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Submitted via web:
http://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtrade2012&comm_period=A

Re: Comments on Amendments to the California Cap on Greenhouse Gas Emission and Market-Based Compliance Mechanism to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

Mr. Steve Cliff
Chief, Climate Change Market Development and Oversight Branch
California Air Resources Board
1101 I Street
Sacramento, CA 95814

Dear Mr. Cliff,

Chevron has been a California company for more than 130 years and is the largest Fortune 500 Corporation based in the State. Chevron has actively participated in stakeholder meetings, broad-based industry and environmental group meetings and discussions with the Air Resources Board (ARB) and its staff in order to develop a workable program that achieves the State's emission reduction goals while avoiding negative economic impacts at a time when the California is least able to absorb them.

Chevron provided comments on the draft amendments for linking California's and Quebec's Cap and Trade Programs. In spite of Chevron's significant interaction in this development process, it is very disappointing that the amendments to the market-based compliance mechanism remain largely unchanged from the March draft proposal. Chevron's comments to you today, on both the general amendments and the proposed linkage rulemaking, reflect our serious concern that the stakeholder process did not consider critical comments on these important rulemakings.

Chevron supports a well-designed cap-and-trade program that is linked to a broader market as a mechanism to achieve real emission reductions in a cost-effective manner. Only with this broad linkage can California avoid severely disadvantaging its economy and driving investment and jobs out of the state.

Concerns over Proposed Linkage

No Broad Support - A California-Quebec linked system does not achieve the basic goal of linkage - to develop a broader more cost-effective cap and trade market. The ARB's Initial Statement of Reasons (ISOR) states that this linkage is a first step, however, it is also the only step that California can make in the foreseeable future. Other WCI partners (U.S. states and Canadian provinces equally) have backed away from implementing cap-and-trade programs.

Entrenching Flawed Market Policies - Chevron is concerned that linking will be used by ARB or otherwise requires ARB to keep or even introduce market design flaws in California. Indeed, in this rulemaking, staff has explained that its amendment to the holding limits applicable to future vintage years results from "WCI discussions". This amounts to the prioritization of a future hypothetical market's interests over the current need to promote efficiency and liquidity in the California market. Chevron has already communicated its serious concerns that the current market design does not adequately mitigate the risk of market power and market abuse. Specifically, Chevron has introduced documents in the record describing how experiences in other markets demonstrate that frequent auctions are the best policy tool to address market power and that the current holding limit (without an exception for large compliance entities) will result in a liquidity crunch. Chevron is disappointed with the lack of attention to these materials and best interests of the California market. As the current leader in Cap-and-Trade development in the WCI, California should set the standard for sound market practices rather than accommodate the flawed market policies of other members.

Increasing Costs for California - At this stage, when realistically there are no other viable WCI partners to enable a broader, more liquid, efficient market, it is unreasonable to take on a partner that will increase the costs of the market to California. The economics study done by the Western Climate Initiative[1] (WCI) shows that the linkage and administrative design rules proposed in the regulation will have significant negative impacts on the California economy. The estimated impact will be an increase in allowance prices of $2.00 in 2013 rising to $4.00 in 2020. This is a significant increase which will increase the competitive disadvantages faced by California's business sector, electrical generators, and ultimately residents.

Unnecessary Complications - In addition to being premature, the proposed method of linking is needlessly complicated. A joint auction between jurisdictions is not a requirement for linkage and in this case will only serve to complicate and increase the potential costs of the California program. California could take a simpler approach by accepting the allowances from a larger and already mature climate change program - the European Union Emissions Trading System (EU ETS), which would represent a truly broad and efficient market. California could recognize the allowances of the EU without the lengthy, restrictive process required by a joint auction.

Administrative Burden on ARB Staff - Finally, the linking process has imposed a considerable administrative burden on ARB staff. We are concerned that this burden has resulted in a diversion of limited resources away from key priorities such as auction preparation and modeling, offset protocol development, accreditation of third-party offset registries and fixing program flaws identified by industry and other groups such as Legislative Analyst's Office. Indeed, we understand that, contrary to prior statements made to us by staff, ARB will not have an opportunity to run another rulemaking before the start of the program.

On balance, while Chevron remains steadfastly supportive of true linkage to broaden markets for cost-effective market efficiencies, it is premature to embark on a costly linkage until California's program design is completed and fully tested and additional partners or a cost-effective and efficient broader cap-and-trade market can be established.

Other Proposed Changes

In addition to adding costs to the California market through linkage to Quebec, the general rulemaking proposes to add new constricting requirements and further entrenches policies that create an imbalance between market oversight and market effectiveness. Although several helpful provisions were added by

[1] "Discussion Draft Economic Analysis Supporting the Cap-and-Trade Program - California and Québec," prepared by the WCI Economic Modeling Team, May 7, 2012, available at: http://www.westernclimateinitiative.org/document-archives/func-download/333/chk,a9a30ff2cb5ef182886ee94f64f8f085/no_html,1/.

the general amendments including increasing the account representatives and consolidating accounts, these changes are not adequate to overcome the excessive and intrusive restrictions on time limits for trading and Know Your Customer ("**KYC**") requirements.

Chevron continues to be concerned that unnecessary and unprecedented restrictions and requirements are being adopted solely in the name of linkage to Quebec. Additionally, concerns regarding market manipulation will lead to a fettered and unwieldy market adding increased costs due to illiquidity. A badly designed cap and trade market will only further disadvantage California companies and reduce incentives to invest in California, adding more burdens on California's fragile economy.

