Clerk of the Board
California Air Resources Board
1001 I Street, Sacramento, California 95814
Submitted to: http://www.arb.ca.gov/lispub/comm/bclist.php

14 February 2014

IETA COMMENTS ON CALIFORNIA AIR RESOURCES BOARD'S INFORMAL CAP-AND-TRADE 15-DAY DISCUSSION DRAFTS

The International Emissions Trading Association (IETA) appreciates this opportunity to provide comments in response to the California Air Resources Board's (ARB) informal cap-and-trade 15-day discussion drafts encompassing both the draft amendments to the program regulation as well as the Mine Methane Capture offset protocol. We thank you for considering IETA's perspectives.

OVERVIEW

IETA's comments are structured around the following topics:

1. **Compliance Unit Surrender Order;**
2. **Registration with ARB;**
3. **Transaction Reporting Requirements;**
4. **Limited Exemption;**
5. **Cost Containment;**
6. **Mine Methane Capture Offset Protocol; and**
7. **Offsets Issuance Fee For Early Action Projects.**

1. COMPLIANCE UNIT SURRENDER ORDER

Section 95856 of the discussion draft specifies an automatic compliance unit surrender order in which the Executive Officer retires compliance units from a compliance entity's account in both annual and triennial compliance years. While the September 2013 proposed amendments removed annual compliance surrender obligations, this discussion draft re-instates those annual compliance obligations.

Regardless of whether there exists, or doesn't exist, an annual compliance surrender obligation, IETA's membership has a strong preference for individual entities to be given the flexibility to indicate which compliance units they would like to surrender. We appreciate the need to provide a default surrender order in case an entity fails to indicate its own surrender order, but this default order should not supersede an entity's preference, if indicated. We understand that the Compliance Instrument Tracking System Service (CITSS) currently does not have the functionality to allow entities to indicate their own retirement order preference, but our membership contends that the benefits of implementing such functionality outweigh the cost.

Holding Limits

Due to the holding limit as currently written, a large final emitter (LFE) has comparatively less flexibility to keep allowances in its holding account than other regulated entities, and often must store a significant number of allowances in its compliance account. Where smaller entities may hold

onto allowances in their holding account right up until the compliance deadline, an LFE must keep allowances to cover its compliance obligation in its compliance account to navigate the holding limit. The pre-determined compliance unit retirement order that ARB proposes presents just another additional challenge to navigate for account representatives, who will face the additional challenge of balancing allowances and offsets in their compliance accounts.

Tax and Accounting Considerations

In previous stakeholder comments, IETA has provided detail on how the proposed automatic compliance unit surrender order may prove problematic in dealing with important accounting concerns. We repeat those concerns again here.

Consider the U.S. Environmental Protection Agency's (EPA) Acid Rain Program in determining the importance of an entity's ability to choose which compliance units it retires in light of tax implications. In the Acid Rain Program, an entity has the option to choose to retire specific allowances based on their tax basis (this is often referred to as "specific identification" by the accountants).

For tax purposes the basis of a freely allocated allowance is zero. That contrasts with a purchased allowance, where for tax purposes the basis would be the purchase price. An entity can then choose to retire an allowance based on its tax basis. In the Acid Rain Program, since SO2 allowances are treated as a capital asset, a company could choose allowances based on how it would impact its capital gains posture for a given year.

According to a Journal of Accountancy report, approximately three quarters of companies value freely allocated allowances at zero, and purchased allowances at cost[1]. With this in mind, entities may want to choose to retire compliance units in a different order than is proposed by ARB. Different entities will have different financial drivers depending on their industry, financial situation, accounting policy, etc. – so while one company may wish to retire freely allocated allowances first, another may wish to do the opposite. Similarly, one company may wish to retire earlier vintages first, and another may wish to retire later vintages first. Consider the following example:

A company in California is expected to emit 100 tons of GHGs per year in 2013 and 2014, and ARB allocates 80 allowances/year for free (i.e. 80 vintage 2013 allowances and 80 vintage 2014 allowances) leaving a shortfall of 20 tons/year that must be bought in the marketplace.

