Comments of the Western Power Trading Forum on Discussion Draft Proposed Changes to the Cap and Trade Regulation

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The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (CARB) on the discussion draft for possible change under the California Cap and Trade Program.

WPTF provides substantive comments on the following issues:

- Compensation for legacy electricity contracts that do not provide for carbon cost pass through;
- Possible pass-through of carbon costs by natural gas suppliers to natural gas generators;
- Information requirements for employees and contractors involved with the cap and trade program;
- Information required for compliance instrument transfers;
- The proposed requirement for a "transaction agreement" to be in place for compliance instrument transfer
- The expanded scope of "Corporate Associations"
- Procedures for retirement of compliance instruments
- Resource-shuffling;
- The RPS adjustment

In addition, WPTF understands that, due to time constraints, CARB staff has not yet been able to provide draft regulatory proposals in this document to respond to the direction of the Board to address additional cost-containment provisions and to increase the auction purchase limits. WPTF considers these to be high-priority issues and urges CARB to propose regulatory amendments to address them in the formal 45 day rule-making package this year. Additionally, WPTF notes broad stakeholder interest in these issues, and encourages CARB to continue to develop its approach in an inclusive and transparent matter.

<u>Comments on proposed changes</u>

Legacy contracts:
WPTF has consistently advocated for full allowance allocation to compensate independent power producers for emissions incurred under legacy electricity contracts that do not provide for carbon cost pass through. In this regard, the proposed temporary allocation of allowances for these contracts is insufficient. We support allocation of allowances to cover affected emissions through the life of these legacy contracts.

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[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within California, western states, as well as other markets across the United States.

Pass through of Carbon Costs by Natural Gas Suppliers to Gas Generators
WPTF remains concerned regarding the possibility that generators using natural gas will be subject to double carbon costs – once for the direct compliance obligation resulting from GHG emissions and again via pass through of carbon costs in natural gas prices once natural gas suppliers become covered entities under the program in 2015.

CARB's approach of notifying gas suppliers of the GHG emissions of their customers who are also covered entities presumes that the natural gas suppliers will thus ensure that carbon costs are not included in the prices charged to those customers. Yet, there is nothing in the regulation that explicitly prohibits natural gas suppliers from including carbon costs in those prices. Further, in response to stakeholder questions about monitoring and enforcing the 'expectation' that natural gas suppliers will not include carbon costs in natural gas prices to covered entity consumers, staff have suggested that this would be the responsibility of the CPUC. Again, we do not consider this response sufficient, since operators of interstate pipelines are subject to the jurisdiction of the Federal Energy Regulatory Commission --not the CPUC.

To address these concerns, WPTF recommends that CARB include an explicit provision in the regulation that prohibits natural gas suppliers from including carbon charges in their gas charges to customers that are covered entities under the cap and trade regulation. Additionally, CARB should require that each natural gas supplier include in its annual report on the Use of Auction Proceeds and Allowance Value information on how it has ensured that it excluded customers that are covered entities from any natural gas related price increase due to carbon costs incurred under this program.

Information requirements on employee and contractors
The Proposed Amendments contain significant new informational requirements which do not appear to be justified based on the ARB's responsibilities and role as "market monitor." WPTF is concerned about several proposed new requirements for entities to provide information on employees or contractors involved with compliance with the cap and trade regulation in sections 95830(c)(1)(i) and (j) and 95923.

WPTF does not object to requiring entities to provide information on employees or contractors involved in decisions regarding strategies for procurement, management and hedging of compliance instruments. However, WPTF believes that the current language is overly broad.

Specifically, the language of section 95830(i), which refers to "all persons employed by the entity that will either have access to any information regarding compliance instruments, transactions or holdings; or be involved in decisions regarding transactions or holding of compliance instruments, or both" would impose a

significant administrative burden on large companies, as the number of employees that fits this definition could be substantial and include those employees that are only tangentially involved in discussions regarding compliance instruments (e.g., administrative assistants). CARB's right to apply penalties for failure to comply with any requirement under the regulation means that there is a real financial risk if an entity fails to fully account for and identify every employee. Thus, it is important that the language be specific so that it does not create the potential for significant inadvertent non-compliance. Section 95830(i) should be limited to employees that actually make decisions about holding and transferring compliance instruments

Similarly, the language of Section 95923 (Disclosure of Cap-and-Trade Contractors) is also too broad in that it would require entities to identify contractors that assist in the preparation of entity emission reports or provide advice on regulatory requirements under the cap and trade regulation and associated mandatory reporting regulation, rather than focusing on contractors that have a substantive role in an entity's procurement decisions. Moreover, there is a reference in Section 95923(c) to an apparent placeholder for the collection of information regarding the contractors' communications with a regulated entity regarding a compliance strategy. Such a requirement would be overreaching and run-afoul of confidentiality concerns (e.g., attorney-client communications). CARB should not propose to collect information on the substance of advice provided by Cap-and-trade Contractors.