In conclusion, Chevron recommends that the ARB revisit the concept of linkage after they have developed a robust, flexible and responsive market. The enclosed comments in Attachment A further describe concerns that were not adequately addressed in the ISOR or in the proposed amendments.

Sincerely,

via e-mail

Stephen D. Burns

Enclosure

1. **Linkage with Quebec should not further entrench flawed market policies, such as holding limits. These policies punish larger entities that have invested in California and as a result have larger compliance obligations than the holding limits.**

   Not only are flawed market policies such as the holding limit problematic for the participants in both jurisdictions, these overly restrictive policies will lead to higher costs. Holding limits decrease liquidity by creating a barrier to entry for the voluntary market participants (e.g., market makers, investors) and restricting the availability of allowances on the market. Illiquid markets do not benefit the overall environmental goals of the program. High costs will chill other markets' interest in linking with California. Chevron also objects to the change to the holding limit in the new program amendments, which would effectively create separate holding limits for each vintage year, creating additional structural obstacles to the satisfaction of Chevron's compliance obligation.

   Because changes to the joint market will require changes to both Quebec and California policies, linkage to Quebec will result in unreasonable new hurdles to modify flawed market policies. We propose that simpler approaches using minimum criteria rather than a combined market are better for all. Linkage can be pursued using the minimum harmonization criteria necessary for all parties to have confidence that the reductions represent real reductions and that reductions will be made to the same level in each partner's market (i.e., the caps are equivalent).

   Simpler approaches to linkage and market administration would better serve the state and the goals of AB 32. It is preferable to develop this program in a way that helps create a well functioning market with reasonable administrative rules that is able to continually expand through additional linkages. This can be done without complex matching rules and without a coordinated auction by meeting only two criteria: 1. each system has a robust mechanism to ensure that a ton is a ton; 2. Accepting allowances and offsets from the other program (even with the inclusion of limitation on such use by individual emitters). We believe this best fulfills the promise of AB 32.

2. **Administrative requirements should not complicate compliance obligations.**

   A number of requirements have been changed with regard to the transfer process. Many of these changes are needlessly onerous.

   - **Confirmation of trades**: We agree that a time frame for confirmation of trades is necessary. Limits on time for confirmation should allow for reasonable internal review and occasional contingencies. A 24 hour period required to confirm a trade is not sufficient to assure that trades will proceed efficiently. We propose a period of 48 business hours to allow for unexpected absences and internal review.

   - **Push-push-pull**: Chevron recommends the importance of market monitoring and fraud prevention, but finds that requiring three separate representatives to sign off on a transfer could prove onerous to companies and could create barriers to liquidity – particularly in conjunction with other restrictions on trades.

   - **Transfer Request Deficiencies**: We support the inclusion of a grace period when holding limits are exceeded. However in order to provide business certainty and fair treatment for all, any grace period should include exemption of the compliance entity from the threat of fines and penalties.

   - **Know Your Customer ("KYC") requirements:** Chevron is sympathetic to the concept of KYC requirements, and recommends that they could be tailored in a number of ways to better promote market efficiency and respect personal confidentiality.

- KYC requirements should recognize the difference between a representative of a covered entity and a representative for a non-covered entity. Covered entities have the capacity to ensure the identity of their employees who are authorized to act on their behalf. Documentation requirements such as an open bank account in the US or Canada, address of permanent residence, and passport number should not be necessary for an authorized representative for a covered entity.

- In addition, KYC requirements for publicly traded companies are redundant and should be eliminated. SEC regulation of these companies effectively accomplishes the same objectives of KYC requirements. Thus, compliance with these requirements is unnecessary for these Companies, particularly since the California requirements are actually slightly more onerous than the EU ETS requirements.

- In any event, entities should be permitted to comply with KYC requirements through electronic submission and verification procedures. On the other hand, Chevron appreciates and supports ARB's efforts to introduce flexibility into the market administration process, such as the expanded account representative provisions.

3. Beneficial Holding should be allowed for companies with corporate associations. .

Chevron is concerned with changes to eliminate beneficial holdings and trading prohibition for covered entities to trade on each other's behalf. Not all covered entities will have the resources to create a trading desk and staff to follow the complicated rules that ARB has created for this market. Without a trading desk, these entities will be forced to use outside traders. We do not believe that it was the intention of ARB to force the use of traders if such companies absent the trading prohibition could otherwise provide services within their own organization and we request clarification on the language used. While it was drafted to address concerns held by the market monitor and public utilities, the current language could have the consequence of reducing market-making trading activities that would increase liquidity and otherwise improve the operation of the cap-and-trade system. Specifically, we believe that the prohibition should not apply to entities in disclosable corporate associations, since these disclosed relationships are transparent to the ARB and the market monitor.

We would also like ARB to clarify whether it would be possible for entities that are part of a corporate association to consolidate accounts upon request. ARB has identified several relevant policy considerations behind its consolidation provisions in its ISOR, all of which may apply to entities in a corporate association just as they would apply to an entity in a direct corporate association.

Consolidation is the default rule for direct corporate associations under the May 9th Proposal, but there are no provisions whatsoever for the consolidation of corporate associations. The regulations do not specifically exclude such a measure, but we believe there should be a more clear procedure for the voluntary consolidation of corporate associations into a single set of accounts, in order to address the policy considerations mentioned above.