation of allowances would add a duplicative and unduly disproportionate penalty to the penalties already established in the MRR.

The second requirement that the utility must have "obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to the MRR" is more specific but equally problematic. While electrical distribution utilities expect to receive positive or qualified positive emission data verification statements without exception, the receipt of an adverse emission data verification statement cannot be ruled out. Section 95107 of the MRR establishes penalties for submitting verification reports late and for including inaccurate information in such reports. Again, the additional penalty of denying the utility its allocation would be duplicative and grossly disproportionate.

It would be egregious to deny an allocation to a utility, forcing the utility to purchase allowances on the market to cover its compliance obligation. Imposing such a harsh as penalty would not be consistent with the goal of enabling each utility "to fully compensate their consumers for the costs associated with the cap-and-trade program…." Appendix A at 5.

Compare the situation of having an adverse verification emissions report to the situation in which emissions are reported and verified accurately, but insufficient allowances are surrendered to cover them. In the latter case, an electrical distribution utility must surrender four compliance instruments for every one that is short under § 95857(b)(2) (p. 99) and may be subject to additional financial penalties under § 96014 (p. 281). In the former case, an entity could surrender compliance instruments to completely cover the emission obligation for a year with an adverse emissions statement and then forfeit an entire year's allocation of compliance instruments for the following year in addition to bearing penalties for inaccuracy or failure to report properly. This would be excessive and unfair.

Utilities should not be required to have "complied with the requirements of the MRR" and "obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to the MRR" to be eligible for the allocation provided to them in Table 9-3. Being named and provided an allocation in Table 9-3 should, in itself, establish each utility's eligibility for an allocation. Accordingly, § 95890 should be deleted:

> **§ 95890. General Provisions for Direct Allocations.**
>
> ~~(b) Eligibility Requirements for Electrical Distribution Utilities. An electrical distribution utility shall be eligible for direct allocation of California GHG allowances if it has complied with the requirements of MRR and has obtained a positive or qualified positive emissions data verification statement for the prior year pursuant to MRR.~~

Alternatively, if the ARB decides that a provision on eligibility for electrical distribution utilities should be retained in § 95890 to parallel the section on eligibility for industrial facilities in § 95890(a), SCPPA recommends that § 95890(b) be revised as follows:

> **§ 95890. General Provisions for Direct Allocations.**
>
> (b) Eligibility Requirements for Electrical Distribution Utilities. An electrical distribution utility shall be eligible for direct allocation of California GHG allowances <u>if it meets the definition of "Electrical Distribution Utility" in section 95802(a)(82)</u>.~~has complied with the requirements of the MRR and has obtained a positive or qualified positive emissions data verification statement on its sales number for the prior year pursuant to the MRR.~~

XIII. SECTION 95892(a) SHOULD BE REVISED TO PROVIDE FOR THE DIRECT ALLOCATION OF ALLOWANCES TO ELECTRICAL DISTRIBUTION UTILITIES.

Section 95892(a) (p. 120) places restrictions on the use of allowances by electrical distribution utilities but fails to establish the foundational fact that allowances shall be allocated to the electrical distribution utilities. Accordingly, SCPPA recommends that § 95892(a) be revised as follows:

§ 95892. Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.

(a) Allowances shall be directly allocated to electrical distribution utilities each budget year in an amount calculated in the manner described in section 95870(d). Any allowance allocated to electrical distribution utilities must be used exclusively for the benefit of retail ratepayers of each such electrical distribution utility, consistent with the goals of AB 32, and may not be used for the benefit of entities or persons other than such ratepayers.

XIV. SECTION 95892(b)(2) SHOULD PERMIT A UTILITY'S ALLOCATED ALLOWANCES TO BE DIRECTED TO ANOTHER UTILITY'S ACCOUNT IN CERTAIN CIRCUMSTANCES.

