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Steven Cliff, Ph.D.

Chief - Climate Change Market Branch

California Air Resources Board

1001 I Street

Sacramento, CA 95812-2828

**Re: Pacific Gas and Electric Company’s Comments on the Air Resources Board third 15-day Language: Linkage with Québec**

Dear Dr. Cliff:

Pacific Gas and Electric Company (PG&E) welcomes the opportunity to submit these comments on the Air Resources Board’s (ARB) 3rd 15-day language package for linkage with Québec. PG&E views successful linkage with Québec as a critical first step in broadening California’s cap-and-trade market through linking with other jurisdictions. Larger more diverse markets enhance the prospects for efficient market outcomes, eventually leading to lower-cost emission reduction opportunities.

We appreciate staff’s incorporation of stakeholder comments provided in response to previous iterations of the amendment language and applaud the decision to pursue activities that will ensure implementation readiness prior to a joint auction in 2014. A practice joint auction with significant stakeholder involvement and independent evaluation of processes, procedures, and systems will further improve the likelihood of successful linkage with Québec.

However, due to the complexity of linking these two jurisdictions, PG&E believes several issues yet to be addressed in the amendment language should be resolved. PG&E outlines several such unresolved issues in its comments below to help ensure successful linkage with Québec. In addition, several recommendations to prevent linkage from adversely affecting covered entities in California offered in previous comments (see attached) were not incorporated into the 15-day language. Recommendations such as harmonizing annual compliance showings will ensure consistency across jurisdictions, preventing the regulation from offering a competitive advantage to one jurisdiction over another. Stakeholders’ concerns should be addressed before ARB moves forward with linking California and Québec’s cap-and-trade programs.

1. **INTRODUCTION**

PG&E’s detailed comments on the 15-day language and additional documents added to the record are set forth below. The following summarizes the key issues:

* **A Contingency Plan is Needed to Respond to Instances of Market Stress/Failure and “De-linkage”**
* **The Exchange Rate and Auction Reserve Price Should be Posted Prior to the Day of the Auction (Section 95911(c)**
* **Québec’s Regulation Unnecessarily Limits Offset Credit Supply**
* **Information Sharing Guidelines Should Be Harmonized**
* **Clarify Procedure for Sale of Consigned Allowances In The Event of An Undersubscribed Auction (Section 95911(f))**

1. **DISCUSSION.**
2. **A Contingency Plan is Needed to Respond to Instances of Market Stress/Failure and “De-linkage”**

In September 2012, the Emissions Market Assessment Committee (EMAC) advised ARB to resolve five issues prior to linkage. Those included:

* Coordinating legal and regulatory frameworks;
* Consistency in transparency about market mechanisms;
* Consistency of definitions and market rules for the use of compliance instruments;
* Consistency in the enforcement of market rules; and
* Ability to respond quickly to unforeseen contingencies.

ARB and Québec have made significant strides in several of these areas over the last year, but significant progress towards developing a joint response to unforeseen contingencies is needed before successful linkage can occur. As the EMAC suggested during its September workshop, the integration of multiple jurisdictions introduces challenges in assessing the cause of market stress or failure and implementing regulatory remedies. A process for coordinating between jurisdictions to recognize and effectively address market stress conditions, including the increased potential for market manipulation under a linked auction, should be established in Québec and California regulation prior to a joint auction. Linkage should not preclude California from making necessary adjustments to its program in market stress situations. This plan should also address the possibility of “de-linkage” and guarantee the permanence of compliance instruments issued from linked jurisdictions. In a time of crisis, the Board should be able to rely on a pre-established framework for problem resolution.

1. **The Exchange Rate and Auction Reserve Price Should be Posted Prior to the Day of the Auction (Section 95911(c))**

According to ARB’s 15-day language (Section 95911(c)(3)(C)), the exchange rate for the Auction Reserve Price will be set “as the most recently available noon daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada.” The auction administrator will then “use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated in U.S. and Canadian dollars.” Section 49(2) of the Québec regulation specifies that the joint minimum price of emission units is defined in terms of “the official conversion rate of the Bank of Canada at noon on the date of the auction or, when that rate is not available, the most recent rate published in its Daily Memorandum of Exchange Rates.”

