BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON CAP AND TRADE WORKSHOP ON JUNE 25, 2013

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I. INTRODUCTION AND SUMMARY.

The Southern California Public Power Authority ("SCPPA") [1] respectfully submits this comment on the issues discussed at the two Cap and Trade workshops held by the California Air Resources Board ("ARB") on June 25, 2013: the morning workshop on compliance and information requirements and the afternoon workshop on cost containment.

In summary, SCPPA considers that:

- The emissions report verification deadline should not be moved to August 15. This imposes difficulties on all covered entities. Rather, the Allowance Price Containment Reserve ("Reserve") sale should be moved to a later date.
- Individual compliance account balances should not be published. Doing so would, as the ARB previously recognized, increase the vulnerability of each covered entity and the market as a whole to manipulation. Providing a compliance account balance aggregated across all covered entities will give sufficient information.
- The ARB's cost containment options to increase the availability of allowances at the highest price tier of the Reserve and obtain compensating emission reductions outside of California, as well as from uncovered sectors within California, would be effective in ensuring costs are contained with environmental integrity. In addition, a suite of complementary cost containment measures should be adopted to avoid, delay or reduce the need to procure additional allowances from the Reserve.

[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.

- Entities should not be required to retire renewable energy certificates ("RECs") for specified source imports and the RPS Adjustment. Rather, double counting should be addressed by means of a database of REC serial numbers. However, if the ARB requires RECs to be retired, entities should at least have flexibility as to when they retire their RECs. Guidance as to the rules that apply to REC retirement should be provided, and a drafting error in the RPS Adjustment provision should be corrected.
- It is unclear why the ARB wishes to gather more detailed data on compliance instrument transactions. The ARB should release information on the purpose for gathering such data, and how (if at all) the ARB intends to publish such data. This data should be published only in aggregate due to its confidentiality.
- The Qualified Exports Adjustment should be calculated using the default emission factor rather than the lowest emission factor in the hour, as the lowest emission factor will often be zero.
- An entity's excess surrendered offsets should be counted towards its next surrender obligation and the next period's offset limit, rather than being excluded and rendered worthless. If offsets run the risk of becoming worthless, offset use is likely to decrease and the costs of the cap and trade program as a whole would increase.

These issues are discussed in more detail below.

II. THE VERIFICATION DEADLINE SHOULD NOT BE CHANGED.

Slides 19-20 of the compliance and information workshop presentation ("C&I Presentation") proposed moving the emissions report verification deadline from September 1 to August 15 each year, to allow time for natural gas suppliers to be informed of their emissions liability before the September Reserve sale.

The verification deadline should not be moved. This imposes difficulties on all covered entities.

Verification is a detailed and time-consuming process which would be difficult to compress into a smaller timeframe. After initial investigations and site visits have been made, there is a period of dialog between the verifier and the covered entity to address any questions the verifier may have. Shortening the time for verification would make it more difficult for the verifier to complete a thorough verification and for the covered entity to respond to any questions.

As we will discuss in our comments on the 6/26/13 Mandatory Reporting workshop, moving the reporting deadline two weeks earlier (so as to allow the same length of time for verification) would impose a host of additional difficulties.

Rather than moving the verification deadline earlier, the Reserve sale could be moved later to accommodate the participation of natural gas suppliers. SCPPA understands that this may pose administrative difficulties, but it may be easier for the ARB to overcome these difficulties than for all covered entities to compress their verification schedules. There may be overlap with the preparations for the next allowance auction, but this does not seem to be an insurmountable problem. Participants can distinguish between events and deadlines relating to the Reserve sale and those relating to the auction.

III. INDIVIDUAL COMPLIANCE ACCOUNT BALANCES SHOULD NOT BE PUBLISHED.

Slides 30-31 of the C&I Presentation[2] proposed publishing compliance account balances quarterly, either individually or aggregated by sector.

[2] The slide numbering of the version of the presentation available on the ARB website (http://www.arb.ca.gov/cc/capandtrade/meetings/062513/arb-cr-mrr-present.pdf) is used in this comment; the slide numbering of the version presented at the workshop differed after slide 20.

Individual compliance account balances should not be published. Doing so would increase the vulnerability of each covered entity to manipulation. Providing a compliance account balance aggregated across all covered entities will give sufficient information to the market.