SCPPA appreciates the efforts of ARB staff to accommodate the particular circumstances of publicly-owned utilities ("POUs") in the provisions on the allocation of allowances to utilities. However, an additional provision is needed to address the situation exemplified by the Magnolia generating facility in Burbank, California. Magnolia is owned by SCPPA, a joint powers authority, but is operated by Burbank Water & Power ("Burbank"). Burbank rather than SCPPA will have the compliance obligation and will need to have the other SCPPA members that participate in Magnolia direct the Executive Officer to place a share of their directly allocated allowances in the compliance account that Burbank will maintain for Magnolia. In order to permit POU participants to direct the Executive Officer to place a share of their allowances in the compliance account of the operator of a facility that delivers electricity to multiple participants, § 95892(b)(2) (p. 121) should be revised as follows:

§ 95892. Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.

(b) Transfer to Utility Accounts. …

(2) Publicly Owned Electric Utilities or Electrical Cooperatives. At least 90 days prior to receiving a direct allocation of allowances, publicly owned electric utilities or Electrical Cooperatives will inform the Executive Officer of the share of their allowances that is to be placed:

(A) In the publicly owned electric utility's or Electrical Cooperative's compliance account, ~~or~~ the compliance account of a Joint Powers Agency in which the electrical distribution utility is a member and with which it has a power purchase agreement, or the compliance account of the operator of a generating facility that generates electricity for the account of the publicly owned utility or Electrical Cooperative; or

(B) In the publicly owned electric utility's or Electrical Cooperative's limited use holding account. …

XV. SECTION 95892(f) RESTRICTIONS ON USE OF ALLOWANCE VALUE SHOULD BE AMENDED.

Section 95892(f) (p. 123) should be amended to address the situation of several SCPPA members who are members of the California Independent System Operator ("CAISO"). CAISO members are required to sell the electricity they generate or import into the CAISO's market and then bid the electricity back in a wash transaction in order to use the electricity they generate to serve their native load. Section 95892(f) as currently written would prohibit the SCPPA members of the CAISO from using directly allocated allowances that the Executive Officer places in their compliance accounts to meet the compliance obligation associated with the electricity they generate or import to serve their native load but which must be sold into the CAISO market and then bid back in a wash transaction. In order to permit the SCPPA members of the CAISO to use their directly allocated allowances to meet the compliance obligation associated with the electricity they generate or import to serve their native load, § 95892(f) should be revised as follows:

§ 95892. Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.

(f) Prohibited Use of Allocated Allowance Value. Use of the value of any allowance allocated to an electrical distribution utility, other than for the benefit of retail ratepayers consistent with the goals of AB32 is prohibited, including use of such allowances to meet compliance obligations for electricity sold into the California Independent System Operator markets in excess of the electricity needed to meet the electrical distribution utility's native load in the same hour.

XVI. SECTION 95913(c) SHOULD BE EXPANDED TO INCLUDE PROVISIONS ON REFILLING A FULLY DEPLETED ALLOWANCE RESERVE.

SCPPA thanks the ARB for proposing the Allowance Price Containment Reserve ("Reserve") to address the potential for higher than expected allowance prices. Because a robust allowance reserve is necessary to manage allowance prices and ensure long-term market success, the ARB should establish a procedure in the Regulation to automatically replenish the reserve if it becomes depleted. With language in the Regulation identifying the triggering event and action to be taken, the market will have assurance that a timely remedy will be in place.

SCPPA stands ready to work with ARB staff and concerned stakeholders to develop appropriate regulatory language that creates a process to replenish the reserve if it becomes depleted and provides for temporary suspension of the cap-and-trade market and related compliance obligations if the balance in the reserve drops to zero.

The proposed language below is offered in the spirit of ensuring the cap-and-trade market will be robust, will work for our customers, will provide additional emissions reductions at a fair price, and will be an example for others to follow.

> **§ 95913. Sale of Allowances from the Allowance Price Containment Reserve.**
>
> (c) Timing, Eligible Participants, ~~and~~ Limitations, Reserve Replenishment and Market Stabilization. …
>
> (5) Replenishing the Reserve and Market Stabilization.
>
> (A) When the Reserve is fully depleted, the Executive Officer shall make available for purchase by each Covered Entity sufficient allowances to allow that Covered Entity to fully satisfy any remaining compliance obligation. Only Covered Entities with a combined Holding Account and Compliance Account balance of zero shall be able to purchase such allowances. Such allowances shall be offered at the allowance price of the third tier of the Reserve at the time the Reserve contained 40 MMT or fewer allowances available for purchase. Purchases of such allowances shall be transferred directly into a Covered Entity's Compliance Account.

