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California Air Resources Board

1001 I Street

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**RE: Proposed Changes to Cap-and-Trade Regulation**

Dear Board Members:

San Diego Gas and Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) appreciate the opportunity to comment on proposed changes to the cap-and-trade regulation to improve transaction processing while maintaining security and to harmonize its regulations with Quebec to allow for immediate linking with its cap-and-trade program and with other jurisdictions in the future. We support linking to provide a successful market model and for all the reasons stated in the Air Resources Board’s (ARB) Initial Statement of Reasons (ISOR). These comments recommend changes that should be addressed in either ARB guidance documents on implementation of the regulation or in future changes to the regulation to protect against identity theft, improve market efficiency, and reduce unnecessary compliance costs.

**KNOW-YOUR-CUSTOMER REQUIREMENTS AND FINANCIAL SERVICES ADMINISTRATOR**

Section 95834 (Know-Your-Customer Requirements) requests significant personal information from individuals in a capacity requiring access to the tracking system, even from those who are employees of compliance entities, where the threat of fraud is minimal. SDG&E and SoCalGas understand that the ARB’s intent is to protect the Cap and Trade system from fraud or theft, however, we believe that section 95834 requires much more information than ARB needs to accomplish this objective.

In addition to the excessive requirements of section 95834, the regulation adds sections 95912(d)(5)(B) and 95913(c)(2) that require even more extensive information be provided to the financial services administrator. Sections 95912(d)(5) and 95913(c) should be eliminated from the regulation. Appendix A requests more information than section 95834 without protections or limitations on the use by the financial services administrator. If the sections are not deleted, then there should be ARB guidance that clarifies that the personal information requested by the financial services administrator in these sections, beyond what is contained in 95834, is only required of individuals desiring to participate on their own behalf and registered as voluntary associated entities and NOT for employees of covered entities. Requesting detailed personal information from employees of covered entities may violate employees’ right to privacy under the California Constitution.[[1]](#footnote-1)

The data requested on individuals in Appendix A includes residence address, phone number, email, Social Security number, date of birth, citizenship, employer name, employer address, copy of a valid identity card issued by a state or province with an expiration date, copy of a government-issued identity document, copy of a passport, and documentation of an open bank account. With that amount of information, if such records were hacked or stolen, identity theft would be easy to accomplish. This detailed information would be in the possession of the financial service administrator, rather than a government agency, with no stated protections or limitations on the use of the data. SDG&E recently had employee data that was provided to a third party hacked, so it is a very real threat. Requiring the provision of such extensive personal data to a financial institution creates an unnecessary risk of privacy violations.

It should be enough for the financial services administrator to know that a primary or alternate account representative has complied with the rigorous process of registering with CARB. Individuals should not need to re-register with another entity. Even if there is a compelling reason to require individuals to re-submit personal information, the financial services administrator does not need more information than ARB regarding the primary or alternate account representative since it is registered entities that are participating in the auction. The registered entities are putting up the bid guarantees that the financial services administrator is validating. Analysis of the bid guarantee does not relate to the primary or alternate account representative in any way unless they are personally registered as a voluntary associated entity. Further, any winning bids will result in allowances being transferred to the registered entity, not the primary or alternate account representative, unless they are also the voluntary associated entity. Since the risk of fraud does not exist, there is no need to ask primary or alternate account representatives to provide any more information than required in section 95834 unless they are also the registered entity. The ARB guidance document should clearly state that sections 95912(d)(5)(B) and 95913(c)(2) and Appendix A information apply only to primary or alternate account representatives who are also the registered entity.

**ELIMINATION OF BENEFICIAL HOLDING RULES**

With the elimination of beneficial holdings sections of the regulation, it looks as though an entity cannot acquire and hold allowances in its holding account on behalf of another entity according to Section 95921(f)(1)) shown below. This concerns SDG&E since we have contractual obligations to purchase allowances for entities with which SDG&E has tolling agreements.

**95921 Conduct of Trade**

(f) General Prohibitions on Trading.

(1) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity~~, except when part of a disclosed beneficial holdings relationship pursuant to section 95834~~.

Both the definition of “hold” and the term “on behalf of another entity” are ambiguous, the ARB should revise the regulation to clarify these definitions or should provide guidance as to their meaning in a guidance document.

