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Clerk of the Board, ARB  
1001 I Street  
Sacramento, CA 95814

**RE: SECOND NOTICE. PUBLIC HEARING TO CONSIDER ADOPTION OF AMENDMENTS TO THE CALIFORNIA CAP ON GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE MECHANISMS TO ALLOW FOR THE USE OF COMPLIANCE INSTRUMENTS ISSUED BY LINKED JURISDICTIONS**

Dear Madame Clerk:

The Sempra Energy Utilities (SEu), San Diego Gas and Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) appreciates the opportunity to comment on the second proposed 15-day change to the cap-and-trade regulation to harmonize its regulations with Quebec to allow for linking its cap-and-trade program with Quebec's program in the near future and with other jurisdictions later. SEu supports linking for all the reasons stated in the ARB Staff's Initial Statement of Reasons, issued May 9, 2012, for the changes in the cap-and-trade program to allow for linking with other jurisdictions,. This step is important to achieve the vision of the Western Climate Initiative partners of broadening the cap-and-trade program to provide a successful market model.

However, SEu agrees with the Emissions Market Assessment Committee's (EMAC) recommendation: "To harness the greatest benefits from linking with other GHG C&T markets and still ensure the integrity and viability of California's market, linkage with Quebec should be considered once each market is found to be well-functioning."<sup>1</sup>

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<sup>1</sup> Elizabeth M. Bailey, Severin Borenstein, James Bushnell and Frank A. Wolak, Emissions Market Assessment Committee for AB 32 Compliance Mechanisms (EMAC), "Linkage with Quebec in California's Greenhouse Gas Emissions Cap-and-Trade Market," September 20, 2012, page 5.

## **DETERMINATION THAT THE CALIFORNIA MARKET IS FUNCTIONING PROPERLY**

The EMAC Committee succinctly described the conditions that should be present before linkage goes forward:

We believe that the decision to link with other GHG C&T markets should not be tied to a specific date, but instead to meeting certain market performance criteria in both the California market and the linking market, so that CARB can be confident that the linkage will have the desired effect on the total cost of compliance for each of the linking jurisdictions. Linking California's market with Quebec and other jurisdictions' GHG C&T markets has the potential to reduce the cost of compliance for each linked jurisdiction. For this reason, we believe that linking with well-functioning GHG C&T markets in other jurisdictions should be pursued once the California market can be deemed to be well-functioning.<sup>2</sup>

The EMAC correctly points out that actions to correct any market flaws are much more cumbersome for linked jurisdictions, "Multiple regulatory agencies overseeing the linked markets, with none of them having jurisdiction over the entire linked market, can give rise to circumstances when there is no entity able to take action to quickly respond to an unforeseen circumstance."<sup>3</sup> It would be prudent to make sure any flaws in the California market design are addressed before linking with Quebec.

The example metrics to determine the market is well-functioning as laid out by the EMAC include "GHG allowance prices that are tied to abatement costs, convergence in allowance prices (subject to transaction costs) across trading venues, evidence of allowance trading activity taking place, and price volatility reflective of changes in the cost of abatement, not market manipulation."<sup>4</sup> Analysis of these or other similar types of metrics would provide some evidence that there were no major flaws that needed to be addressed before linking. Based on analysis by EMAC and/or the market monitor, the Executive Director could then certify there was a well-functioning market and allow linking to move forward.

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<sup>2</sup> EMAC, page 2.

<sup>3</sup> EMAC, page 4.

<sup>4</sup> EMAC, footnote 4, page 2.

## Proposed Change:

### § 95943. Linked External GHG ETS

Covered or opt-in entities may use compliance instruments issued by the following programs to meet their compliance obligation under this article **once the Executive Director certifies the existing emissions trading system is functioning properly**:

(a) Government of Quebec.