(B) Whenever the Reserve is fully depleted, the Executive Officer and Market Monitoring Board shall report to the Board within 3 months. The report shall make recommendations to the Board on program modifications necessary to replenish the Reserve and to enable allowance prices in each quarterly allowance auction held pursuant to section 95910 to clear at or below the first tier of the Reserve.

XVII. SECTION 95920 HOLDING LIMIT PROVISIONS SHOULD BE CLARIFIED.

A. Section 95920(d) provisions for the "limited exemption" should be clarified.

Section 95920(d)(2) (p. 158) refers to a "limited exemption" from the Holding Limit. However, in fact the amount calculated in the "limited exemption" provision is added to and forms part of the Holding Limit, rather than being an exemption to it. For clarity, the wording should be changed from "exemption" to "addition" to reflect the intended operation of this section.

In § 95920(d)(2), it appears that subsections (B) to (H) are intended to act as a cap on the limited addition set out in subsection (A). This should be specified.

Section 95920(d)(2)(B) refers to the most recent verified report received as of June 1, 2012. This will be the report on 2010 emissions, as the 2011 report will not be verified until later in 2012. SCPPA understands that § 95920(d)(2)(C) will operate to provide that, in October 2013, the limited addition would be [2010 + 2012] emissions. In October 2014, it would be [2010 + 2012 + 2013] emissions. In October 2015, it would be [2010 + 2012 + 2013 + 2014] emissions. SCPPA further understands that §95920(d)(2)(H) will operate to provide that on December 31, 2015, for example, the limited addition would be [2010 + 2012 + 2013 + 2014] – [2013 + 2014] = [2010 + 2012] emissions. If this understanding is not correct, §95920(d) should be clarified.

§ 95920. Trading.

(d) The holding limit will be calculated for allowances qualifying pursuant to section 95920(c)(1) as the sum of (1) and (2) below:

(1) The number given by the following formula:

Holding Limit = 0.1*Base + 0.025*(Annual Allowance Budget – Base)

In which:

"Base" equals 25 million metric tons of CO2e.

"Annual Allowance Budget" is the number of allowances issued for the current budget year.

(2) A Limited Addition to~~Exemption from~~ the Holding Limit, ~~is~~ calculated as follows:

(A) The limited addition~~exemption~~ is the number of allowances which are exempt from the holding limit calculation after they are transferred by a covered entity or an opt-in covered entity to its compliance account, subject to the limitations set out in sections 95920(d)(2)(B) to (H) inclusive.

(B) On June 1, 2012 the limited addition~~exemption~~ will equal the amount of emissions contained in the~~annual emissions~~ most recent emissions data report that has received a positive or qualified positive emissions data verification statement.

(C) Beginning in 2013 on October 1 of each year the limited addition~~exemption~~ will be increased by the amount of emissions contained in the most recent emissions data report that has received a positive or qualified positive emissions data verified statement during that year.

(D) If for any year ARB has assigned emissions to an entity in the absence of a positive or qualified positive emissions data verification statement the calculation of the limited addition~~exemption~~ will use the assigned emissions.

(E) For the first compliance period all reported emissions or assigned emissions used to calculate the limited addition~~exemption~~ will include only the emissions associated with the scope for the program during the first compliance period.

(F) Beginning in 2015, all reported emissions or assigned emissions used to calculate the limited addition~~exemption~~ will include the emissions associated with the change in scope taking place in 2015.

(G) On January 1, 2015 the limited addition~~exemption~~ will be increased by the amount of emissions included in the emissions data report received during 2014 but not yet included in the limited addition~~exemption~~ pursuant to section 95920(d)(2)(E).

(H) On December 31 of the calendar year following the end of a compliance period, the limited addition~~exemption~~ will be reduced by the sum of the entity's compliance obligation over that compliance period.