Assume that this company is concerned about rising costs, so it buys 40 tons of vintage 2013 allowances (the most liquid contract) in the marketplace at $15/ton to hedge its price risk. The regulation allows the company to use vintage 2013 allowances for compliance with 2013 or 2014 emissions.

Assume, now, that for whatever reason (perhaps production was down), that company only actually emitted 90 tons in 2013 and 90 tons in 2014. This leaves it with 20 surplus allowances, which it banks for 2015.

[1] Journal of Accountancy Access here: http://www.journalofaccountancy.com/Issues/2009/Jul/20081312

The regulation says that ARB will retire allowances in a specific order, starting with the earliest vintages (i.e. all vintage 2013s will be retired first). So in the company's registry account, it is left with 20 vintage 2014 allowances. Since all of these were allocated for free, this would be valued at zero on the company's balance sheet.

However, depending on the company's inventory/accounting policy, that company may actually prefer to retire all freely allocated allowances first (including all vintage 2014s), leaving them with 20 vintage 2013 allowances instead (which they value at cost).

As this example points out, there are important accounting considerations that make it necessary that an entity has the option to choose its own compliance unit surrender order depending on different circumstances. IETA strongly encourages ARB to provide this capability within CITSS.

Annual 8 Percent Offset Usage Limit

With the proposed re-instatement of the annual compliance surrender order in this discussion draft, the concern of over-surrendering an entity's 8 percent offset usage limit on annual compliance surrender years reappears. ARB has specifically asked stakeholders whether the usage limit should apply on annual compliance years, or only the triennial compliance years.

IETA recommends that there should be no 8 percent usage limit on offsets in annual compliance surrender years. If an entity over-surrenders offsets in its annual compliance years to the extent that it is already beyond its 8 percent limit by the triennial compliance deadline, ARB should devise means to allow those over-surrendered offset credits to retain value – whether that be through returning the units to the compliance entity, allowing those excess units to be applied towards the next compliance period, or some other means.

2. REGISTRATION WITH ARB

A. Section 95830 (c)(1)(H): Identification of Corporate Associations

Section 95830 of the discussion draft retains a proposed change within the program that requires identification of all other entities with whom the entity has a corporate association, direct corporate association, or indirect corporate association. In the currently standing regulation, these association disclosures are only required for associated entities registered pursuant to the program. The new proposal significantly expands the requirement for identification to associations far beyond the reach of the California program.

A number of IETA's members are large corporations with many corporate associations across the globe. For some IETA members, the number is in excess of 1000 affiliates and subsidiaries. The proposed requirement as outlined in the discussion draft would be very difficult to maintain as hundreds of these associations are constantly changing, making submitted lists obsolete soon after submittal to ARB. Given the magnitude of what is being required, IETA wonders if ARB itself would view it as worthwhile to undertake the management of such a large influx of information.

Further, IETA is unsure why it is of interest to ARB to have record of corporate associations for entities not registered or otherwise involved in the cap-and-trade program. Unless there is some rationale that IETA is not aware of, we recommend reverting to the language as written in the current regulation.

B. Section 95830 (c)(1)(I): Identification of Persons with Access to Information

IETA appreciates the direction of the proposed changes in this section of the discussion draft that attempts to provide a more specific definition of those employees that should be required to provide contact information for program registration.

In the discussion draft, for registration purposes, the identification of persons is necessary for those who have clearance to "approve, initiate or review transaction agreements, transfer requests, or account balances." We would like to point out, though, that the list of people authorized to "review transaction agreements" could still be very broad and possibly include everyone within a company. It would be more appropriate, much less burdensome, and equally effective if the provision did not require the identification of those persons with only access to "review transaction agreements".

C. Section 95830 (c)(7): Registration of Account Viewing Agents

The added language in section 95830(c)(7) that requires account viewing agents to provide registration details to ARB seems unnecessary and onerous for individuals whose account access is already limited. By definition, an account viewing agent cannot transact, and can only review an account status. The level of detail required for registration in ARB's proposed amendments is not commensurate with an account viewing agent's responsibility.