Allowance purchases by an electricity buyer for the seller as part of a contractual obligation should be allowed. However, the ambiguity of both the definition of “hold” and the term “on behalf of another entity,” make it unclear whether or not these types of purchases are permissible. The ARB should update the regulation to allow for purchasing of allowances under contractual obligation in some fashion. This could be accomplished by recognizing these types of agreements as exempt from the prohibition in 95921 or by defining what is meant by “hold.” If a regulation update is not possible, then the ARB needs to clarify what interpretations should be made in a guidance document. Without some type of clarification, covered entities are left with unanswered questions and the fear that they will be penalized if their own interpretation differs from the ARB enforcement team interpretation.

For example, one view is that allowances can be transferred to the electricity seller immediately after the auction or exchange transaction. This would avoid a violation of the regulation because, while the allowance is passing through the holding account, it is not being “held” in the normal meaning of the term. If this is the intent of the regulation, then the ARB should update the regulation or issue a guidance document stating the amount of time allowed to transfer the allowances (e.g., five days or three business days) out of the holding account before it is considered a holding violation. In addition, ARB should provide guidance on the price to be reported for the transaction – “Not Applicable” or $0, so that there is clear understanding that this transaction is a transfer and not an independent sale.

Does the phrase “on behalf of another entity” mean that any contract to deliver allowances in the future requires an immediate purchase and transfer (at the point in the future) to be legal? SDG&E has contracts where the CPUC allows the seller to transfer the GHG obligation to SDG&E. Does the legal interpretation of “on behalf of another entity” exempt such contracts since counterparties don’t have a specific legal interest in allowances of the seller until they are transferred to them? This should be clarified in the regulation or the guidance document.

Going further, does the legal interpretation of “on behalf of another entity” allow for forward contracts where the seller agrees to delivery of allowances at some point in the future to the buyer? These types of transactions are common in the energy industry and help to provide liquidity to the market. The ARB should make it clear in its regulation or in a guidance document that forward contracts are allowed. If the ARB sees these as financial transactions, then they should exclude financial transactions from the prohibition in 95921. Or is the legal interpretation of the regulation that any allowances being held by the seller at the point of the contract are now being held “on behalf of another entity”? Both markets and compliance entities need clear direction on what is allowed under the regulation, either stated directly in the regulation or through a binding guidance document (i.e., “binding” meaning ARB enforcement division is not allowed to create a separate view of the language).

**RELATED HOLDING LIMIT VIOLATIONS**

Related to the elimination of beneficial holdings, Sections 95911(e)(3)(B) and 95913(g)(3)(A), which reject bids in the current auction or the price containment reserve auction that exceed the holding limits, should be eliminated or guidance should be provided to account for post-auction contractual transfers to third parties that are conditional on receiving allowances from the auction. 95912(j)(3) states,

Upon determining that the payment for allowances has been deposited into the Air Pollution Control Fund or transferred to entities that consigned allowances, transfer the serial numbers of the allowances purchased into each winning bidder’s Holding Account, **or to its Compliance Account if needed to comply with the holding limit**;

This portion of the regulation is at odds with rejecting bids that exceed the holding limit since 95912(j)(3) would only occur if the holding account limit is exceeded. The guidance document should indicate Sections 95911(e)(3)(B) and 95913(g)(3)(A) do not apply if the bidder indicates it will transfer allowances to its compliance account or to another entity per an existing contract if successful in the auction.

**DIRECT CORPORATE ASSOCIATIONS AND AFFILIATE TRANSACTION RULES**

It is unclear if ARB intended Section 95833(c) on affiliate rules to treat entities subject to state and federal affiliate transactions rules as separate entities or as a single entity with respect to purchase and holding limits. California affiliate transactions rules require entities such as SDG&E to act independently of its sister company, SoCalGas, and independently of Sempra Energy unregulated affiliates, Sempra Generation and Sempra International. The ISOR states the intent of section 95833 to be as follows:

Under the regulation, entities are required to disclose any corporate associations with other registered entities and unregistered entities that may control registered entities. This disclosure aids market monitoring. Staff also structured auction purchase limits and holding limits to apply to corporate associations as if they were single entities, since they are presumed to coordinate market activity. [Emphasis added]

While subsection (a) of 95833 Disclosure of Corporate Associations makes all four of Sempra’s affiliates have a “direct corporate association,” there are complete restrictions on information flow between SDG&E, SoCalGas, and the unregulated affiliates as far as procurement activities in gas and electricity markets required by the CPUC affiliate transaction rules that prevent any coordination. For this reason, SDG&E, SoCalGas and its unregulated utilities will be opting out of consolidation. However, there is still some confusion as to whether or not the limits will need to be shared amongst our direct corporate associations. For purposes of purchase limits and holding limits, section 95833(c) should be modified to make clear that if affiliate transaction rules require procurement entities to act independently and preclude disclosure of confidential market information, then they should be treated as independent entities for purposes of procurement limits and holding limits.