A. Regulatory language on releasing compliance account balances is in context of protecting confidential information.

The relevant provision of the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms regulation ("Regulation") is section 95921(e)(4):

> Protection of Confidential Information. The Executive Officer will protect confidential information to the extent permitted by law by ensuring that the accounts administrator: ...
>
> (4) Releases information on the quantity and serial numbers of compliance instruments contained in compliance accounts in a timely manner.

Subsection (e)(4) must be interpreted in the context of section (e) as a whole, which deals with the protection of confidential information. Reading subsection (e)(4) in this way, the subsection means that information on compliance account balances should only be released if it is done in a manner that "protect[s] confidential information to the extent permitted by law." That is, rather than being a requirement to release information, subsection (e)(4) is a limitation on how such information can be released. This interpretation is supported by statements in the Final Statement of Reasons for the Regulation, released in October 2011 ("FSOR") – see below.

The wording of section 95921(e)(4) does not require individual account balances to be released. To the contrary, releasing such information would violate section 95921(e) as it would constitute the release of confidential information. The provision would however be satisfied, in its context of protecting confidentiality, if compliance account balances were reported in the aggregate.

B. The importance of protecting confidential information is recognized in the Final Statement of Reasons.

The FSOR provides additional context for this provision. The FSOR states in relation to section 95921(e) (previously section 95921(d)) that:

- "New section 95921(d) was added to provide provisions on the *protection of confidential market information*."[3]
- "What data will be released and when is a question of implementation. ARB appreciates the complexity of protecting confidential business information and its relationship to the integrity of the allowance market."[4]
- "New section 95921(d) (Protection of Confidential Information) was added to address many stakeholders concerns regarding the confidentiality of information reported on the transfer request. At the same time, section 95921(d)(1) was added to ensure that information needed by the market would be released, with the added protections of the restrictions imposed in the rest of the section. *Regular release of holdings of individual firms may reveal commercially sensitive information on trade strategies that could increase the vulnerability of a participant or the market as a whole to manipulation*."[5]

C. Frequently publishing individual compliance account balances would be detrimental.

Slide 31 of the C&I Presentation asks: "Does revealing an individual compliance account balance expose a covered entity to manipulation?" The answer is yes. If, as proposed, the compliance account balance of each covered entity were published quarterly, covered entities would face exactly the issues noted in the FSOR (excerpted above) – the increased vulnerability of each entity and the market as a whole to manipulation.

For many covered entities, publication of current compliance account balances will provide a good indication of the entity's total holdings, short or long position, and compliance

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[3] FSOR page 30. Emphasis added.

[4] FSOR page 1636.

[5] FSOR page 1658. Emphasis added.

strategy, leaving it open to manipulation. This is particularly the case for (a) high-emitting covered entities (such as the large investor-owned utilities) that can be expected to hold allowances up to the holding limit in their holding accounts; and (b) entities that do not wish to or are not permitted to engage in complex secondary market transactions such as options or other derivatives.

If individual compliance account balances are published, an entity in category (a) would be vulnerable to manipulation as its total holdings could be accurately estimated by adding the holding limit to its compliance account balance. This figure could then be compared to its compliance obligation (also proposed to be published – slide 25) to determine whether the entity is long or short.

In relation to category (b), the California Public Utilities Commission has imposed strict limits on how investor-owned utilities are able to procure compliance instruments and how many they can procure, with a ban on options, swaps or other derivatives of allowances.[6] The governing boards of publicly-owned utilities may impose similar restrictions for risk-management purposes, at least initially. Entities should not be forced to enter into complex financial transactions simply to prevent their allowance holdings being known.

Entities that fall into both category (a) and category (b) are at particular risk. As entities that fall into one or both categories currently make up a relatively significant share of the carbon market, if these entities become exposed to manipulation, the market as a whole is likely to suffer.

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[6] CPUC Decision 12-04-046 (approved on April 19, 2012) in Rulemaking 10-05-006.

D. Publishing an aggregated compliance account balance would provide the necessary information.

At the workshop, one reason given for publishing individual compliance account balances was to inform the market of increased allowance procurement by some entities, so that other market participants would not be taken by surprise and could take protective or counteracting steps. Slide 31 of the C&I Presentation asks "Does revealing this [individual compliance account] information prevent manipulation by someone tightening the market?"