WPTF therefore recommends that the language of section 95830(i) be modified as follows: "all persons employed by the entity that will ~~either have access to any information regarding compliance instruments, transactions or holdings; or~~ be involved in decisions regarding transactions or holding of compliance instruments, or both".

We also that CARB remove the proposed language added to the regulations at section 95923(a), since this is information already collected in section 95830(c)(1)(J), or amend this section as follows:

(1) A "Cap and Trade Contractor" is a contractor employed by an entity registered in the cap and trade program to work on cap and trade compliance if the contractor:
   - ~~(A) Verifies the entity emissions as part of ARB's Mandatory Reporting Regulation;~~
   - (B) Advises ~~or consults with~~ the entity regarding transactions or holdings of compliance instruments ~~with the Cap and Trade Program, and receives information from another Cap and Trade Participant~~.'

CARB should delete Section 95923(c) in its entirety.

Information Required for Compliance Instrument Transfer Requests

WPTF remains concerned about the proposed expanded information requirement for compliance instrument transfers in the Compliance Instrument Tracking System (CITSS). Again, it is unclear why the ARB needs this information or how this information will help the ARB fulfill its role as "market monitor."

These new information requirements would impose significant burdens on entities to have to unwind many complex and varied compliance instrument transactions in order to accurately provide price and transaction type information. The additional requirements also increase the risk of an entity inadvertently entering inaccurate information, which could result in rejection of a transfer request and/or the imposition of financial penalties by CARB. These additional administrative burdens and increased risks are not insignificant, and will ultimately raise program compliance costs for covered entities.

CARB's regulations also lack clarity as to how CARB intends to use information that it collects on price and transaction type information. One explanation provided at the July 18th workshop was that CARB only wants to be able to understand the secondary market. However, CARB's proposed regulation would allow it to audit these transactions, which raises concern that CARB may also claim the right to opine on the appropriateness of individual compliance instrument transactions and associated price . This concern could drive many market intermediaries (voluntary entities) out of the market and reduce liquidity, if there is an indication that such prices could be subject to review and/or disallowance of some sort.

WPTF is also concerned that the ARB has begun to systematically collect contracts for CCA transactions. It is unclear why the ARB is collecting this information, what the ARB is doing to protect the information in these contracts, or how it furthers the ARB's role as a market monitor. It is not clear that collecting these contracts is permitted under the ARB's statutory or regulatory authority under AB 32.

WPTF's strong preference is to retain the current transaction information requirements rather than to expand them. If CARB goes forward with the expanded information requirements, we request that staff provide a clear explanation of how information collected will be utilized , why the collection of this information is necessary and how confidentiality will be maintained.

CITSS Requirement for "transaction agreement"

CARB has introduced a new requirement in section 95921(a)(4) that would require an entity to have a transaction agreement in place with another entity before the first entity can initiate a transfer request to the second entity.

WPTF does not object to this requirement *if* the meaning of transaction agreement is simply an agreement that results in the physical transfer of instruments between account holders in CITSS and provided that there is no requirement for the initiating

entity to provide documentation of the transaction agreement prior to initiating the transfer.

Is CARB intends differently, then WPTF would oppose this requirement because of the additional administrative requirements imposed and lack of meaningful information gathered.

Revised scope of corporate associations
Staff's proposed changes to Section 95833 have significantly broadened the umbrella of corporate associations to include affiliated entities "regardless of whether the second entity is subject to the requirements of this article". WPTF notes that many registered entities under the cap and trade program are large corporations with many affiliated companies, and a multi-national presence. In many cases, a regulated entity is a subsidiary of a large corporation, and the subsidiary does not have complete information about all of its corporate associations. This is particularly true of "disclosable" corporate associations (as distinguished from direct corporate associations). Compliance with the existing disclosure requirements under Section 95833 has already proved very challenging and delayed many entities' participation in quarterly auctions. Expanding the definition of corporate associations to include entities that are not subject to the cap and trade program would create additional administrative burden for these companies. Further, WPTF does not see the benefit of including entities that are subject to neither the California cap and trade program nor linked programs under the umbrella of corporate associations.

