

Alex Jackson
13-9-9



October 25, 2013

Rajinder Sahota
Steven Cliff
Climate Change Program Evaluation Branch
California Air Resources Board
1001 I Street
Sacramento, CA, 95812

Re: Comments on the Proposed Amendments to the Cap-and-Trade Program Regarding Resource Shuffling

Dear Ms. Sahota and Dr. Cliff,

On behalf of the Natural Resources Defense Council, and our more than 250,000 members and activists in California, we appreciate the opportunity to comment on staff's proposed amendments to the cap-and-trade program for consideration at the October 25th Board hearing. These comments address only staff's proposal regarding resource shuffling. NRDC submitted separate comments on other aspects of the proposed amendments on October 16, 2013.

INTRODUCTION AND SUMMARY

We appreciate staff's continued commitment to refine key aspects of the cap-and-trade program through an open and public process. Over the past few years, staff has held multiple public workshops to discuss the resource shuffling provisions and issued regulatory guidance documents to put stakeholders on notice for the current proposed amendments.

We also appreciate the challenge ARB faces in designing a rule that effectively prohibits resources shuffling, a form of leakage, within the limits of its jurisdictional authority. Pricing carbon creates an obvious market incentive to shuffle given the lack of comparable emission reduction requirements in other states that export power to California. We are optimistic that landscape will begin to change under EPA's existing source standards for power plants, however, which will apply in every state. We also recognize the tremendous impact the package of power-sector policies developed under AB 32 is having throughout the West by reducing both the demand for electricity and the carbon-intensity of electricity.

But the scope of potential leakage resulting from unchecked resource shuffling in California's carbon market is significant if the proposed amendments are adopted without further modification. The proposed amendments contain both affirmative examples of electricity

deliveries that would constitute resource shuffling (in Section 95852(b)(2)(B)) and a series of exemptions or "safe harbors" for transactions ARB would not consider resource shuffling (in Section 95852(b)(2)(A)). The rule is silent, however, on where the burden lies to qualify for a safe harbor, and fails to address the possible conflict between the presence of a safe harbor and one of the prohibited forms of resource shuffling specified in the rule.

Accordingly, we recommend ARB:

1. **Clarify the hierarchy of authority between the safe harbors and prohibited forms of resource shuffling.** In the event a first deliverer exploits a safe harbor to undertake a plan, scheme, or artifice to reduce its emissions compliance obligation in a manner that would otherwise constitute a prohibited form of resource shuffling, ARB should clarify the transaction constitutes a violation of the article and is subject to an enforcement action.
2. **Put the burden of proof on first deliverers of electricity** to satisfy the conditions necessary to claim exemption under one of the safe harbors.

We propose modifications to the definition of resource shuffling to address these two concerns. We also ask the Board to direct staff to further examine the scope and definitions of the safe harbors with the aid of the Emissions Market Assessment Committee (EMAC) over the next year.

DISCUSSION

Staff proposes to amend the definition of resource shuffling from its longstanding focus on a plan, scheme or artifice "to receive credit based on emissions reductions that have not occurred, involving the delivery of electricity to the California grid," and explicitly exempt electricity deliveries that qualify for one of 13 "safe harbors" listed in section 95852(b)(2)(A).

"Resource Shuffling means any plan, scheme, or artifice involving the delivery of electricity to the California grid undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation. Resource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A)."

A number of the safe harbor provisions are written so broadly, however, that we are concerned most electricity deliveries can be structured to fit within their scope. For example, in safe harbor two, what constitutes a delivery "made for the purpose of compliance with state or federal laws and regulations" would seem to encompass a wide range of transactions and possible interpretations. Many safe harbors also hinge on whether electricity deliveries were

"necessitated" by some other condition (e.g., "electricity deliveries that are necessitated by termination of a contract," in safe harbor eight), which leaves ARB in the nearly impossible position of attempting to discern the intent or motivation behind a particular electricity delivery.

The scope of the proposed exemptions is exacerbated as the rule is silent on where the burden lies to qualify for a safe harbor, or how the safe harbors relate to the affirmative examples of resource shuffling identified in Section 95852(B). It is entirely conceivable that electricity deliverers will attempt to structure a transaction that constitutes a plan, scheme, or artifice to resource shuffle within one of qualifying safe harbors. For example, safe harbor two explicitly permits both "cherry picking" and "facility swapping," two examples of resource shuffling ARB has long identified as prohibited,¹ as long as the delivery was intended to comply with state or federal law. A first deliverer could also claim exemption for facility or contract swapping by simply claiming the transaction was "necessitated" by the termination of the contract under safe harbor 2.

As proposed below, we therefore urge ARB at a minimum to clarify (1) that the presence of a safe harbor is not an absolute shield from liability if ARB determines the transaction constitutes a prohibited form of resource shuffling specified in the rule; and (2) that the burden is on first deliverers to establish they satisfy conditions to qualify for a safe harbor.

Proposed Amendment to the Definition of Resource Shuffling in Section 95802(a)(317)

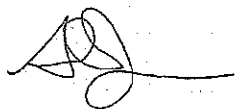
Resource Shuffling means any plan, scheme, or artifice involving the delivery of electricity to the California grid undertaken by a First Deliverer of Electricity to substitute electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources to reduce its emissions compliance obligation. Resource shuffling does not include substitution of electricity deliveries from sources with relatively lower emissions for electricity deliveries from sources with relatively higher emissions resources when the substitution occurs pursuant to the conditions listed in section 95852(b)(2)(A), **unless ARB determines the substitution is prohibited pursuant to the conditions listed in section 95852(b)(2)(B). A First Deliverer of Electricity bears the burden of establishing that an electricity delivery satisfies the conditions listed in section 95852(b)(2)(A).**

¹ Throughout the rulemaking process, ARB identified three practices it considers resource shuffling: 'facility swapping' (replacing power that has a high emissions factor with power that has a lower emissions factor), 'cherry picking' (replacing power that has an unspecified emissions factor with power that has a specified, lower emissions factor), and 'laundering' (replacing power that has a high emissions factor with power that has an unspecified emissions factor). See California Air Resources Board, Compliance Obligations of First Deliverers of Electricity, Staff Presentation at Electricity Technical Meeting (Aug. 26, 2011), available at: <http://www.arb.ca.gov/cc/capandtrade/meetings/082011/cap-trade-presentation.pdf>

CONCLUSION

We appreciate the Board's attention to this issue and look forward to working closely with ARB staff and other stakeholders.

Sincerely,

A handwritten signature in black ink, appearing to be 'Alex Jackson', with a long horizontal line extending to the right.

Alex Jackson
Legal Director, California Climate Project
Natural Resources Defense Council