July 9, 2013

Dr. Steve Cliff, Chief
Climate Change Program Evaluation Branch
California Air Resources Board
1001 "I" Street
Sacramento, CA 95812

Dear Dr. Cliff:

Subject: Los Angeles Department of Water and Power (LADWP) Comments
California Air Resources Board (CARB) Greenhouse Gas
Cap-and-Trade Regulation

The LADWP appreciates the opportunity to submit the following comments on CARB's proposed compliance and information requirements and its *Policy Options for Cost Containment* as presented at its Public Workshop of June 25, 2013. In addition, although not presented during the Public Workshop, LADWP offers its comments and recommendations on the Renewable Portfolio Standard (RPS) Adjustment and Qualified Export provisions of the cap-and-trade regulation. LADWP further supports comments being filed concurrently by the Southern California Public Power Authority (SCPPA).

I. Surrender of Compliance Instruments

At the public workshop, CARB presented examples of how compliance instruments could be retired on an annual and triennial basis in order to demonstrate how CARB will implement Sections 95855 and 95856 of the cap-and-trade regulation. LADWP supports CARB's flexible approach as shown in its first example with respect to surrender of allowances and recommends that the information be included in its cap-and-trade guidance document.

With respect to CARB's approach to the surrender of offsets, LADWP believes that permanent deletion of offsets from an entity's compliance account which exceed the 8 percent limit is punitive, discourages the use of offsets for compliance, and unnecessarily increases the complexity of complying with the regulation. Entities placing offsets above their 8 percent limit into their compliance account to ensure compliance with the rule should not be penalized by losing those offsets. LADWP recommends that entities be able to use those offsets towards compliance in the next compliance period.

II. Compliance deadlines

CARB has acknowledged that there are many regulatory deadlines between August and November of each compliance year. CARB has also pointed out that some of the deadlines do not provide opportunity for covered entities in the natural gas sector to purchase allowances through CARB's September Allowance Price Containment Reserve (APCR) sale if their emissions verification indicates that they are short allowances.

At the June 25 workshop, CARB requested comments on the merits of moving the emissions verification deadline of September 3rd ahead by two weeks (e.g. to mid-August) to address this issue. LADWP recommends keeping the current emissions verification deadline. Moving the deadline ahead by two weeks, as contemplated by CARB, would impact other regulatory deadlines and present a challenge for both verifiers and covered entities, especially those with multiple reports, to meet the accelerated schedule.

For example, reconciliation of renewable energy imports is a lengthy process that involves querying renewable energy credit (REC) data and serial numbers for inclusion in a covered entity's GHG report. A challenge in obtaining REC data is the three to four month delay in issuing RECs after the generation data is reported to WREGIS. RECs for December generation would not be issued until the end of April to early May. Any corrections to the generation data would further delay receipt of the RECs. Because of the challenges associated with reconciling imported renewable energy by June 1, CARB allowed covered entities until July 15 to finalize their RPS Adjustment.

Site visits to each covered entity and their generation facilities are required during years with full verification. Verifiers must perform verifications for multiple clients. Scheduling site visits involves coordinating a date that works for the verifier, facility manager, and staff. In addition to the site visit (field work), the verifiers must review all the report documentation (desk audit) and compile a verification report. Completing these tasks on the proposed schedule could be a challenge for entities with multiple reports.

In addition to submitting reports to CARB, facilities and covered entities must submit reports to other agencies, including local air management districts and the US Environmental Protection Agency (EPA). If the reporting deadline for the Electric Entity Report is moved ahead by two weeks, reporting obligations to CARB and other agencies would overlap significantly, stretching the covered entities' reporting staff thin.

As such, LADWP recommends that CARB keep the current emissions verification deadline. Moving the deadline ahead by two weeks, as contemplated by CARB, would impact other regulatory deadlines and present a challenge for both verifiers and covered entities, especially those with multiple reports, to meet the accelerated schedule.

If there is strong interest among stakeholders to participate in the APCR, LADWP recommends moving the APCR schedule to a later date to accommodate natural gas suppliers. In addition or in the alternative, CARB could move the auctions to a later date to offer all covered entities an opportunity to true-up their allowance holdings if their emissions verification indicates a shortage.

III. Public Information Sharing Issue

CARB proposes releasing compliance account balance data of individual covered entities on a quarterly basis. Publishing individual compliance account information would allow a covered entity's allowance trading counterparties to estimate that covered entity's short or long position in the market. Since there are a finite number of emission allowances available, and limited control options that can be implemented within a short time period to reduce emissions, disclosure of individual covered entity holdings may put individual covered entities at the mercy of owners of surplus allowances. Further, LADWP does not see any significant benefit for publishing individual covered entities' compliance account balance data.

