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TO: AIR RESOURCES BOARD
Clerk of the Board
1001 I Street, Sacramento, California 95814
<http://www.arb.ca.gov/lispub/comm/bclist.php>

FROM: GAZ MÉTRO LIMITED PARTNERSHIP
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**SUBJECT: GAZ MÉTRO LIMITED PARTNERSHIP COMMENTS /
PUBLIC HEARING TO CONSIDER AMENDMENTS TO THE CALIFORNIA CAP ON
GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE
MECHANISMS REGULATION (the "REGULATION")**

Gaz Métro is a diversified energy company established in the province of Québec, in Canada. We distribute natural gas in Québec and Vermont, and we develop and operate a wide range of energy projects, including natural gas as fuel, liquefied natural gas as a replacement for higher emission-producing energies, wind and solar power, and biomethane.

In the context of this public hearing, Gaz Métro presents comments as a member of the public for the following reasons:

- Gaz Métro owns California Carbon Allowances (CCAs), and, as a result, may be affected by the proposed modifications;
- Gaz Métro is party to CCA sale and purchase agreements with entities that are subject to the Regulation, and, as a result, may be affected by the proposed modifications;
- Gaz Métro is established in Québec, a jurisdiction that is a member of the Western Climate Initiative (WCI) and linked with California.

Gaz Métro's comments and recommendations relate to the following three areas:

- 1- Allowance Price Containment Reserve

- 2- Linkage with External Greenhouse Gas Emissions Trading Systems and Programs
- 3- Compliance Offset Credits

1- Allowance Price Containment Reserve

ARB staff proposal

The staff is proposing amendments to the Regulation to include a method for transferring to the Reserve State-owned (not consigned) allowances that remain unsold at auction for a significant period of time, with the amendments taking effect by January 1, 2018. The proposed method would specify that allowances that remain unsold for more than 24 months would be transferred to the Reserve.

The staff is also proposing to collapse the current three tier prices of the existing Reserve into a single tier and to offer allowances from that tier at each Reserve sale at a single price, which would be the sum of Auction Reserve Price used at the auction plus \$60.

Gaz Métro's comments

The current Regulation seeks to put up for resale part (25%) of the allowances unsold at an auction after two auctions where the final price will have been higher than the floor price.

The transfer of allowances unsold after 24 months to the Reserve could reduce the amount of allowances available on the WCI market. This decrease in supply in California could increase the price of allowances for all members of the WCI market, including Québec-based members because the Quebec market is linked to the California market.

Having allowances not sold at an auction could be the result of a temporary drop in demand for allowances caused by the positive effects of GHG emission projects. A temporary drop in demand could also be due to the uncertainty surrounding the suit against the California carbon market for the post-2020 period.

However, demand for allowances could rise in the coming years, if, for example, there is growth in economic activity. At that point, unsold allowances could find a buyer at an auction taking place after the proposed 24 months period.

In such a situation, Gaz Métro believes that the transfer of unsold units to the Reserve could have a significant impact on the price of allowances, particularly since the drop in demand could be only temporary and disappear in the medium term, beyond the 24-month period.

The current Regulation (Subarticle 10, § 95913) sets the price for reserve units according to three tiers:

- (A) Allowances from the first tier shall be offered for \$40 per allowance;

- (B) Allowances from the second tier shall be offered for \$45 per allowance; and
- (C) Allowances from the third tier shall be offered for \$50 per allowance.

The prices for the three tiers were set at the same time as the minimum initial price of allowances of US\$10 per unit.

Consequently, the original version of the Regulation provided for a gap of US\$35 between the effective floor price of US\$10 in 2013 and the average reserve unit price of US\$45.

Gaz Métro's recommendations

Gaz Métro recommends not modifying the current Regulation's provisions about the reintroduction of unsold allowances in the market.

However, if the Regulation were to be amended to introduce the possibility of transferring unsold allowances to the Reserve, Gaz Métro recommends that only 50% of any unsold volume be transferred to the Reserve and that this transfer be made only after 36 months.

Regarding the price variance between reserve units and the minimum auction price, Gaz Métro supports the proposal to set the variance at a predefined amount to keep that variance constant in the future. However, Gaz Métro recommends setting the variance at US\$35 instead of US\$60 to reflect the variance initially provided by the Regulation in 2013.

2- Linkage with External Greenhouse Gas Emissions Trading Systems and Programs

ARB staff proposal

The staff is considering forms of linkages with other trading systems and programs in order to 1) "allow entities in California to retire compliance instruments issued by another GHG ETS to be used to meet their compliance obligation in California," and 2) "allow entities registered in a non-California GHG program to retire California compliance instruments to meet obligations in their own program."

Gaz Métro's comments

Gaz Métro supports linking the California carbon market to markets in other jurisdictions. Gaz Métro also supports the intent to enter into agreements with other programs and systems to allow for the use and withdrawal of compliance instruments issued by other partners.

Such agreements can offer many benefits for all partners, in particular giving covered entities access to a larger pool of compliance instruments, offering them more ways to meet their compliance obligations at the lowest possible cost. Two types of agreements may be considered: unilateral agreements and reciprocal agreements.