WPTF therefore opposes the proposed addition to Section 95833.

Retirement of Compliance Instruments
WPTF opposes the proposed changes in Section 95856 regulation that would proscribe the order in which CARB would move compliance instruments from a covered entity's Compliance account to the centralized Retirement Account for each surrender obligation. The proposed revisions would prohibit obligated entities from choosing which instruments to retire based on vintage and cost, and create serious financial consequences. Regulated entities are in the best position to determine the most cost effective means of compliance (a fundamental tenant of the cap-and-trade design).

In addition, WPTF notes that there may be financial accounting implications (and possibly corporate tax implications) for companies if CARB imposes a predefined retirement order. For example, most companies recognize their free allocations at $0 on their balance sheet, but purchased allowances at cost. In order to optimize its balance sheet, a company may wish to retire all of its freely allocated vintage of one vintage before it retires their purchased allowances of other vintages.

Thus, instead of mandating a retirement order, WPTF strongly prefers that CARB build functionality into CITSS that would enable individual account holders to

designate compliance instruments, by type and vintage, for retirement. In the event that an entity fails to indicate sufficient compliance instruments for movement to the Retirement account by the relevant surrender date, then CARB should manually pull instruments from compliance accounts. Only in this case would the order proposed in section 95856 for the manual pulling of compliance instruments be acceptable.

Additionally, WPTF requests that CARB develop functionality in CITSS to enable entities to create compliance sub-accounts. WPTF understands that this functionality was requested by program participants during the January 2013 CITSS Stakeholder Design process, we continue to believe this function, if implemented, would facilitate management of compliance for individual entities within consolidated corporate association accounts. The addition of this functionality would be consistent with other instrument tracking systems, including WREGIS, and would add considerable value to CITSS account holders.

Lastly, WPTF opposes CARB's proposal that offsets that are inadvertently moved to the retirement account in excess of the 8% compliance period limit be retained by CARB. This proposal runs counter to CARB's continued efforts to contain program costs and should be rejected. The proposal is also antithetical to CARB's policy goals of encouraging a robust offset markets because the proposal adds risks to the use of offsets. Instead, we recommend that CARB implement a flag in CITSS that would notify a covered entity if it designates a quantity of offsets in excess of 8% of covered emissions to date for movement between its compliance account and the retirement account. At the end of the compliance period, any offsets that have been moved to the Retirement account in excess of the 8% limit for that period should be applied toward the entity's compliance in the subsequent compliance period.

Resource-shuffling:
WPTF appreciates CARB's efforts to further clarify the regulatory prohibition against resource shuffling through the codification of the 'safe harbor' exclusions and the elimination of the attestation. While the elimination of the attestation is helpful, if CARB intends to enforce the prohibition, then it is critical to provide further clarity about what does and does not constitute resource-shuffling. In particular, we do not believe that the proposed definition of resource shuffling, or the proposed provisions in Section 95852(b)(2) provide sufficient clarity regarding imports of low-emission power when the import is not a substitute for power previously provided by a high-emission resource under long-term contract.

We have several reasons for this concern. First, while both the definition of resource shuffling and the provisions of Section 95852(b)(2) suggest that CARB is most concerned about scenarios under which a high emission resource under long-term contract to a California utility, or owned by a first deliverer, is inappropriately substituted, use of the word "include" in the main paragraph of 95852(b)(2)(B) and the staff explanation provided during the July 18th workshop indicates that other scenarios could constitute resource-shuffling. Yet the proposed language provides

no indication of what these scenarios would be. Based on earlier comments and discussion, we understand that CARB staff remains concerned regarding the possibility of 'facility-swapping' and 'cherry picking' by a first deliverer with a portfolio of resources. If this is true, then these scenarios should be explicitly identified and defined in the regulation.

Second, section 95852(b)(2) makes a partial distinction between long-term and short-term contract arrangements. Imports pursuant to short-term contracts or via the CAISO markets are a clear safe-harbor, provided that the import is not associated with the inappropriate diversion of electricity from a high-emission resource under contract to a California utility. Similarly, 95852(b)(2)(B)(1) and (2) refer to high emission resources under long-term contract. However, no guidance is provided on imports from low-emission resources. Safe harbor 10 would appear to apply if electricity from low-emission resources is imported via short term contracts, but the regulation is silent on whether imports from low-emission resources pursuant to new long-term contracts are acceptable.