To avoid the potential for market manipulation, LADWP recommends releasing aggregated rather than individual allowance holding data. Aggregated data would be sufficient to show the supply of allowances available to the market. Aggregation of data would provide market transparency without divulging individual entity positions within the market.

For example, CARB could publish an annual carbon market report similar to what the South Coast Air Quality Management District (SCAQMD) publishes annually for the Regional Clean Air Incentives Market (RECLAIM) cap-and-trade market. In SCAQMD's Annual RECLAIM Audit Report, allocation and trading issues that are addressed include:

- Number of covered entities in the cap-and-trade program
- Number of registered transactions and associated values
- Average annual prices of emission credits
- Emission credit supply compared to reported emissions
- Information on market participants (e.g. investors' impact on the RECLAIM trading credit market)
- List of facilities that ceased operation
- Compliance status of facilities (e.g. number of facilities that failed to reconcile emissions and the reasons why, such as arithmetic errors, incorrect use of data, or omission of emissions associated with reportable sources)
- Number of covered entities that left the program and/or voluntarily opted into the program

Aggregating the information and preparing an overall market report will provide market information to the public in a user-friendly format and address CARB's objective that the public see how the market is working and that covered entities and offset developers are complying.

IV. Information Reporting in Compliance Instrument Tracking System Service (CITSS)

CARB proposes that new requirements associated with reporting transaction agreements be imposed. Entities involved in spot bilateral, customized bilateral, and exchange-traded contracts (spot and futures) would be required to report details of the transactions into CITSS as stated in CARB's workshop presentation. LADWP requests that CARB provide its rationale for requiring this additional information and what it plans to do with the data. The information contained in these types of transaction agreements may be considered proprietary information that entities such as LADWP are unable to release.

V. Cost Containment

CARB's paper titled, "Policy Options for Cost Containment in Response to Board Resolution 12-51, June 25, 2013" describes several policy options for ensuring that allowance prices do not exceed the highest price tier of the APCR. LADWP supports CARB's proposal to increase the availability of allowances at the highest price tier of the reserve while maintaining the environmental integrity of the Cap-and-Trade Program. LADWP concurs with CARB's assessment that allowances available at the highest price tier of the APCR will likely eliminate a market participant's willingness to pay more than that price for allowances.

With respect to potential sources of compensating emission reductions, LADWP supports CARB's proposal to redistribute existing allowances within the 2013 to 2020 period which entails making up to 50 percent of all allowances for each future vintage auction eligible for use in the highest price tier of the APCR and make available for immediate use in the highest price tier of the APCR all unsold 2015 vintage allowances offered for auction in 2012. LADWP concurs that this approach would be effective in addressing temporary demand imbalances.

LADWP recommends that CARB adopt the Joint Utilities Group's cost containment approach which is to implement a portfolio of measures consisting of:

a) measures which take effect now and gradually, over time, reduce the likelihood of prices rising above the APCR in the future;

b) measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time; and

c) measures that, when triggered, would keep allowance prices at the highest price tier of the APCR regardless of current demand, while preserving the environmental integrity of the cap-and-trade program.

Please see the attached Joint Utilities Cap and Trade Cost Containment Proposals for additional details on its proposed portfolio of measures.

VI. Additional Cap-and-Trade Issues

Although the June 25 public workshop did not address RPS Adjustment/REC retirement and qualified exports provision issues, LADWP offers its comments on those issues as the cap-and-trade rule will be opened for amendments this summer.

a. RPS/REC Adjustment

Section 95852(b)(4)(B) of the RPS adjustment provision states, "The RECs associated with the electricity claimed for the RPS adjustment must be used to comply with California RPS requirements during the same year in which the RPS adjustment is claimed." From the plain reading of this provision, and as CARB as confirmed in Joint Utility Group meetings, RECs for specified sources do not need to be retired in the year for which the specified source import is generated, but can be retired later. Thus, an entity can claim an RPS adjustment when it is ready to retire the RECs.

However, the March 26, 2013 Mandatory Reporting Rule webinar presentation stated that RECs for the RPS adjustment must be generated in the same calendar year as the claim. Furthermore, the webinar presentation stated that entities would receive a "qualified positive" verification determination if the RECs are not retired in the generation year.