B. Section 95920(g) on corporate association holding limits should be clarified.

ARB should clarify whether this limit applies to future allowances (purchased at advance auctions) as well as allowances for current and previous compliance periods. Holding limits are calculated separately for those categories, according to § 95920(c) (p. 158).

Section 95920(g)(1) (p. 160) refers to a holding limit applying to compliance instruments, but all other provisions of this § 95920 (other than section (b)(3), which should also be amended) refer to limits on the holding of allowances, not compliance instruments in general. There is no reason to apply a holding limit to offsets as there is already a surrender limit on offsets.

Section 95920(g)(2) refers to a limited exemption as defined in §95920(f). However, § 95920(f) does not define a limited exemption (or addition). It appears that the reference should be to § 95920(d) instead. It is also unclear how the limited exemption (or addition) would apply to the amount provided in § 95920(g)(1). Will the limited exemption/addition for each entity be added to the group holding limit calculated under § 95920(g)(1)? This should be clarified. SCPPA recommends the following revisions to § 95920(g):

§ 95920. Trading.

(g) Application of the Corporate Association Disclosure to the Holding Limit.

(1) The total number of ~~compliance instruments~~allowances held by a group of entities with a disclosable corporate association pursuant to section 95833 in their holding accounts must sum to less than the holding limit pursuant to section 95920(e), plus the sum of the limited additions specified in section 95920(g)(2).

(2) The limited addition~~exemption~~ for each entity which is part of a corporate association is the same as defined in section 95920(d~~f~~). …

XVIII. BUYER LIABILITY IS NOT A WORKABLE APPROACH TO ADDRESSING POST-ISSUANCE PROBLEMS WITH OFFSETS.

A. A Buyer Liability Rule Will Prevent the Development of a Viable Offsets Program, Resulting in Adverse Impacts on the Entire AB 32 Effort.

SCPPA has strong concerns about ARB's "buyer liability" approach to addressing situations in which problems are identified with offset credits after they have been issued. *See* § 95985, p. 242. To be clear, SCPPA believes the risk of such post-issuance problems is small because of the rigor of the ARB's offset regulations. However, any policy under which already-issued offset credits carry a risk of invalidation will prevent the development of a market in offsets—and the current provisions make it very easy for invalidation to occur.

An unworkable offsets program would have very adverse consequences for the AB 32 program, as shown by ARB's own March 24, 2010 economic analysis. As part of this analysis, ARB modeled the cap and trade program under a scenario in which no offsets could be utilized. Relative to the baseline case (in which offsets are utilized to the full 8 percent limit), ARB's modeling concluded that this "no offsets" scenario would yield allowance prices in 2020 that would be $108 higher ($148/ton instead of $30/ton)—resulting in $18 billion more in costs in that year alone.[2] The current buyer liability approach effectively will drive the AB 32 program to the "no offsets" scenario.

B. Buyer Liability is Neither Fair nor Efficient.

In the case of offset discrepancies, it almost certainly will be the offset project operator, verifier, or offset project registry that is at fault—and, under Regulation, each of these parties submits to the jurisdiction of ARB. Yet, under ARB's proposed buyer liability rules, the holder or user of a credit is presumptively liable. This arrangement turns fairness on its head, as the party less likely to be responsible for the issue bears the cost, while the parties that may be

[2] *Id.*, at p. ES-7 (Table ES-2).

responsible bear no direct cost. This approach does not encourage offset project operators and verifiers to be careful and conservative.

In addition, the approach is highly inefficient. To be efficient, a liability system should impose liability on the party that has the most information and ability to control performance. Most covered entities do not have any special insight into methane digesters, ozone-depleting substances, or forestry. In an offsets program, covered entities will rely on the work of verifiers—and on ARB itself as credit issuer. For this reason, making covered entity buyers liable for problems not detected through the regulatory system would impose substantial new costs on buyers without materially reducing the risk that such problems will occur.