### COMPATIBLE OFFSET RULES

ARB has harmonized compliance instruments with Quebec with one notable exception - Quebec and California have different rules for offset compliance. California assigns liability for invalid offsets on the buyer of the offset. If California invalidates an offset, the buyer must replace it with another valid compliance instrument (with the exception of the forestry protocol). On the other hand, Quebec has an environmental integrity pool into which each offset project contributes a small percentage. If Quebec invalidates an offset, the environmental integrity is maintained by retiring a valid offset from the environmental integrity pool.<sup>5</sup>

This difference is particularly problematic for California investor-owned electric utilities (IOUs) because of the decision by the California Public Utilities Commission, D.12-04-046, to prohibit IOUs from buying offsets where the buyer has liability for invalid offsets.<sup>6</sup> As a result, IOUs can buy Quebec offsets, but not California offsets (except forestry offsets where there is an integrity pool). It is unclear of the impact of this circumstance on the market, but it may cause unforeseen market impacts. California should further harmonize its offset program by adopting an optional Quebec integrity pool concept that can be approved for all adopted Compliance Offset Protocols. The integrity pool concept is consistent with the approach used in the regulation for the forestry protocol, so that only minor changes are required to allow for an optional integrity pool approach to offsets and put California on a more equal footing with Quebec from the perspective of offset risks.

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<sup>5</sup> EMAC, page 3.

<sup>6</sup> D.12-04-046, Ordering Paragraph 8 d., page 75.

## Proposed Changes:

### § 95802. Definitions.

(108) “~~Forest~~ **Offset** Buffer Account” means a holding account for ARB offset credits issued to ~~forest~~ offset projects. It is used as a general insurance mechanism against unintentional reversals, for all ~~forest~~ offset projects listed under a Compliance Offset Protocol.

(139) “Intentional Reversal” means any reversal caused by a ~~forest~~ **buffered offset** owner's negligence, gross negligence, or willful intent, ~~including harvesting, development, and harm to the area within the offset project boundary.~~

(277) “Unintentional Reversal” means any reversal, ~~including wildfires or disease~~ that is not the result of the ~~forest~~ **buffered offset** owner's negligence, gross negligence, or willful intent.

### § 95831. Account Types.

(b)(5) A holding account to be known as the ~~Forest~~ **Offset** Buffer Account:

- (A) Into which ARB will place ARB offset credits pursuant to section 95983(a); and
- (B) From which ARB may retire ARB offset credits pursuant to sections 95983(b)(2), (c)(3), and (c)(4) and place them into to the Retirement Holding Account.

### § 95983. ~~Forestry~~ **Buffered Offset Reversals.**

(a) ~~For forest sequestration projects, a~~ portion of ARB offset credits issued to ~~the forest~~ **buffered** offset project will be placed by ARB into the ~~Forest~~ **Offset** Buffer Account.

(1) The amount of ARB offset credits that must be placed in the ~~Forest~~ **Offset** Buffer Account shall be determined as set forth in ~~the buffered offset protocol. Compliance Offset Protocol U.S. Forest Projects, October 20, 2011.~~

(2) ARB offset credits will be transferred to the ~~Forest~~ **Offset** Buffer Account by ARB at the time of ARB offset credit registration pursuant to section 95982.

(3) If a buffered ~~forest~~ offset project is originally submitted through an Offset Project Registry an equal number of registry offset credits must be removed or cancelled by the Offset Project Registry, such that the registry offset credit is no longer available for transaction on the Offset Project Registry system, and issued by ARB for placement in the ~~Forest~~ **Offset** Buffer Account.

(b) Unintentional Reversals. If there has been an unintentional reversal, the Offset Project Operator or Authorized Project Designee must notify ARB and the Offset Project Registry, in writing, of the reversal and provide an explanation for the nature of the unintentional reversal within 30 calendar days of its discovery.

(1) In the case of an unintentional reversal the Offset Project Operator or Authorized Project Designee shall provide in writing to ARB and an Offset Project Registry, if

applicable, a verified estimate of current carbon stocks within the offset project boundary within one year of the discovery of the unintentional reversal.

(2) If ARB determines that there has been an unintentional reversal, and ARB offset credits have been issued to the offset project, ARB will retire a quantity of ARB offset credits in the amount of metric tons of CO<sub>2</sub>e reversed from the ~~Forest~~ **Offset** Buffer Account.