Unilateral agreements enabling a member entity to use compliance instruments create a significant risk for other entities within the jurisdiction who would face more competition to acquire compliance instruments. Ultimately, this could result in a shortage of compliance instruments and an increase in compliance costs.

Conversely, if reciprocal agreements were put in place, the price of compliance instruments in each of the partner jurisdictions would likely eventually converge. Of course, it is possible that the price of compliance instruments from California and its WCI partners would increase after the markets are linked; however, it would then be similar to another jurisdiction entering the joint market, such as Ontario. Reciprocal agreements would prevent a situation in which California entities and those of its WCI partners do not have enough compliance instruments because their compliance instruments are being used too much outside the WCI.

Gaz Métro recommendations

Gaz Métro encourages the opening of the market, provided that other cap systems are similarly open, and that this take the form of reciprocal agreements to avoid creating a sudden shortage in compliance instruments in the WCI and significantly increasing costs.

3- Compliance Offset Credits

ARB staff proposal

The staff is proposing a number of amendments in order to clarify and modify aspects of the offset program. The amendments contemplated address aspects of the program that are applicable to offset project developers.

Gaz Métro's comments

Even though it is not necessary for WCI partners' offset programs to be identical, it must be acknowledged that there are a few differences between the California and Québec offset programs.

One significant difference involves the invalidation provisions relating to the California offsets. Upon original issuance, all California offsets are subject to an eight-year invalidation period, during which ARB reserves the right to invalidate and therefore revoke the offsets if certain defaults occur. After certain conditions are met, offsets can have their invalidation period reduced to three years.

In Québec, the invalidation risk is addressed in a different manner. Upon issuance of offsets to a promoter, only 97% of the total quantity of offsets awarded are transferred to the promoter; the remainder is placed in the Minister's environmental integrity account. Later, if an invalidation occurs, the holder of the invalidated offsets then sees its invalidated offsets replaced with offsets that were held in the Minister's environmental integrity account.

In the secondary market, Québec offsets are a commodity that is very easy to transact, bearing no more risk than a California or Québec allowance. California offsets, on the other hand, are transacted on a regular basis and parties are able to address invalidation risks through contracts. So-called “Golden CCOs” are also transacted. Golden CCOs refer to California offsets that are sold with a replacement guarantee offered by the seller. Insurance products are also offered by third parties to protect a buyer of California offsets against the invalidation risk.

Furthermore, the “goldenization” of an offset is not a feature that offset developers are generally able to offer, due to their inability to offer financial assurance to cover the invalidation risk for the entire timeframe of that risk. This feature can therefore be offered only by sellers that have strong balance sheets, which has the effect of introducing intermediaries in the process and therefore increases the ultimate costs for buyers, since intermediaries not only sell offsets to cover the invalidation risk that they become liable for, but they also take a premium along the way.

With so many transactions of offsets recorded and with the availability of protection for buyers wishing to limit their exposure to the invalidation risk, we can say without a doubt that the market for California offsets is functioning and active. However, statistics issued by ARB in its 2013-2014 Compliance Report show that offset usage is not evenly distributed among emitters. Some covered entities still prefer to avoid California offsets. Arguably, the invalidation risk and the contractual negotiations behind the purchase of offsets discourages some potential buyers.

Gaz Métro’s recommendations

Gaz Métro believes that the approach taken by the Québec government with regard to the invalidation risk of offsets offers a more suitable and predictable environment for transacting offsets. Accordingly, Gaz Métro recommends that the staff consider adopting changes to its offset program to implement an environmental integrity account in a manner that is substantially similar to Québec’s. Gaz Métro believes that this approach facilitates the transactions of offsets between entities and encourages buyers with a more risk-averse profile to buy offsets.

4- Additional Recommendations Regarding Compliance Offset Credits

4.1 Compliance Offset Protocols (Regulation, Subarticle 13)

The production of offset credits is currently below the 8% limit of emissions to cover emitters subject to the agreements. Adapting current protocols and developing new ones would maximize the number of offset available, in addition to encouraging the development of green technologies and additional reductions in GHG.

For example, developing a protocol to promote reductions in GHG in the maritime transport industry would encourage reductions not covered by the system, but useful for achieving targets in Québec and California.

A collaborative effort with players in the market would make it possible to identify protocols that reflect the needs and reality of the market.

Gaz Métro's recommendations

Gaz Métro recommends continuing to work with market players and representatives from the Québec and Ontario governments to develop protocols and modify current protocols in order to significantly increase the number of offset credits produced in California and elsewhere in the United States.

4.2 Eight percent (8%) limit on the number of offset credits that covered entities may surrender to meet their compliance obligations (Regulation, Subarticle 7, § 95854)

According to the current Regulation, the use of offset credits by an emitter subject to the system is limited to 8% of the total compliance obligation. The 8% limit could be increased to 15% to encourage promoters to complete offset credit programs and allow for the wider use of offset credits as a compliance tool.

Since the price of offset credits is lower than allowances, wider access would also reduce the offset cost of emissions.

Gaz Métro's recommendations

Gaz Métro recommends that the 8% limit for using offset credits be increased to 15%.

This concludes Gaz Métro's comments and recommendations. Please contact me should you have any questions. We look forward to hearing back from you and to the continuation of this public hearing.

Yours sincerely,



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