ARB officials also have asserted that buyers can easily and efficiently manage their liability risk through contracts. This view is not consistent with marketplace realities because of informational asymmetries between buyers (less informed) and sellers (better informed). A viable offsets program will involve the participation of many buyers and sellers—including aggregators who intermediate between smaller covered entities and offset project operators. A buyer liability rule implies a market in which invalidation would unleash a chain of contractual claims involving every party that ever held custody of the credit, paralyzing the marketplace. Aggregators and small businesses will avoid such a market—leaving a stunted offsets program involving only bilateral arrangements by largest covered entities for the largest projects. Small businesses and small projects will fall out of the equation.

C. Economically Viable Insurance Products Will Not Emerge to Manage Buyer Liability.

Some ARB officials see insurers coming to the rescue. For several reasons, SCPPA is skeptical about the emergence of viable insurance products. Insurers typically assess and insure against risks that apply to private activities or enterprises. In an offsets market, by contrast, the risk relates to the performance of a government program—and the ARB offsets system is a government program with no track record of experience. Cost-effective insurance will not materialize in such a small and idiosyncratic market, where the insurance products would have to change over time to match regulatory requirements.

In other types of more mature and "natural" markets, the cost of insurance can come down if offered on the basis of large pools of varying risks. However, there is no mechanism in the Regulation that makes such pooling possible for private insurers. As a result, any insurers for the ARB offsets market will have to build up such pools on their own over time and at very high cost—and these costs will be passed through to covered entities in their rates.

Finally, SCPPA is skeptical that offset project registries can provide a workable insurance pathway. First, as ARB's own Regulation recognizes, registries themselves could be the source of a credit discrepancy.[3] Second, registries are not well capitalized, and therefore could not be relied upon to pay out on claims.

D. ARB Should Apply the Forest Buffer Account Approach to All Offsets.

ARB has included in the Regulation a buffer account that applies for post-issuance problems associated with forest offset projects. SCPPA strongly urges the ARB to apply this Forest Buffer Account approach to all offset projects. The integrity of the emissions cap would be maintained by retiring additional offsets from the buffer account if any problems arise, and offsets would not need to be invalidated. Compared to the buyer liability system, this approach would be:

- equally effective in making the system whole in the event of invalid credits;

[3] *See* § 95985(b)(1) (providing that a grounds for invalidation includes a determination by ARB 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") (emphasis added).

- far fairer (by holding "bad actors" liable where possible); and
- much more efficient (again by holding bad actors liable, but also including a system-wide backstop).

ARB has not explained why this kind of approach is workable and appropriate for forest offset projects, but not for other offset project types. In particular, ARB has not explained why extending this approach to all offset projects would impose unreasonable administrative or risk burdens on the agency. SCPPA does not believe such burdens would result. The primary role of ARB under the buffer account approach is to determine the portion of offset credits to set aside in the account. This set-aside should be conservative. In any event, ARB would have the ability to increase the amount of the set-aside if the buffer account runs low. The account requires no active management, and no purchase or sale of offsets. It is not a bank account.

The offset buffer account would not be the primary recourse. First, the ARB should identify the entity responsible for the problems with the offsets, and require that entity to provide additional compliance instruments or face penalties. If the responsible entity fails to provide additional compliance instruments, ARB will retire a corresponding amount of offset credits from the Offset Buffer Account. This is similar to the approach taken with the Forest Buffer Account.

E. A definition of "Offset Buffer Account" should be inserted in § 95802(a).

To implement the buffer approach discussed above, a definition of "Offset Buffer Account" is required, as a new subsection in § 95802(a). A proposed definition is set out below, mirroring the existing language for the Forest Buffer Account.

§ 95802. Definitions.

(a)(X) "Offset Buffer Account" means a holding account for ARB offset credits. It is used as a general insurance mechanism against failure to surrender additional compliance instruments under section 95985(f) when ARB has made a determination pursuant to Section 95985 (e)(4).

F. **The Offset Buffer Account should be specified as a new account type, in § 95831.**

The Offset Buffer Account will be one of the accounts under the control of the Executive Officer. This proposed language, to be inserted into § 95831(b) (p. 60), mirrors the existing language for the Forest Buffer Account.