LADWP recommends that the MRR guidance be revised to reflect CARB's current interpretation of the RPS adjustment provision and that a reporting entity not be subject to an automatic "qualified positive" if RECs are not retired in the generation year.

b. Qualified Export Provision

In response to stakeholders' concerns that simultaneous exports that are part of exchange agreement should not carry a compliance burden, CARB developed the qualified export provision (Section 95852(b)(5)). CARB's intent per its Final Statement of Reasons allowed GHG emissions associated with qualified exports (a subset of exports limited to simultaneous exports) to be subtracted from a reporting entity's covered emissions. However, Section 95852(b)(5)(A)(2) requires an entity to calculate the qualified export adjustment for an hour using the lowest emission factor of the entity's imports or exports in that hour. The LADWP imports and/or exports zero-emissions electricity during every hour (including base load nuclear energy from Palo Verde, hydro energy from Hoover, and renewable energy from various RPS projects). Based on the qualified export provision as currently written in the cap-and-trade rule [95852(b)(5)], LADWP cannot claim any credit for qualified exports. Thus, LADWP recommends that CARB amend the qualified export provision such that the default emission factor (0.428 MT CO_2e/MWh) be applied.

VII. Conclusion

LADWP appreciates this opportunity to comment and looks forward to working with CARB staff on these important issues. If you have any questions, please contact me at (213) 367-0403 or Ms. Jodean Giese at (213) 367-0409.

Sincerely,

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Joint Utilities Cap and Trade Cost Containment Proposals

The following recommendations constitute essential components of a robust cost containment structure that should be adopted as a single package. The recommendations fall into three categories, described below. It is important to implement multiple (if not all) measures from each category in the 2013 amendments to the Cap and Trade Regulation. Doing so will provide needed certainty to the regulated community and the market that there are mechanisms in place to ensure prices do not exceed the third tier of the allowance price containment reserve (APCR).

A) Measures which take effect now and gradually over time reduce the likelihood of prices rising above the APCR in the future by: 1) reducing demand for compliance instruments; 2) increasing the supply of compliance instruments; and 3) ensuring that compliance instruments are accessible in the marketplace.

B) Measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time. An example trigger is a percentage level of depletion of the APCR.

C) Measures that, when triggered, would keep allowance prices at the third tier of the APCR regardless of current demand, while preserving the environmental integrity of the Cap and Trade Program over time.

A) Potential measures that could be implemented now to reduce the likelihood of prices rising above the APCR in the future:

1. Approve more offset protocols to increase the supply of offsets.
2. Exempt offsets from projects within California from the 8% offset limit.
3. Allow each covered entity to carry over any unused portion of its 8% offset limit, to use for future compliance.
4. Address constraints imposed by the current holding limit.
5. Hold an additional auction after the end of each compliance period:
   - Redistribute allowances between auctions to allow for one additional auction per compliance period, and/or acquire allowances for auction per B2 below.
   - This auction should be held between September 1 of the year following the end of a compliance period, when verification statements for prior-year emissions are due (section 95103(f) of the MRR), and November 1, when compliance entities are required to demonstrate compliance (section 95856(f)(1) of the Cap and Trade Regulation).
6. Provide allowances to electrical distribution utilities to cover emissions from electrification of transportation and distributed fuel uses in California.
   - Each allowance provided to EDUs for electrification represents significantly greater reduction in transportation and distributed fuel sector demand for compliance instruments, lowering demand in comparison to supply.
   - This proposal would be limited to electrification that is incremental from the date this measure is adopted and can be reliably measured.

B) Potential measures that would take effect when a specified trigger is reached (e.g. the APCR is 40% depleted) to quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time:

1. Unused offset proposal:
   - 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."
   - When the trigger is reached, ARB will announce an increase in the maximum level of each entity's offset usage for the current compliance period. The increase will be calculated to ensure that, if all covered 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 next compliance period.
2. 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.
3. Limited borrowing proposal:
   - 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).
4. Offset geographic scope proposal:
   - 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.
5. Offset project start date proposal:
   - 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 Cap and Trade Regulation to an earlier date.

C) Potential measure that would be triggered only if and when the third tier of the APCR is depleted, to keep prices at the third tier level, while preserving environmental integrity:

Allowance-offset proposal: Upon depletion of the highest tier of the APCR, the Executive Officer will make available (through the APCR sale mechanism) additional allowances, in excess of the cap, necessary to satisfy the demand of compliance or opt-in compliance entities at the price set for the highest tier of the APCR in the relevant year. The Executive Officer will use the funds raised by the sale of additional allowances to reduce GHG emissions, with the intent that emissions reductions will be equal to or larger than the number of additional allowances sold.

The options available to the Executive Officer for reducing GHG emissions include, but are not limited to, one or more of the following:

- Commission a third party to obtain and retire high-quality offsets not otherwise eligible to satisfy the compliance obligations of compliance entities.
- Commission a third party to purchase and retire allowances from emissions trading programs outside of California and linked jurisdictions.
- Commission a third party to invest funds in emission reduction projects outside the capped sectors.
- Mandate emission reductions in sectors not covered by the Cap and Trade Regulation.