(c) Intentional Reversals. Requirements for intentional reversals are as follows:

(1) If an intentional reversal occurs, the Offset Project Operator or Authorized Project Designee shall, within 30 calendar days of the intentional reversal:

(A) Give notice, in writing, to ARB and the Offset Project Registry, if applicable, of the intentional reversal; and

(B) Provide a written description and explanation of the intentional reversal to ARB and the Offset Project Registry, if applicable.

(2) Within one year of the occurrence of an intentional reversal, the Offset Project Operator or Authorized Project Designee shall submit to ARB and the Offset Project Registry, if applicable, a verified estimate of current carbon stocks within the offset project boundary.

(3) If an intentional reversal occurs from a ~~forest~~ **buffered** offset project, and ARB offset credits have been issued to the offset project, the ~~forest~~ **buffered offset owner, offset project operator, or authorized project designee** must submit to ARB for placement in the Retirement Account a quantity of valid ARB offset credits or other approved compliance instruments pursuant to subarticle 4, in the amount of metric tons of CO<sub>2</sub>e reversed within six months of notification by ARB.

(A) Notification by ARB will occur after the verified estimate of carbon stocks has been submitted to ARB, or after one year has elapsed since the occurrence of the reversal if the Offset Project Operator or Authorized Project Designee fails to submit the verified estimate of carbon stocks.

(B) If the ~~forest~~ **buffered offset owner, offset project operator, or authorized project designee** does not submit valid ARB offset credits or other approved compliance instruments to ARB within six months of notification by ARB, ARB will retire a quantity of ARB offset credits in the amount of metric tons of CO<sub>2</sub>e reversed from the ~~Forest~~ **Offset** Buffer Account and the forest owner offset project operator, or authorized project designee will be subject to enforcement action and each ARB offset credit retired from the ~~Forest~~ **Offset** Buffer Account will constitute a separate violation pursuant to section 96014.

(4) In the event of an early ~~forest~~ **buffered** offset project termination ARB will retire from the ~~Forest~~ **Offset** Buffer Account a quantity of ARB offset credits in the amount calculated pursuant to project termination provisions in **the buffered offset protocol**. ~~Compliance Offset Protocol, U.S. Forest Projects, October 20, 2011.~~ This provision only applies to ARB offset credits that have been issued to the offset project.

(A) ARB will notify the ~~forest~~ **buffered offset owner, offset project operator, or authorized project designee** of retirement within 10 calendar days.

(B) The **buffered offset owner, offset project operator, or authorized project designee** must submit to ARB for placement in the Retirement Account a valid

ARB offset credit or another approved compliance instrument pursuant to subarticle 4 for each ARB offset credit retired by ARB from the ~~Forest~~ **Offset** Buffer Account within six months of ARB's retirement.

(C) If the ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** does not submit valid ARB offset credits or other approved compliance instruments to ARB within six months of ARB's retirement, they will be subject to enforcement action and each ARB offset credit retired from the ~~Forest~~ **Offset** Buffer Account will constitute a separate violation pursuant to section 96014.

(d) Disposition of **Buffered Offset** ~~Forest Sequestration~~ Projects After a Reversal. If a reversal lowers the ~~forest~~ offset project's actual ~~standing live~~ carbon stocks below its project baseline ~~standing live~~ carbon stocks, the ~~forest~~ **buffered** offset project will automatically be terminated by ARB or an Offset Project Registry.

(1) If the ~~forest~~ **buffered** offset project is terminated due to an unintentional reversal, ARB will retire from the ~~Forest~~ **Offset** Buffer Account a quantity of ARB offset credits equal to the total number of ARB offset credits issued pursuant to section 95981, and where applicable, all early action offset credits issued to the offset project pursuant to section 95990(i) over the preceding 100 years.

(2) If the ~~forest~~ **buffered** offset project is terminated due to an unintentional reversal, another offset project may be initiated and submitted to ARB or an Offset Project Registry for listing within the same offset project boundary.

(3) If the ~~forest~~ **buffered** offset project has experienced an unintentional reversal and its actual ~~standing live~~ carbon stocks are still above the approved baseline levels, it may continue without termination as long as the unintentional reversal has been compensated by the ~~Forest~~ **Offset** Buffer Account. The Offset Project Operator or Authorized Project Designee must continue contributing to the ~~Forest~~ **Offset** Buffer Account in future years as quantified in section 95983(a)(1).