SCPPA agrees that a certain amount of information is useful to the market as an indication of liquidity. However, it is not clear why individual compliance account balances would be more useful to the market in this respect than compliance account balances aggregated across all covered entities. The key piece of information that is useful to market participants is whether the market as a whole is long or short, which can be deduced if an aggregate balance is published, not whether a particular individual is accumulating a large or small number of compliance instruments. If an entity accumulated a worrying number of compliance instruments in its compliance account (which would be difficult in any case, given the purchase and holding limits), it is unclear what other market participants could do in response. Compared to publishing an aggregate balance, the only additional purpose that publishing individual balances would serve is to make it easier for unscrupulous market participants to take advantage of individual covered entities in a short position (as discussed above).

Publishing an aggregate balance would provide useful information on market liquidity, i.e. the number of compliance instruments in circulation compared to those sequestered in compliance accounts, without increasing the vulnerability of individual covered entities.

Detailed information regarding individual holdings would remain available to the ARB, which, as the key regulator of this market, could take steps to address any issues it identifies.

E. The compliance account balance should be aggregated across all covered entities, not sectorally.

For the reasons discussed above, there is no requirement to report compliance account balances on an individual basis. To do so would be detrimental to covered entities and the market as a whole as it would increase the potential for manipulation, as well as being in violation of the confidentiality requirements of section 95921(e) of the Regulation.

Instead, the ARB should comply with the confidentiality provisions of section 95921(e) by publishing a compliance account balance that is aggregated across all covered entities.

The proposal to report compliance account balances aggregated by sector, while certainly preferable to publishing individual balances, is less desirable than publishing a balance aggregated across all covered entities. It is unclear what value the market would obtain from knowing whether a particular sector was accumulating more or fewer compliance instruments, as long as the overall balance is known. Furthermore, some sectors, such as the natural gas sector, are comprised of only a few large entities and some small entities, so changes in the balances of such sectors could be attributed quite accurately to particular entities. This would increase their vulnerability to manipulation as discussed above.

F. The Regulation should be revised to clarify the disclosure requirements.

SCPPA concludes that publishing an aggregated balance, as outlined above, would comply with the wording of section 95921(e)(4) of the Regulation as it currently stands, because that section does not refer to publication of individual balances. However, as changes to the Regulation are currently being considered, it would be helpful to take this opportunity to explicitly limit the release of individual information in section 95921(e)(4) as set out below. In addition, all references to serial numbers should be deleted as serial numbers will not be published.

Protection of Confidential Information. The Executive Officer will protect confidential information to the extent permitted by law by ensuring that the accounts administrator: ...

(4) Releases information only on the aggregate quantity ~~and serial numbers~~ of compliance instruments contained in all compliance accounts in a timely manner.

IV. A SUITE OF MEASURES SHOULD BE ADOPTED FOR COST CONTAINMENT.

A. A range of possible measures are set out in the ARB cost containment paper.

ARB Resolution 12-51 ("Resolution") directs ARB staff to recommend cost containment mechanisms that "will achieve the policy objective of ensuring that the allowance prices will not exceed the highest price tier of the Allowance Price Containment Reserve ...".[7] As studies show the risk of prices exceeding this level is between 3% and 22%, depending on the scenario modeled,[8] SCPPA considers that it is very important to fulfill this Resolution.

The ARB paper "Policy Options for Cost Containment in Response to Board Resolution 12-51" dated June 25, 2013 ("ARB Paper")[9] outlines the following five options for meeting this objective:

- 3.1 Increase the availability of allowances at the highest price tier of the Reserve;
- 3.2 Allow fulfillment of compliance obligation through fixed price-per-ton payment at the highest price tier of the Reserve;
- 3.3 Delay compliance obligation;
- 3.4 Cancel compliance obligation;

[7] California Cap-and-Trade Program Resolution 12-51, adopted October 18, 2012, available at: http://www.arb.ca.gov/cc/capandtrade/final-resolution-october-2012.pdf.

[8] The results are summarized on slide 3 of the workshop presentation by James Bushnell for the Emissions Market Assessment Committee, available at: http://www.arb.ca.gov/cc/capandtrade/meetings/062513/jim-bushnell-presentation.pdf.

[9] Available at http://www.arb.ca.gov/cc/capandtrade/meetings/062513/arb-cost-containment-paper.pdf.

- 3.5 Maintain existing cost containment features.

The Resolution directs ARB staff to propose measures that contain costs "while minimizing the impact on existing allowances and maintaining the environmental objectives of the program." Section 4 of the ARB Paper sets out four ways in which this could be done:

- 4.1 Redistribute allowances within the 2013-2020 period;
- 4.2 Commit to additional emission reductions post-2020;
- 4.3 Mandate additional emission reductions from California sources;
- 4.4 Obtain emission reductions outside of California.