As the exchange rate is set at 9:30AM PST by the Bank of Canada, entities will learn the effective exchange rate and the Auction Reserve Price at most 30 minutes before the auction window opens. This small window of opportunity to make modifications to bids based on an updated Auction Reserve Price could result in potential data entry errors, which is particularly troubling given that bids one cent below the Auction Reserve Price will be rejected. This last-minute modification could also impact the bid guarantee posted by stakeholders at least 12 days before the auction. PG&E strongly encourages the two jurisdictions to work together to remedy this issue before proceeding with a linked auction, rather than unnecessarily complicating the bidding process.

To avoid last-minute errors, the exchange rate and the Auction Reserve Price should both be calculated and announced on the last day prior to the auction that is a business day in both California and any linked jurisdictions. This will afford entities enough time to alter their bids, if needed, while maintaining the accuracy of the calculated exchange rate. PG&E recommends the following modifications:

95911(c)(3)(C): The auction administrator shall set the exchange rate as the ~~most recently available~~ noon daily buying rate for U.S. and Canadian dollars as published by the Bank of Canada on the last day prior to the auction that is a business day in both California and in any jurisdiction operating an External GHG ETS to which California has linked pursuant to subarticle 12, and shall announce the exchange rate prior to ~~the opening of the auction window~~ 10 a.m. Pacific Prevailing Time on the day the exchange rate is set.

95911(c)(4): The Auction Reserve Price will be announced prior to ~~the opening of the auction window at~~ 10 a.m. Pacific Prevailing Time ~~Pacific Standard Time (or Pacific Daylight Time when in effect)~~ on the day the exchange rate is set per Section 95911(c)(3)(C) ~~of auction~~, and will be in effect until the window closes at 1 p.m. Pacific Prevailing Time on the day of the auction. ~~Standard Time (or Pacific Daylight Time when in effect).~~

PG&E would also like to reiterate its April 13, 2012 comments regarding the determination of the Auction Reserve Price. Rather than using the maximum of the two separate prices which will provide an upward bias on the reserve price, PG&E recommends using the average of the two prices. PG&E suggests the following change to section 95911(c)(3)(D):

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~~ average of the two values.

1. **Québec’s Regulation Unnecessarily Limits Offset Credit Supply**

The use of high quality offsets is an effective cost containment tool and an essential component of a successful cap-and-trade program. However, as stated in PG&E’s February 17 and April 13, 2012 comments, without adequate supply and adjustment to the implementation of the quantitative usage limit, the cost containment objectives of providing offsets will not be realized. Québec’s cap-and-trade regulation, which includes three existing offset project protocols, limits the volume of offsets that could be generated in Canada and provided for sale to California entities under a linked program, making linkage less advantageous for California. If Québec is a net buyer of AB 32 offset credits, the demand for the already limited supply of AB 32 offsets will increase. The remaining supply of AB 32 offsets for California covered entities will be even lower, reducing the value of this critical cost-containment feature and increasing costs to California covered entities.

For example, Québec’s protocols limit offset credit volume by restricting project development to Québec (Covered Manure Storage Facilities - CH4 Destruction, Landfill Sites - CH4 Destruction), whereas the AB 32 protocols can be used to develop projects in “the United States or its Territories, Canada, or Mexico”[[1]](#footnote-1) Similarly, “promoters” in Québec (the rough equivalent of Offset Project Operators) must be emitters or people domiciled in Québec, or have an establishment in Québec, whereas ARB’s protocols have no such geographic restriction.

In addition, future protocols, such as those based on forestry, could be precluded from adoption in Québec’s system due to the regulatory requirement that GHG reductions be irreversible. Some projects, by nature, may be reversible due to unforeseen events such as forest fires, etc. The ARB’s forestry protocol effectively manages this potential by adding the concepts of intentional and unintentional reversal. To avoid precluding the adoption of certain future protocols, Québec should eliminate the term “irreversible” in the offset rules, or alternatively develop “buffer pools” to insure against risk of reversals.