§ 95831. Account Types.

(b) Accounts under the Control of the Executive Officer. The accounts administrator will create and maintain the following accounts under the control of the Executive Officer: …

(7) A holding account to be known as the Offset Buffer Account:

(A) Into which ARB will place offset credits pursuant to section 95981.1; and

(B) From which ARB may retire ARB offset credits pursuant to section 95985 and place them into the Retirement Holding Account.

G. **Offsets should be deposited into the Offset Buffer Account, in § 95981.1.**

A step should be added to the offset credit issuance process in § 95981.1 (p. 236), under which ARB would hold back a portion of credits and place them in the Offset Buffer Account. The language mirrors the existing process for the Forest Buffer Account, but the percentage of the hold-back is specified in the Regulation.

§95981.1. Process for Issuance of ARB Offset Credits.

(g) Offset Buffer Account. ARB will place a portion of ARB offset credits issued to an offset project into the Offset Buffer Account.

(1) The amount of ARB offset credits that must be placed in the Offset Buffer Account shall be [1.5% of the amount issued to a project.]

(2) ARB will transfer ARB Offset credits to the Offset Buffer Account at the time of ARB offset credit registration pursuant to section 95982.

(3) If an offset project is originally submitted through an Offset Project Registry, an equal number of registry offset credits must be retired

by the Offset Project Registry and issued by ARB for placement in the Offset Buffer Account.

H. ARB Should Modify the Credit Invalidation Rules to Improve their Fairness and Efficiency.

Regardless of the liability approach ARB adopts, it is important to ensure that the processes for maintaining the emissions cap when problems with offsets are identified are well designed. SCPPA appreciates many of the modifications that the ARB added to the offset invalidation procedures. However, SCPPA urges the ARB to consider the further modifications outlined below.

In the Proposed Changes, ARB added a provision under which the period of time during which the offset credit is subject to invalidation can be shortened from eight years to five years. This period should simply expire upon the earlier of the date of the ARB's acceptance of the second verification, or five years after issuance. There is no reason to require that a second verification "sit" for a certain period of time before lifting the shadow of invalidation. Nothing is gained from the passage of time—and yet, the marketplace will not consider the credit valid and marketable for the length of that period.

Second, the ARB should modify the list of potential issues with offset credits. SCPPA respectfully requests the ARB to eliminate § 95985(b)(1): the project information is not "true, accurate, or complete." Given the myriad requirements of the offset regulations, any number of projects will have documentation that has inadvertent inaccuracies or omissions. Yet, under this vague and overbroad provision, a minor paperwork problem could result in invalidation of 100 percent of the offset credits already issued for a project—*even if there was no impact on the reductions or removals actually achieved by the project*. This is a draconian, "gotcha" approach that will deter development of offset projects for reasons unrelated related to environmental integrity. Furthermore, any discrepancies that *do* have material effects on the environmental integrity of the project are completely addressed by §§ 95985(b)(2), (3), and (4). For these reasons, SCPPA respectfully urges the ARB to delete § 95985(b)(1).

Third, the provision related to "overstatement" (§ 95985(b)(2)) should be modified to avoid unnecessarily punitive outcomes. If an offset data report overstates emission reductions achieved by a project, the ARB should require additional offsets to be surrendered in an amount that corresponds to the overstatement. As currently proposed, the ARB would invalidate all offset credits associated with the report, even the portion of the offset credits that correspond to real emission reductions. If the ARB continues to rely on a buyer liability approach, it could apply the more limited invalidation pro rata to all holders of offset credits from the particular vintage year.

Finally, 90 days remains a very tight timetable for any entity to obtain additional compliance instruments. SCPPA respectfully urges the ARB to align this provision with the provision on under-reporting of emissions, which allows six months to surrender additional compliance instruments.[4]

I. Proposed Changes to Section 95985 Regarding Offset Credits.

For the reasons discussed above, § 95985 (p. 242) should be revised as follows, to implement the buffer approach, remove references to invalidation, and refine the grounds for finding that problems have arisen in relation to issued offset credits.