B. Option 3.1 is the only feasible way to ensure the Board's Resolution is fulfilled.

Option 3.1 in the ARB Paper, "Increase the availability of allowances at the highest price tier of the Reserve", is similar to Measure C in the Joint Utilities cost containment paper presented at the afternoon workshop: an unlimited number of additional allowances will be sold through the Reserve at the highest price tier. This appears to be the only feasible option presented to date that will ensure that allowance prices will not exceed the highest price tier of the Reserve.

Option 3.2 ("Allow fulfillment of compliance obligation through fixed price-per-ton payment at the highest price tier of the Reserve") is not, in effect, significantly different from option 3.1, and it too would ensure the Resolution is met. However, as the ARB Paper notes, it is doubtful that the ARB would have authority to implement this option, and it is considered infeasible.[10]

Option 3.3 ("Delay compliance obligation") may assist if short-term price spikes occur, but it would not, alone, ensure that prices never rise above the highest Reserve price. If the

[10] ARB Paper page 10.

market perceives a severe ongoing supply/demand imbalance, prices may remain high even if a delay is implemented, as covered entities would still need to surrender the same number of compliance instruments. Furthermore, this option could lead to undesirable uncertainty in the market.

Option 3.4 ("Cancel compliance obligation") seems problematic because, as the ARB Paper notes, it would be difficult to correctly calibrate the cancellation to restore supply/demand balance. It is also likely to require a large compensating emission reduction (discussed below), which may be difficult and/or politically undesirable to obtain, particularly given that Option 3.4 would not give rise to any revenue that could be used to procure such emission reductions. This option may also destabilize the market.

Option 3.5 ("Maintain existing cost containment features") would not meet the Resolution, as existing cost containment features will not ensure prices never rise above the highest Reserve price. There is a mention of reconsidering additional mechanisms in the future.[11] However, this would contravene two important principles noted in the ARB Paper: to be effective, the cost containment mechanism "must be known in its entirety and automatic in its execution (i.e., not subject to the discretion of future decision makers)."[12] SCPPA considers that it is crucial to adhere to these principles.

For these reasons, Option 3.1 should be adopted. An unlimited number of allowances should be made available in the highest price tier of the Reserve. The usual Reserve rules would apply, with sales to covered entities only and allowances placed directly in compliance accounts. There does not appear to be any reason to restrict availability of these additional allowances to the final Reserve sale each year; rather, they should be available at each Reserve sale. Covered

[11] ARB Paper page 11.

[12] ARB Paper page 6.

entities will only purchase allowances at the highest price tier of the Reserve when no other cheaper compliance instruments are available. Knowledge that such allowances will be available at each Reserve sale, not just the September sale, will help prevent prices being driven to extremes in the 12 months between each September Reserve sale. The holding limit should apply to these allowances as there does not appear to be any rationale for different rules to apply.

C. Environmental integrity can be maintained under Options 4.3 and 4.4.

If additional allowances are issued pursuant to Option 3.1, additional emission reductions must be achieved to maintain the environmental integrity of the cap and trade program as a whole. There are many ways in which this may potentially be done, but each option has some drawbacks.

Option 4.1 from the ARB Paper ("Redistribute allowances within the 2013-2020 period"), essentially a form of borrowing, is in fact a cost containment option rather than a way to provide compensating emission reductions. As a cost containment option, it may be helpful for short-term price spikes but would not, on its own, ensure the Resolution is met. It does not provide emission reductions in addition to those already mandated by the current emission cap, so it could not be a partner for Option 3.1.

Option 4.2 ("Commit to additional emission reductions post-2020") appears to be infeasible until the details of a post-2020 program are determined, which is unlikely to occur until closer to 2020. The interaction of the current program and a post-2020 program requires careful thought and cannot be properly addressed in this year's amendments to the Regulation.

Option 4.3 ("Mandate additional emission reductions from California sources") is an option that should be considered. This option is likely to be the most consistent with the current legislative directions as to the use of the State's cap and trade revenue,[13] including revenue from the sale of additional Reserve allowances.[14] It may provide a useful part of the solution. However, given the broad scope of the Regulation, it may be difficult to obtain a large number of cost-effective emission reductions from uncovered sectors in California, so additional sources of emission reductions should be considered.