Finally, if Québec cannot generate sufficient offset credits and becomes a net buyer, fewer offset credits will be available for California entities to fully utilize their 8% quantitative usage limit. Therefore, PG&E also supports changing the ARB’s quantitative usage limit described in Section 95854 to include a new Section 95854(c) that would allow an entity to bank any unexhausted portion of its limit from one compliance period for use in subsequent compliance periods. This language change will improve the potential for successful linkage with Québec. This new Section 95854(c) could read:

If OO/S is less than LO for any one compliance period, the number of compliance instruments identified in section 95854(a) that are between OO/S and the number of compliance instruments identified in section 95854(a) where OO/S is equal to LO

can be added to the quantitative usage limit of the subsequent compliance period.

1. **Information Sharing Guidelines Should Be Harmonized**

ARB is in the process of determining what auction information will be shared publicly, following a January 25, 2013 workshop and comment period.  At this workshop, ARB expressed that both jurisdictions will be aligned on the release of information, for all types of data.  PG&E recommends that section 95921(e) be clarified to state that the section applies both to accounts registered to entities in California and in any linked jurisdictions.

1. **Clarify Procedure for Sale of Consigned Allowances In The Event of An Undersubscribed Auction (Section 95911(f))**

Section 95911(f) specifies (1) an order of sale if the auction is undersubscribed, with consigned allowances sold first, and (2) that when there are insufficient winning bids to exhaust the allowances from a consignment source in section 956911(f)(1), the auction operator will sell an equal proportion of allowances from each consigning entity in that source.  The situation becomes more complex if linkage occurs because the amended Québec regulation Section 54 merely states, “Emission units of the vintage of the current year or of previous years that remain unsold after an auction are put up for sale at a later date…”  PG&E requests ARB to clarify that section 95911(f)(1) applies to the proportion of total bids coming from California.  PG&E proposes the following modification:

(f) Allowances will be sold from California sources (including consigned allowances) and from each jurisdiction to which California has linked pursuant to subarticle 12 in the same proportion as allowances were provided to the auction, rounded to the nearest 1000 allowances.

~~(f)~~ (g) If the quantity of bids accepted by the Auction Administrator is less than the number of allowances offered for sale then some allowances will remain unsold.

(1) If allowances remain unsold at auction, the auction administrator will fulfill winning bids with California-sourced allowances from consignment sources in the following order:

(A) Allowances consigned to auction pursuant to section 95910(d)(2);

(B) Allowances consigned from limited use holding accounts pursuant to section 95910(d)(1);

(C) Allowances redesignated to the auction pursuant to section 95911(~~f~~g)(3); and

(D) Allowances designated by ARB for auction pursuant to section 95910(c)(1)(B) and (c)(2)(B) and (C).

(2) When there are insufficient winning bids to exhaust the allowances from a consignment source in section 95911(~~f~~g)(1), the auction operator will sell ~~an equal proportion of~~ allowances in equal proportion to the number of allowances consigned from each consigning entity in that source, rounded down. If, as a result of rounding down, not all California-sourced allowances specified in section 95911(f) are sold, the auction operator will assign a random number to each unsold bundle of 1,000 metric tons of CO2e from that source. Beginning with the lowest random number assigned and working in increasing order, the auction operator shall sell allowances assigned the random number until all California-sourced allowances specified in section 95911(f) are sold.

1. **CONCLUSION**

Thank you for the opportunity to submit these comments. PG&E urges ARB to carefully review these suggestions and make the recommended changes before pursuing further action. We look forward to continuing our work with ARB and other stakeholders to ensure the successful implementation of AB 32.

Very truly yours,

/s/

Judi K Mosley

cc: Rajinder Sahota, via email

1. §95972(c) [↑](#footnote-ref-1)