To address these concerns, WPTF recommends the following:

- If CARB is solely concerned with inappropriate diversion of high-emission resources that are owned by or under long-term contract by the first deliverer or a California utility, then the definition of resource shuffling should be revised to explicitly state this, similar to the language used in 95852(b)(2)(B). We would suggest something along the lines of the following:

  "Resource Shuffling" means any plan, scheme, or artifice undertaken by a First Deliverer of Electricity to substitute delivery of electricity ~~deliveries~~ from a power plant that does not meet the California EPS and that is owned by or under long-term contract to the First Deliverer or to a California Electrical Distribution Utility with delivery of electricity ~~from sources~~ with relatively lower emissions l~~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)."

- If CARB is not solely concerned with the with inappropriate diversion of high-emission resources that are owned by or under long-term contract by the first deliverer or a California utility, then
  - Expand Section 95852(b)(2)(B) to explicitly define the other scenarios, such as facility-swapping or cherry-picking, that would be considered resource-shuffling.

- Provide an additional safe-harbor in section 95852(b)(2)(A) to exempt delivery of electricity under long-term contract provided that the activity is not linked to diversion of a high emission resource:

  "Long-term transactions and contracts for delivery of electricity with terms of greater than 12 months, unless such activity is linked to the selling off of power from, or assigning of a contract for, electricity subject to the EPS rules from a power plant that does not meet the EPS with which a California Electricity Distribution Utility has a contract, or in which a California Electricity Distribution Utility has an ownership share, that is not covered under paragraphs 11, 12 or 13 below."

Additionally, WPTF requests that CARB clarify several aspects of the proposed language and staff comments made during the July 18 workshop.

- In response to a question regarding safe harbor 9 (i.e., proposed Section 95852(b)(2)(A)(9), as well as discussion of 95852 (b)(2)(B), CARB staff indicated that they would consider historic procurement patterns in determining whether an entity has engaged in resource-shuffling. We ask staff to provide additional explanation regarding how this would work. If CARB intends to use some sort of procurement 'baseline' as a standard against which future procurement would be compared, then this should also be stated clearly in the regulation.

- We are also concerned about a statement made by CARB staff that indicated that incorrect reporting of electricity under the Mandatory Reporting Regulation could be considered resource shuffling. This statement appears to be inconsistent with staff explanations provided to-date indicating that resource-shuffling is a cap and trade violation and involves the delivery of electricity – not the reporting of those deliveries. WPTF considers that a reporting error should be considered a reporting violation only – not resource shuffling. We believe that staff misspoke on this issue and request clarification.

- Finally, we again ask CARB to provide an explanation to electricity deliverers as to how resource-shuffling will be identified, as CARB has stated that this would not be a task of verifiers. In particular, we would like to understand how CARB will determine whether an electricity delivery is linked to the selling off or assigning of a contract from a high emission resource under contract to a California utility. We are concerned about the possibility that a first deliverer of power could be considered to have resource shuffled due to a procuring utility's sell-off of high emission power, without the importing entity's knowledge of the sell-off.

Direct Delivery of Renewable Electricity.

WPTF appreciates and supports the proposed modifications to the provisions for claiming direct delivery of electricity from a renewable resource. However, we would request that CARB make an additional modification to the definition of "Renewable Energy Credit" to reflect guidance documentation issued under the Mandatory Reporting Regulation.

Specifically, on February 8, CARB issued guidance that, among other things, addressed the role of environmental attributes in claims to specified sources. This guidance clarified that use of the term REC in the cap and trade regulation means only RECs associated with generation from a California Renewable Portfolio Participating Facility. This is much clearer than the current definition in the regulation, which suggests that the term applies to any REC issued via the Western Renewable Energy Generation Information System (which is the tracking system established by the CEC).

WPTF therefore recommends that CARB modify the definition of a REC to explicitly apply only to those RECS associated with generation from a California Renewable Portfolio Participating Facility.

RPS Adjustment

We remain concerned that the provisions related to the RPS adjustment are not consistent with RPS program requirements. We have three concerns. First, while we appreciate CARBs attempt to address RPS program inconsistency through the modification of Section of 95852(b)(4)(B) to allow RECs to be retired during the same year for which the RPS adjustment is claimed, this is still problematic for many importers. As proposed, it would force an importer of firming and shaping electricity to carry a carbon obligation until such a time as the REC is retired, consistent with RPS program rules allowing to RECs be retired within 36 months of generation. To avoid carrying this carbon obligation, the RPS obligated entity would be forced to retire the REC early.