Option 4.4 ("Obtain emission reductions outside of California") seems to be the best option for obtaining the additional emission reductions required to balance Option 3.1. Large pools of reputable international offsets[15] are currently available at comparatively low prices. There will no doubt be changes in the prices and availability of some of these instruments over the period to 2020. However, given the increasing number of cap and trade programs with offset components around the world,[16] SCPPA expects that there will be sufficient instruments available for purchase whenever they are needed, at prices lower than the top Reserve price. As Brian Murray of the Nicholas Institute noted at the workshop, any well-founded concerns regarding the stringency and integrity of other offset programs could be addressed by setting a multiplier, for example one California allowance equals 1.5 offsets from the other program.

Although the ARB does not have control over revenues from the sale of allowances from the Reserve, the ARB does provide input into the investment plan for those funds,[17] and could

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[13] See e.g. Assembly Bill 1532 (2012).

[14] Payments for Reserve allowances will be deposited into the Air Pollution Control Fund pursuant to Regulation section 95913(h)(3).

[15] Certified Emission Reductions ("CERs") under the Kyoto Protocol's Clean Development Mechanism are one example. As per the European Union emissions trading system, the ARB could choose to procure only CERs from certain protocols, or certain countries, to set a higher standard of additionality.

[16] In addition to the EU, Japan and New Zealand have cap and trade programs with offset components, and programs in Australia and the Republic of Korea are planned to commence in 2015. Large new regional cap and trade systems are currently being established in China. Mexico, Chile, Brazil and Turkey are also considering cap and trade. See "Mapping Carbon Pricing Initiatives 2013: Developments and Prospects", available at: http://www.ecofys.com/files/files/world-bank-ecofys-2013-mapping-carbon-pricing-initiatives.pdf.

[17] See Assembly Bill 1532 (2012).

recommend that funds from the sale of additional Reserve allowances be set aside to procure compensating emission reductions in the form of offsets from other programs. If the ARB does not wish to procure those instruments itself, an independent contractor could be engaged to do so, operating under detailed and transparent rules imposed by the ARB.

D. Additional measures should be taken to reduce the likelihood of resorting to Options 3.1, 4.3 and 4.4.

In addition to adopting Option 3.1 together with Options 4.3 and 4.4 as the only feasible ways to ensure the Resolution is met, the ARB should consider further cost containment mechanisms to help avoid, delay or reduce the need to obtain compensating emission reductions (the more difficult part of the cost containment equation). These measures fall into two categories, both of which are important:

1) Measures that would take effect now and gradually over time reduce the likelihood of prices rising above the Reserve in the future by reducing demand for compliance instruments, increasing the supply of compliance instruments, and ensuring that compliance instruments are accessible in the marketplace.

2) Measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time, to address short-term price spikes. An example trigger is a percentage level of depletion of the Reserve.

For the first category of cost containment measures, the proposals by the Joint Utilities in the paper presented at the workshop include:

- Approve more offset protocols to increase the supply of offsets.
- Exempt offsets from projects within California from the 8% offset limit.

- Allow each covered entity to carry over any unused portion of its 8% offset limit, to use for future compliance.
- Address constraints imposed by the current holding limit.

For the second category of cost containment measures, Option 4.1 in the ARB Paper ("Redistribute allowances within the 2013-2020 period") could be helpful. Additional measures proposed by the Joint Utilities include:

- Unused offset proposal: The ARB would track the number of offsets used for compliance (cumulatively) compared to the number of offsets that would have been used if every covered entity exhausted its 8% limit. The difference between the two numbers would be the "8% offset shortfall." Each covered entity would be given the option to register (e.g. through the Compliance Instrument Tracking System Service ("CITSS")) to receive a proportional share of the 8% offset shortfall if the trigger is reached. The registration process ensures that only the entities that are interested in procuring additional offsets are given the ability to do so (entities that do not register remain able to use up to the 8% limit). When the trigger is reached, the ARB will distribute rights to use additional offsets, up to the 8% offset shortfall in total, among the registered entities. The new offset limits for those entities will be calculated to ensure that, if all registered entities surrender offsets up to the new higher level, the 8% offset shortfall will be used up but not exceeded. If the 8% offset shortfall is not used up in that compliance period, a new offset level will be calculated for the registered entities for the next compliance period. (Note: The distribution mechanism is revised from the Joint Utilities proposal.)
- Compliance account proposal: When the trigger is reached, allow covered entities the flexibility to transfer surplus allowances from their compliance account to their limited

use holding account. This allows entities that have built up a bank of allowances in excess of their compliance needs to re-inject those allowances into the market.