Consider, also, that it may be common practice for multi-national companies to employ non-US residents as account viewing agents – employees who would not have US bank accounts.

D. Section 95834 (c)(2): Resubmittal of Know-Your-Customer Requirements

Section 95834(c)(2) continues to propose that the Executive Officer *may* re-verify all documents associated with Know-Your Customer (KYC) requirements every two years, which could require submittal of updated KYC registration documents from an individual registered in the program. Added clarity on why re-verification of KYC documents might be necessary would be appreciated, particularly as re-submittal of KYC documents may be quite onerous (bank account information, addresses, photo identification). Current regulatory language that requires re-submittal of information simply in the event that an individual's registration details change is preferable for IETA members.

E. Section 95912 (d): Registration in Auctions

While IETA appreciates the changes to Section 95912(d)(5), the language contained in the discussion draft could still bar an entity from participating in an auction if there are changes to information provided in an entity's auction or account application 30 days before or 15 days after an auction. The activities described in the auction or account application cover a range of activities that a company may need to perform in the course of its business and simply cannot remain static in order to participate in the cap-and-trade auctions, including officer names, capital structure, opening of or changes to an investigation, etc.

While ARB staff acknowledges that Section 95912(d) is intended to facilitate effective settlement of the auctions and support market monitoring, and is not intended to be overly burdensome, the language included in the discussion draft encompasses a far wider array of information than should be necessary, including officer names. Section 95912(d) should be further tailored because it

unnecessarily jeopardizes an entity's auction participation for activities associated with its normal business operations.

F. Section 95912 (d)(4)(E): Attestations for Registration in Auctions

IETA appreciates the change in the discussion draft to the provision in section 95912(d)(4)(E) that removes language requiring that an entity participating in an auction (including all associated entities) submit an attestation indicating that it has never been subject to any previous or ongoing investigation regarding "any alleged violation of any rule, regulation, or law associated with any commodity, securities, or financial market, including a change in the status of an ongoing investigation". The new language requiring instead disclosure of the existence of any ongoing or previous investigation is much more reasonable.

However, IETA would like to propose ARB include knowledge and material qualifiers to this section as well to ensure companies (particularly large companies) are able to provide the required information in a timely fashion. For example, a utility would not want to violate the cap-and-trade regulation due to a failure to report a minor administrative violation of a CFTC rule connected to its energy purchases, which would likely be unrelated to the utility's cap-and-trade activities.

3. TRANSACTION REPORTING REQUIREMENTS

A. Definitions

IETA's previous stakeholder comments raised concerns with the definitions of "futures" and "spot" contracts, and extending from those definitions, the reporting requirement to distinguish between futures and spot contracts in section 95921(b)(5)(C). The discussion draft eliminates "futures" and "spot" contract language completely, thereby assuaging IETA's concerns.

However, the definition of "over-the-counter" is still problematic. An over-the-counter definition should turn on whether the subject matter of the trade is listed on an exchange, not whether the trade takes place through an exchange. ARB should consider replacing the word "listed" with the words "executed or entered for clearing". The resulting definition would be: "Over-The-Counter means the trading of carbon compliance instruments, contracts, or other instruments not *executed or entered for clearing* on any exchange."

B. Section 95921(b)(1)(B): Counterparty Account Representative Confirmation

IETA supports the change in the discussion draft section 95921(b)(1)(B) removing the requirement that the seller of units in a transaction must need to know the "… identification of a primary account representative or alternative account representative for the destination account confirming the transfer request, if confirmation of the transfer request is required."

C. Section 95921(a)(4): Pre-Existing Transaction Agreements

IETA supports the change in the discussion draft section 95921(a)(4) that provides added clarity that written or recorded oral agreement may constitute a transaction agreement.