As we have previously commented, this inconsistency is discriminatory and eliminates the flexibility provided under California statute to support short-term REC procurement contracts to meet RPS compliance targets. Under RPS program rules, once retired, RECs acquired pursuant to short-term RPS contracts can not be carried over for future compliance.

Second, the language of the main paragraph of 95852(b)(4) assumes that the entity claiming the RPS adjustment will either be importing or procuring renewable energy. The first case will never occur, as that would be considered a direct delivery of renewable energy and ineligible for the RPS adjustment. The second case would occur if the importer is the entity subject to the RPS. However, in many cases the

entity that needs to claim the RPS Adjustment will only be importing substitute power on behalf of an entity subject to the RPS. Under RPS program rules, the importing entity is not required to have any contract to procure the renewable electricity or associated RECs. In addition, there are instances where the importing entity has a "Corporate Association" with the RPS obligated entity, but there is no contract in place for the transfer of power.

Finally, the current language is not sufficiently clear with respect to whether the various references to 'electricity' refer to the imported substitute electricity (i.e. the firming and shaping power) for which the RPS adjustment is needed, or to the electricity generated by the eligible renewable resource. Because of this ambiguity, the language suggests that the contract for substitute electricity must be the same contract as the contract for procurement of the RECs. This is not the case – RPS program rules only require that the contract for substitute electricity be entered into no earlier than the time the renewable electricity is purchased and prior to the initial date of generation of the renewable electricity. We believe the intent of and requirements for claiming the RPS adjustment would be clearer if the regulation were to explicitly and correctly characterize the link between the importation of 'substitute energy' in association with renewable electricity that is procured by an entity subject to the RPS, but is not directly delivered.

WPTF recommends the addition of a new definition of the RPS adjustment, and modifications to section 95852(b)(4) to address these concerns:

"RPS Adjustment" means a deduction from the compliance obligation of an electricity importer that is an entity subject to the RPS or its designated counter-party, associated with the procurement pursuant to California Public Utilities Code 399.16 (b)(2) by the entity subject to the RPS program of electricity that is generated by an eligible renewable resource, but not directly delivered to California.

(4) RPS adjustment. Delivery of e~~E~~lectricity associated with the procurement by an entity subject to the RPS of electricity ~~imported or procured by an electricity importer~~ from an eligible renewable energy resource reported pursuant to MRR must meet the following conditions to be included in the calculation of the RPS adjustment:

(A) The electricity importer must ~~have~~ either:

1. Be an entity subject to the California RPS with o~~O~~wnership or contract rights to ~~procure the electricity and~~ the RECs associated with the electricity generated by the eligible renewable energy resource, or have a corporate association with that entity, as verified pursuant to the MRR; or

2. Have a contract to import ~~procure~~ electricity on behalf of ~~and the associated RECs on behalf of~~ an California entity subject to the California RPS that has ownership or contract rights to the ~~electricity and associated~~ RECs associated with the electricity generated by the eligible renewable energy resource, as verified pursuant to MRR.

(B) Within 36 months of creation, t~~T~~he RECs associated with the electricity generated by the eligible renewable resource and claimed for the RPS adjustment must be placed in the retirement subaccount of the entity subject to the RPS ~~party to the contract~~ in 95852(b)(4)(A) or (B), in the accounting system established by the CEC pursuant to PUC 399.13 and designated as retired for the purpose of compliance with the California RPS program ~~during the same year in for which the RPS adjustment is claimed.~~ RECs claimed for the RPS Adjustment must not be resold by the entity subject to the RPS, or used for a purpose other than that entity's compliance with the RPS.

(B bis) The electricity importer must be able to provide evidence that the electricity delivered was matched with the eligible renewable resource.

(C) The quantity of emissions included in the RPS adjustment is calculated as the product of the default emission factor for unspecified sources, pursuant to MRR, and the quantity (MWh) of ~~reported~~ electricity generated by the eligible renewable resource ~~(MWh)~~ and procured by the entity subject to the RPS. ~~that meets the requirements of this section, 95852(b)(4).~~

(D) No RPS adjustment may be claimed for an eligible renewable energy resource when its electricity is directly delivered.

(E) No RPS adjustment may be claimed for electricity generated by an eligible renewable energy resource in a jurisdiction where a GHG emissions trading system has been approved for linkage by the Board pursuant to subarticle 12.

(F) Only RECs representing electricity generated after 12/31/2012 are eligible to be used towards the RPS adjustment.