- <u>Limited borrowing proposal</u>: When the trigger is reached, allow covered entities to surrender for compliance allowances with vintages of the current year and the following year (not applicable post-2020).
- <u>Offset geographic scope proposal</u>: When the trigger is reached, increase the number of compliance-grade offsets by expanding the geographic scope of the approved offset protocols to North America.
- <u>Offset project start date proposal</u>: When the trigger is reached, increase the number of compliance-grade offsets by changing the Offset Project Commencement date in sections 95973(a)(2)(B) and (c) of the Regulation to an earlier date.

SCPPA recommends that several (or all) measures from each of category one and category two be adopted to complement the key cost containment mechanisms.

V. ENTITIES SHOULD HAVE FLEXIBILITY AS TO WHEN THEY RETIRE RECS.

Although not discussed at the workshop, issues relating to REC retirement for specified source imports and the RPS Adjustment are important when determining electric sector entity liability and compliance requirements (in addition to potential impacts on compliance with the RPS program). Therefore, these issues are addressed below.

A. The cap and trade program should not require RECs to be retired.

SCPPA's preferred solution continues to be that the ARB should not require RECs to be retired under its cap and trade program. REC retirement is a crucial part of the Renewable Portfolio Standard ("RPS") program administered by the California Energy Commission. To avoid interfering with that program and making it more difficult for utilities to meet its challenging goals, no other agencies should require RECs to be retired.

The ARB's concern regarding the potential for double-counting of RECs under the cap and trade program could be addressed by establishing a database of the REC serial numbers that utilities report under section 95111(g)(1)(M) of the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions ("MRR"). Any REC with a serial number that has already been reported would be rejected and could not be counted towards the RPS Adjustment or specified source imports.

Implementing this solution would require minimal changes to the Regulation. Proposed changes to section 95852(b)(3)(D) on specified source imports and section 95852(b)(4)(B) on the RPS Adjustment are set out below:

> (3)(D) If RECs were created for the electricity generated and reported pursuant to MRR, then the RECs must be reported ~~retired and verified~~ pursuant to MRR section 95111(g)(1)(M).
>
> (4)(B) The RECs associated with the electricity claimed for the RPS adjustment must be ~~used to comply with the California RPS requirements during the same year in which the RPS adjustment is claimed~~reported pursuant to MRR section 95111(g)(1)(M).

If this solution cannot be adopted, at a minimum the ARB should ensure that its timing requirements for REC surrender are no stricter than the three-year period allowed by the RPS law, Senate Bill X1 2 (2011). The rules regarding REC surrender under both the Regulation and the MRR should be clarified in written guidance materials as soon as possible.

B. Specified source imports: Clarify that RECs can be retired in a year after they were claimed.

If section 95852(b)(3)(D) of the Regulation cannot be amended as proposed above, its exact meaning should be clarified. It currently requires that, if RECs were created for specified source electricity, the RECs "must be retired and verified pursuant to MRR." It has long been unclear as to exactly when those RECs must be retired in order to claim the specified source electricity in a particular year, and different interpretations have been put forward by different ARB staff members at various times.

Statements made by ARB staff in discussions with the Joint Utilities, most recently on June 27, 2013, indicate that RECs for specified source imports do not need to be retired in the year for which the specified source import is claimed, but can be retired later. For example, RECs generated from specified sources in 2013 could be claimed in an entity's emissions report for 2013 submitted in 2014, even if the RECs had not been retired by the time the report was submitted. The reporting entity would need to retire those RECs at some point in the future. (The consequences for the verification statement for the entity's report are addressed in SCPPA's comment on the June 26 Mandatory Reporting workshop.)

This approach provides the entity with the desired flexibility as to when it retires its RECs, and SCPPA looks forward to receiving confirmation, in written guidance, that this approach has been adopted.

C. RPS Adjustment: Clarify that RECs can be banked, and claimed when retired.

If section 95852(b)(4)(B) of the Regulation cannot be amended as proposed above, its exact meaning should be clarified and a small drafting error (discussed below) should be addressed. Section 95852(b)(4)(B) currently requires electric sector entities to use the RECs "to comply with the California RPS requirements [i.e., to retire them] during the same year in which the RPS Adjustment is claimed." MRR staff had interpreted this to mean that RECs must be generated in the same year in which they are claimed, and must be retired by the reporting deadline – a very restrictive interpretation.[18]

[18] ARB presentation at the MRR webinar for electric power entities, March 26, 2013, slides 18 and 20.