If ARB does not modify the regulation to make this clarification, then ARB should provide guidance that 95833(c) means entities with federal or state affiliate transactions rules requiring entities to act independently with regard to procurement should be treated as separate entities for purposes of the purchase and holding limits under the regulation.

**AUCTION ADVISOR**

Section 95912 (f) states that an entity cannot share its bidding information with any other entity unless the other entity has a direct corporate association or is an advisor as described in section 95914 (c), Non-disclosure of Bidding Information Among Auction Participants. The regulation specifically states,

 (1) Unless it is to an auction advisor or other members of a direct corporate association not subject to auction participation restriction or cancellation pursuant to section 95914(b), an entity approved for auction participation shall not release any confidential information related to its auction participation, including:

(A) Qualification status;

(B) Bidding strategy;

(C) Bid price or bid quantity information;

(D) Information on the bid guarantee it provided to the financial services administrator; and

(E) Other information identified as confidential information in the auction application by the auction administrator.

(2) If an entity participating in an auction has retained the services of an advisor regarding auction bidding strategy, then:

(A) The entity must ensure against the advisor transferring information to other auction participants or coordinating the bidding strategy among participants;

(B) The entity will inform the advisor of the prohibition of sharing information to other auction participants and ensure the advisor has read and acknowledged the prohibition under penalty of perjury; and

(C) Any entity that has retained the services of an advisor must inform ARB of the advisor’s retention.

The regulation or guidance document should make it clear that an advisor “retained” includes the Procurement Review Group required by the California Public Utilities Commission (CPUC) for oversight of electricity procurement. This advisory group is not covered by the affiliate transaction rules described in 95833 (c), but serves as a procurement advisor to the investor-owned utilities, compensated indirectly by the utility per CPUC Decision 07-11-024.

The guidance document should also allow for release of bidding information, subject to confidentiality requirements of section 95914(c), to the CPUC if requested as part of its oversight role. Such a disclosure would not violate the intent of the rule and may be required by the CPUC to fulfill its regulatory obligations under AB 57.

**PENALTIES FOR HOLDING ACCOUNT VIOLATIONS**

Section 95920(b)(6) should be modified to assess penalties only if an entity fails to cure the *perceived* holding account violation within five days. With the potential time lag for allowance transfers from bilateral transfers, exchange transfers or transfers to compliance accounts, it is not reasonable to assume that at any given time a holding account violation has in fact occurred. For example, a transfer request from an exchange to an electric utility may be made at the same time as a transfer request by the electric utility to another compliance entity or to its compliance account. At a given moment, the entity could be in a *perceived* holding account limit exceedence, but when all potential transactions are taken into account, there may not be an actual violation. These types of simultaneous transactions may be common for electric utilities with contractual obligations for the purchase of allowances for a generator and with small holding account limits relative to compliance obligations.

95920(b)(6) states, “Penalties may be applied whenever the holding limit is exceeded or transfer requests are filed with the accounts administrator that would violate the holding limit.” [Emphasis added]. The transactions would not be real violations per 95920(b)(3), “Compliance instruments transferred out of an exchange clearing holding account will count against the holding limit of the destination account listed in the transfer request submitted by an exchange clearing holding account at the time the transfer request is confirmed.” [Emphasis added]

If the regulation is not modified, then ARB should issue a binding guidance document that exempts from penalties all post-auction and post-transaction transfers to an entity’s compliance account or to a compliance entity for which it has a contractual obligation to buy compliance instruments.

**TRANSFER REQUEST DEADLINE**

The deadline for submitting a transfer request in section 95921 needs to be changed in order to not require business to be conducted on weekends or holidays. In sections 95921(a)(1)(E) and 95921(a)(3), the three days requirement should be modified to “three business days.” It is essential that mandated timelines for compliance instrument transfers refer to “business days” as opposed to “calendar days” to not limit secondary market trading to Monday through Thursday. Compliance instrument buyers may be reluctant to enter into spot transactions on Fridays because the transfers may require a confirmation during the weekend or risk ARB penalties.

Thank you for the opportunity to submit these comments.

Respectfully,

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1. Personnel information is protected by an employee’s right of privacy under the California Constitution, Article I, §1.  See:   Harding Lawson

Associates v. Superior Court (Bailey) (1992) 10 Cal.App.4th 7, 10; Valley Bank of Nevada v. Superior Court (Barkett) (1975) 15 Cal.3d 652, 655-656. [↑](#footnote-ref-1)