> **§ 95985. Surrender of additional~~Invalidation of~~ ARB Offset Credits if circumstances arise in relation to existing ARB Offset Credits.**
>
> (a) An ARB offset credit issued under this Article will remain valid provided that, if ARB makes a determination pursuant to section 95985(e)(4) then an additional compliance instrument must be surrendered in accordance with sections 95985(f) and (g). ~~unless invalidated pursuant to sections 95985(b) and (c)~~.

[4] Section 95858(c) (p. 102).

(b) ARB may determine at any time until the earlier of (i) a post-issuance verification of the Offset Project Data Report by a different offset verifier, and (ii)~~within~~ 5~~8~~ years after~~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~~

(~~2~~1) The Offset Project Data Report contains errors that overstate the amount of GHG reductions or GHG removal enhancements by more than 5 percent (in which case, ARB shall determine the amount of offset credits that corresponds to the overstatement); or

(~~3~~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~~4~~) ~~ARB determines that o~~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.

~~(5) If an offset project is developed under Compliance Offset Protocol U.S. Ozone Depleting Substances Projects, ARB may invalidate within five years of issuance of the ARB offset credits covered by an Offset Project Data Report.~~

~~(6) If an offset project is verified after three years of ARB offset credit issuance by a different offset verifier, ARB may invalidate within five years of issuance of the ARB offset credits covered by an Offset Project Data Report.~~

(~~7~~c) 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.

(d~~e~~) If ARB makes a determination pursuant to section 95985(b), then ~~determines that an ARB offset credit is invalid pursuant to section 95985(b)~~ ARB will identify all parties that may have some responsibility for the action that gave rise to the determination. Such parties may include:

(1) ~~Identify~~ the current holder of an ARB offset credit that has not been transferred to a compliance account or submitted for retirement;

(2) ~~Identify~~ the entity that holds an ARB offset credit in its compliance account or has submitted it for compliance or retirement; and

(3) The Offset Project Operator and Authorized Project Designee, and, if applicable, the Forest Owner~~, if applicable~~.

(e~~d~~) ARB will notify the parties identified in section 95985(~~c~~d) of the determination pursuant to section 95985(b)~~invalidation~~ and provide ~~the~~each party an opportunity to submit additional information to ARB ~~prior to invalidation~~ as follows:

(1) ARB will include the reason for finding that the issue listed in section 95985(b) occurred~~invalidation of an ARB offset credit~~ in its notification to the party identified in 95985(d~~e~~).

(2) After notification the parties~~y~~ identified in 95985(d~~e~~) will have 25 calendar days to provide any additional information to ARB.

(3) ARB may request any additional information as needed in addition to the information provided under this section.

(4) The Executive Officer will have 30 days after all information is submitted under this section to make a final determination that one of the conditions listed in section 95985(b) has occurred, to identify and notify the party responsible, and to determine the number of offset credits affected and the compliance instruments that are required to be surrendered~~to invalidate an ARB offset credit~~.

~~(e) If the Executive Officer determines that an ARB offset credit is invalid pursuant to sections 95985(b) and (d):~~

~~(1) The ARB offset credit will be invalidated and removed from any Holding or Compliance Account;~~

~~(2) The party identified pursuant to section 95985(c) will be notified of ARB's determination of invalidation pursuant to section 95985(d)(4);~~

~~(3) The Offset Project Operator or Authorized Project Designee, or the Forest Owner, if applicable, of the offset project for which the ARB offset credits were invalidated will be notified of ARB's determination of invalidation pursuant to section 95985(d); and~~

~~(4) Any approved program for linkage pursuant to subarticle 12 will be notified of the invalidation at the time of ARB's determination pursuant to section 95985(d)(4).~~

(f) Requirements for Surrender of Additional Compliance Instruments~~Non-Sequestration Offset Projects~~. If the Executive Officer makes a determination~~an ARB offset credit is found to be invalid~~ pursuant to section~~s~~ 95985(e)(4)~~b) and (d)~~, the party identified in section 95985(e)(4)~~c)(2)~~ must surrender the specified number of ~~replace each ARB offset credit with a~~ valid ARB offset credits or ~~an~~other approved compliance instruments pursuant to subarticle 4, within ~~90 calendar days~~six months of notification by ARB pursuant to section 95985(e).