However, statements made by ARB staff in discussions with the Joint Utilities, most recently on June 27, 2013, and an email from ARB staff dated July 5, 2013, indicate that from 2013 onwards the RPS Adjustment can in fact be banked, i.e. carried forward and claimed when the utility wants to retire the RECs. The RECs do not have to be claimed and retired in the year in which they were generated. For example, eligible RECs generated in 2013 that an entity retires in 2015 would be counted towards the entity's 2015 RPS Adjustment, reported in 2016.

This approach provides the entity with the desired flexibility as to when it retires its RECs, and SCPPA looks forward to receiving confirmation, in written guidance, that this approach has been adopted.

D. Amend RPS Adjustment provision to correct error as to year of retirement.

To properly implement the ARB's approach as described above, a small amendment to the RPS Adjustment section of the Regulation needs to be made. Section 95852(b)(4)(B) refers to RECs being used for the RPS (retired) "during the same year ***in which*** the RPS Adjustment is claimed" (emphasis added). This is problematic, and could lead to unintended consequences. Consider a scenario where a utility retires RECs in September 2015. Its emissions report for the 2015 compliance year is due in June 2016, so the year ***in which*** it would seek to claim the RPS Adjustment is 2016 (in its report for 2015). However, the utility cannot claim the RPS Adjustment in this report because the RECs were retired in 2015, not 2016, the year in which the report was submitted. Nor could the utility have claimed the RPS Adjustment in its 2014 report submitted in 2015, as the 2014 report was due in June 2015, before it retired the RECs. In effect, any RECs retired between the reporting deadline and the end of the year would be unable to be counted towards the RPS Adjustment in any year. There appears to be no reason for this restriction. Utilities should be free to retire RECs at any time throughout the year, without worrying that they will lose the benefit of the RPS Adjustment.

Therefore, section 95852(b)(4)(B) of the Regulation should be amended to state that RECs must be retired in the year ***for*** which the RPS Adjustment is claimed, not the year ***in*** which the RPS Adjustment is claimed. Thus, a utility preparing its 2015 report in 2016 would count in its RPS Adjustment for 2015 all eligible RECs that it retired in 2015 – a simple and logical approach. This amendment is set out below:

> The RECs associated with the electricity claimed for the RPS adjustment must be used to comply with the California RPS requirements during the same year for~~in~~ which the RPS adjustment is claimed.

VI. EXPLAIN WHY FURTHER INFORMATION ON COMPLIANCE INSTRUMENT TRANSACTIONS IS REQUESTED.

Slides 40-44 of the C&I Presentation proposed to require entities to provide more information on compliance instrument transactions when requesting transfers of compliance instruments in CITSS, particularly for customized bilateral transactions and exchange-traded contracts.

For customized bilateral agreements, the additional information includes:

- If the contract contains provisions for further compliance instrument transfers, the transfer frequency (e.g. quarterly);
- If the contract is a "bundled" purchase of instruments and other products, the products (e.g. natural gas); and
- How the price is determined, e.g. fixed price or base plus margin.

For exchange-traded contracts, the additional information includes:

- Name of exchange and exchange code;
- Type of contract (spot, future);
- Date of close of trading for the contract; and
- Price at close of trading.

However, the C&I Presentation did not contain any information on why the ARB wishes to collect this additional data or what it proposes to do with this data. Before stakeholders can make informed comments on the proposal to collect more transaction information, the ARB must clearly indicate the purpose for collecting it. Transaction information is highly confidential and the ARB must ensure that if it provides any transaction data to the market, it is aggregated so that it cannot be traced to individual entities.

VII. QUALIFIED EXPORT ADJUSTMENT SHOULD BE CALCULATED USING DEFAULT EMISSION FACTOR.

In response to stakeholders' concerns that electricity import/export exchange agreements would carry double carbon liability for the same amount of electricity used to serve load in California, the ARB developed the Qualified Export ("QE") Adjustment. However, the way in which the QE Adjustment is calculated is flawed, resulting in a drastic under-valuation of the adjustment and consequently higher liability for the affected utilities.