(4) If the ~~forest~~ **buffered** offset project is terminated due to any reason except an unintentional reversal, new offset projects may not be initiated within the same offset project boundary, unless otherwise specified in a Compliance Offset Protocol.

#### **§ 95984. Ownership and Transferability of ARB Offset Credits.**

(a) Initial ownership of an ARB offset credit will be with the registered Offset Project Operator, Authorized Project Designee, or another third party as provided in section 95974(a)(1), unless otherwise required by section 95983. An ARB offset credit may be sold, traded, or transferred, unless:

(1) It has been retired, surrendered for compliance, or used to meet any GHG mitigation requirements in any voluntary or regulatory program;

(2) It resides in the ~~Forest~~ **Offset** Buffer Account pursuant to section 95983; or

(3) It has been invalidated pursuant to section 95985.

#### **§ 95985. Invalidation of ARB Offset Credits.**

c (4) The following shall not be grounds for invalidation:

(A) An update to a Compliance Offset Protocol will not result in an invalidation of ARB offset credits issued under a previous version of the Compliance Offset Protocol; or

(B) A reversal that occurs under a ~~forest~~ **buffered** offset project. If such a reversal occurs the provisions in section 95983 apply.

**(i) Requirements for Replacement of ARB Offset Credits for Forest Offset Projects.**

(1) If an ARB offset credit in the Retirement Account from a ~~forest~~ **buffered** offset project is determined to be invalid pursuant to section 95985(f) for only the circumstance listed in section 95985(c)(1):

(A) The ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** identified in section 95985(e)(3) must replace ARB offset credits in the amount calculated according to the following equation, rounded to the nearest whole ton:

$$RF_{ARBOC} = (TF_{Retired}/IF_{ARBOC}) \times OF_R$$

Where:

“ $RF_{ARBOC}$ ” is the total number of retired ARB offset credits for the applicable ~~forest~~ **buffered** offset project’s Offset Project Data Report, rounded to the nearest whole ton, that must be replaced by the ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee**;

“ $TF_{Retired}$ ” is the total number of ARB offset credits issued for the applicable ~~forest~~ **buffered** offset project’s Offset Project Data Report for which ARB transferred any ARB offset credits from into the Retirement Account;

“ $IF_{ARBOC}$ ” is the number of ARB offset credits issued under the applicable Offset Project Data Report for the ~~forest~~ **buffered** offset project pursuant to section 95981.1 or 95990(i);

“ $OF_R$ ” is the amount of overstated GHG reductions and GHG removal enhancements calculated pursuant to section 95985(c)(1) for the ~~forest~~ **buffered** offset project for the applicable Offset Project Data Report.

(B) The ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** identified in section 95985(e)(3) must replace ARB offset credits in the amount calculated pursuant to section 95985(i)(1)(A) with valid ARB offset credits or other approved compliance instruments pursuant to subarticle 4, within six months of notification by ARB pursuant to section 95985(g)(2).

(C) If the ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** identified in section 95985(e)(3) does not replace each invalid ARB offset credit in the amount calculated pursuant to section 95985(i)(1)(A) within six months of notice of invalidation pursuant to section 95985(g)(2), each unreplaced invalidated ARB offset credit will constitute a violation for that Forest Owner pursuant to section 96014.

(D) ARB will determine the lowest serial numbers assigned to ARB offset credits issued under the applicable Offset Project Data Report in the amount calculated pursuant to section 95985(i)(1)(A) and invalidate those serial numbers.

(E) The ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** identified pursuant to section 95985(e)(3) will be notified of which serial numbers were invalidated.

(F) Any approved program for linkage pursuant to subarticle 12 will be notified of which serial numbers were invalidated.