(g) If the party identified in section 95985(e~~c~~)(~~2~~4) does not surrender the specified number of compliance instruments~~replace each invalid ARB offset credit~~ within ~~90 calendar days~~six months of the notice ~~of invalidation~~ pursuant to section 95985(e):~~,~~

(1) ARB will retire the specified number of ARB offset credits from the Offset Buffer Account; and

(2) the party will be subject to enforcement action pursuant to section 96014; and

(3) each ~~outstanding~~ ARB offset credit retired from the Offset Buffer Account 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.~~

~~(g) Requirements for Forest Offset Projects. If an ARB offset credit is found to be invalid pursuant to sections 95985(b) and (d) for a forest offset project, the Forest Owner 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 Forest Owner does not replace the invalid ARB offset credit within 90 calendar days of being notified by ARB pursuant to section 95985(e), each outstanding ARB offset credit will constitute a violation pursuant to section 96014.~~

(h) Nothing in this section shall limit the authority of the State of California from pursuing enforcement action against any parties in violation of this article.

XIX. SECTION 96014 VIOLATION PROVISIONS SHOULD BE AMENDED.

A. Section 96014(a) should be amended.

Section 96014(a) (p. 281) provides for a separate violation for each compliance instrument that is not surrendered. The basic penalty amount per violation under Health and Safety Code § 40402(b) is up to $10,000. At this amount, potential penalties when each ton is a violation are 200 to 1000 times higher than expected allowance prices. There is no need for such extreme penalties, but the prospect of them has market impacts. Using each 1,000 instruments as way to limit the number of violations yields maximum penalties equivalent to expected allowance prices, and these are sufficient on top of the 4-1 excess surrender requirement in § 95857.

Section 96014(a) contains a reference to § 95856, but that section is not relevant. If compliance instruments are not surrendered in accordance with § 95856, then § 95857(b) will apply, not § 96014. Section 96014 will apply only if compliance instruments remain outstanding under § 95857(c) (the "new untimely surrender obligation").

Section 96014(a) also contains some wording that SCPPA requested in response to an earlier version of the Regulation – specifically referring to § 95857(c). This wording is no longer necessary as § 95857(c) has since been significantly amended.

§ 96014. Violations.

(a) If an entity fails to surrender a sufficient number of compliance instruments to meet its compliance obligation as specified in section~~s~~ ~~95856 or~~ 95857, ~~and the procedures in 95857(c) have been exhausted,~~ there is a separate violation of this article for each 1,000 required compliance instruments, or portion thereof, that ha~~s~~ve not been surrendered~~, or otherwise obtained by the Executive Officer under 95857(c)~~.

B. Section 96014(b) should be amended.

Instead of daily penalties, a 45-day period was included in § 96014(b) of the Discussion Draft. It is also referred to in the ARB's summary of the 15-day changes: "The section was also clarified to allow the violation to accrue every 45 days instead of each day the compliance instrument remained unsurrendered." (Page 41, section FFFF.) The 45-day period should be included in the Regulation to avoid unduly onerous penalties.

In addition, § 96014(b) (p. 281) refers to the "Untimely Surrender Period." However, this term is not defined and is not used elsewhere in the Regulation. This term should be replaced with a reference to the relevant section of the Regulation.

For the reasons set out in section XIX.A above, the violations should be per 1,000 unsurrendered compliance instruments.

> **§ 96014. Violations.**
>
> (b) There is a separate violation for each 45-day period or portion thereof after the date determined pursuant to section 95857(b)(4)~~end of the Untimely Surrender Period~~ that each required 1,000 compliance instruments, or portion thereof, haves~~s~~ not been surrendered.

XX. CONCLUSION

SCPPA urges the ARB to consider these comments in finalizing the amendments to the Regulation. SCPPA appreciates the opportunity to submit these comments to the ARB and looks forward to working with the staff of the ARB to further refine the Regulation.

Respectfully submitted,

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