The Regulation currently requires an electricity importer to calculate the QE Adjustment for an hour using the lowest emission factor of that entity's imports or exports in that hour.[19] This calculation produces a zero result (no adjustment) in all hours in which the entity imports zero-emissions renewable energy, disadvantaging entities that import renewable energy throughout the year. In addition, some utilities import zero-emissions baseload nuclear energy (e.g. from Palo Verde). Thus, these utilities would be able to claim only a very small or zero QE Adjustment, despite having significant amounts of qualifying exports that, absent their imports of renewable and nuclear energy, would count towards the QE Adjustment. Disadvantaging entities for procuring zero-emissions energy seems inappropriate in the context of a program that seeks to reduce emissions.

[19] Regulation section 95852(b)(5)(A).

This disadvantage can be corrected by making a simple change to the way in which the QE Adjustment is calculated. Rather than using the lowest emission factor in an hour, the QE Adjustment should be calculated using the default emission factor.[20] (This also has the benefit of simplifying the calculation, reducing the burden on reporting entities.) The proposed amendment to section 95852(b)(5)(A) of the Regulation is set out below:

> (A) During any hour in which an electricity importer claims qualified exports and corresponding imports, the maximum amount of QE adjustment for the hour shall not exceed the product of:
>
> 1. The lower of either the quantity of exports or imports (MWh) for the hour; multiplied by
>
> 2. The default~~lowest~~ emission factor as set out in MRR section 95111(b)(1) ~~of any portion of the qualified exports or corresponding imports for the hour~~.

VIII. EXCESS SURRENDERED OFFSETS SHOULD BE COUNTED TOWARDS THE NEXT SURRENDER OBLIGATION.

Slides 12 and 17 of the C&I Presentation proposed that if an entity surrendered, at an interim surrender deadline, offsets equal to more than 8% of its triennial compliance obligation, the excess surrendered offsets would be excluded and would not count towards compliance.

A. Excluding excess surrendered offsets will increase cap and trade program costs.

SCPPA understands that it would be possible for an entity to reduce or avoid the risk of having offsets rendered worthless in this way, for example by not putting any offsets into its compliance account until the triennial surrender deadline.

However, the mere possibility that offsets could become worthless will tend to further reduce the already low likelihood that entities will seek to use their full 8% share of offsets. Entities that are contemplating procuring offsets will see this risk as one more reason not to

[20] Currently 0.428 $mtCO_2e$ per megawatt hour, as defined in section 95111(b)(1) of the MRR.

invest money and staff time in buying offsets, understanding the rules applying to offsets, and developing and implementing strategies to minimize offset risks (including buyer liability for retroactive invalidation). Entities that do procure offsets will need to be very cautious in surrendering offsets, and will tend to surrender fewer rather than more offsets if the ARB's proposal is implemented.

This diminished use of offsets would have the effect of increasing the costs of compliance with the cap and trade program as a whole, given the important cost containment benefits of offsets (as the ARB's own studies have indicated).

B. Excess surrendered offsets can be carried forward without exceeding the 8% limit.

To avoid negative impacts on the offset market and increased cap-and-trade costs, offsets should not be rendered worthless if too many are in an entity's compliance account on an interim surrender deadline. Instead, the excess surrendered offsets should be counted towards the entity's next surrender obligation and the 8% offsets limit in the next compliance period. This would maintain the value of offsets without violating the 8% limit.

Using the ARB's example on slides 11-12 of the C&I Presentation, the 14,000 offsets surrendered in 2014 that were in excess of the 8% limit for the first compliance period would be counted towards the compliance obligation due in November 2016. The entity would need to surrender a further 16,000 compliance instruments to meet the 30% compliance obligation for 2015, assuming it continues to emit 100,000 mtCO_2e per year. The 14,000 offsets applied to the November 2016 obligation would also count towards the entity's 8% offset limit for the second compliance period, so the entity could surrender an additional 10,000 offsets in that period.[21] If it surrenders more than 10,000 offsets, the excess would be applied towards the entity's third

[21] 100,000 mtCO2e per year x 3 years x 8% = offset limit of 24,000 for second compliance period.

compliance period obligation and offset limit. The number of offsets that are counted towards the next deadline could be indicated in CITSS so the entity is aware of the status of these offsets.

IX. CONCLUSION

SCPPA appreciates the opportunity to submit these comments to the ARB and urges the ARB to consider these comments when preparing the draft revisions to the Regulation. If further information is required, we would be happy to discuss any of the proposals in these comments with ARB staff. We look forward to continuing to provide input to the ARB as the 2013 revisions to the Regulation are developed and finalized.

Respectfully submitted,

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