(2) If an ARB offset credit in the Retirement Account from a ~~forest~~ **buffered** offset project is determined to be invalid pursuant to section 95985(f) for any circumstance listed in sections 95985(c)(2) and (c)(3):

(A) The ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** must replace each ARB offset credit transferred by ARB into the Retirement Account for the applicable Offset Project Data Report with a valid ARB offset credit or another approved compliance instrument pursuant to subarticle 4, within six months of notification by ARB pursuant to section 95985(g)(2).

(B) If the ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** does not replace each invalid ARB offset credit within six months of the notice of invalidation pursuant to section 95985(g)(2), each unreplaced invalidated ARB offset credit will constitute a violation for that ~~forest~~ **buffered offset** owner, **offset project operator, or authorized project designee** pursuant to section 96014.

(C) The parties identified pursuant to section 95985(e) will be notified of which serial numbers were invalidated.

## **AUCTION RESERVE PRICE**

The 15-day proposed changes to Section 95911 should be modified to 1) eliminate the reference to a Quebec-specific price index; and 2) keep the auction reserve prices separated across linked jurisdictions. The cleanest way to incorporate these modifications is to delete sections 95911(c)(3)(D) and 95911(c)(3)(E) in their entirety.

Proposed section 95911(c)(3)(D) should be deleted. This section implements a Quebec-specific measure of inflation. Unlike the rest of the proposed changes to the cap-and-trade regulation to implement linkage, here there is a specific reference to Quebec's measure of inflation – the Quebec consumer price index excluding tobacco and alcohol. It is inappropriate to insert a linked jurisdiction's price index in California's regulation. It will also be a future problem if other Canadian jurisdictions link with California. It is doubtful they will want to use a



Quebec-specific inflation measure instead of a national Canadian price index or their specific region's price index.

Sections 95911(c)(3)(D) and 95911(c)(3)(E) should be deleted to eliminate a calculation of a single auction reserve price. As written, Quebec's auction reserve price becomes part of California's regulation if it is higher than California's reserve price measured in a common currency. First, this approach will become unwieldy as more jurisdictions are added if they all have different auction reserve prices. Each jurisdiction's auction reserve price and escalator would have to be inserted into California's regulation. More importantly, the approach of taking the higher of the two auction reserve prices in this section potentially puts California compliance entities at the mercy of other jurisdictions' reserve prices. While Quebec's reserve price is similar, it is not necessarily the case that other jurisdictions will have a reserve price as close to California's auction reserve price. California entities may be required to pay more than the reserve price specified in the California regulation if the auction reserve price is set by another jurisdiction through section 95911(c)(3)(E). Third, if Quebec or another jurisdiction allocates most or all allowances to regulated entities and puts a very small amount into the auction, its auction reserve price should not be given equal weight with the California auction reserve price in setting a single combined auction reserve price.

Instead of taking the higher of the two prices, the auction reserve prices should remain separate for each jurisdiction. Entities in each jurisdiction would not be allowed to bid below their respective jurisdiction's reserve price. If the market-clearing price in a combined auction were to fall below a jurisdiction's reserve price, all entities in the jurisdiction would receive all allowances demanded at the jurisdiction's reserve price. All other compliance entities would receive allowances at the market clearing price. All allowances supplied by the jurisdiction would receive funds based on the jurisdiction's reserve price. If the demand by entities in the jurisdiction exceeded the supply at the jurisdiction's reserve price, excess funds generated would go to the jurisdiction. Such an approach would allow funds returned to each jurisdiction as if they had implemented their individual auction reserve prices and will protect California compliance entities if a future linked jurisdiction has an auction reserve price significantly higher than California and Quebec.

**Proposed Changes:**

**§ 95911. Format for Auction of California GHG Allowances.**

~~(c)(3)(D) The Auction Reserve Price in Canadian dollars shall be the Canadian dollar Auction Reserve Price for the previous calendar year increased annually by 5 percent plus adjusted in the manner provided for in section 83.3 of the Financial Administration Act (R.S.Q., c. A-6.001) of Quebec.~~

~~(c)(3)(E) The auction administrator will use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated separately in U.S. and Canadian dollars. The auction administrator will set the Auction Reserve Price equal to the higher of the two values.~~

Thank you for the opportunity to comment.

Sincerely,

*Tamara Rasberry /s/*