D. Section 95921(b)(3)(B): Settlement Dates

IETA appreciates the addition in the discussion draft allowing for the listing of an expected settlement date in transactions where the settlement date is not fixed and may be subject to floating dates or dates triggered by other events. Additional clarity would be useful pointing out that if an expected settlement date happens to change, ARB will not hold the reporting entity liable.

E. Section 95921(b)(4)(B): Transaction Agreement Termination Dates

IETA supports the changes allowing for an expected termination date. Similarly to the settlement date issue above, IETA requests confirmation that if an expected termination date happens to change, that ARB will not hold the reporting entity liable.

F. Section 95921(b)(4)(D): Identification of Other Products

In a transfer request, if the transaction agreement provides for transfers of other products, ARB requests that those other products be specified in the agreement. IETA would be interested to know more about why ARB believes it important to have these other products identified.

4. LIMITED EXEMPTION

Section 95920(d)(2)(G) seems unclear. It states that on December 31, 2014 the limited exemption will be reduced by the sum of the entity's compliance obligation over the compliance period. However, compliance surrender will not have occurred until November 2015. Shouldn't the ability to hold allowances under the limited exemption, as calculated during the current compliance period, continue until that compliance surrender deadline? Additional clarity on this provision would be appreciated.

5. COST CONTAINMENT

As stated in IETA's previous stakeholder submission, IETA supports ARB's proposal (as an initial first step) to make available 10% of future allowance budgets, as needed, at reserve sales once per year starting in 2015 at the highest price tier of the Allowance Price Containment Reserve (APCR).

This provision may provide some short-term relief in the case that prices rise unexpectedly. However, IETA does not believe that this provision adequately satisfies the Board Directive to prevent allowance prices from rising beyond the APCR, particularly in the case of an extended period of high demand due to unforeseen market dynamics or economic imbalances. Ultimately, it is in ARB and IETA's interest alike to ensure that prices do not rise so high that the Governor feels pressure to step in and exercise his/her right to suspend the cap-and-trade program.

IETA encourages ARB to re-visit the proposals originally discussed at the 25 June 2013 Public Workshop (including those by ARB, EMAC, and the Joint Utilities Group[2]), which explored a number of innovative options that would serve to keep prices below the highest-tier APCR price, while at the same time maintain environmental integrity.

[2] Joint Utilities Group Presentation: http://www.arb.ca.gov/cc/capandtrade/meetings/062513/industry-present.pdf

In particular, IETA considers two options presented at the 25 June 2013 workshop to be worth further consideration:

Offsets as Cost Containment

Expanding offset supply would be an effective means of containing the cost of the cap-and-trade program, while also ensuring environmental integrity of the program.

Additional low-cost compliance options could be introduced into the system through offsets in a variety of ways, but first and foremost is ensuring that offset supply meets demand. That can be done through the timely development and adoption of additional compliance offset protocols such as the Mine Methane Capture protocol (more on this below).

Aside from the adoption of additional protocols, two relatively simple options to increase the effectiveness of offsets as a cost containment mechanism are: 1) expand entity compliance limits beyond 8%; or 2) allow entities to carry over unused offset limits from one compliance period to the next.

Sourcing Allowances from Third Party Greenhouse Gas Reduction Programs

If faced with an extreme case where keeping prices below the highest tier of the APCR was proving difficult, ARB could have a provision ready to kick in that allowed the creation of additional allowances to be sold at the highest tier price, providing crucial cost relief.

In order to maintain environmental integrity, the state of California could use revenue from the sale of these additional allowances to buy and then retire quantifiable and certified allowances from third party greenhouse gas reduction programs (such as the Regional Greenhouse Gas Initiative (RGGI)). Meaning that for each additional California Carbon Allowance (CCA) that ARB created and sold, a corresponding RGGI allowance would be retired. California could even choose to implement a quota system where for each additional CCA it created it would retire (for example) three RGGI allowances.

Not only would such a system provide cost relief and maintain environmental integrity, it would also serve to indirectly link its market to other markets – a goal outlined in AB32 to build regional and international markets. IETA would be pleased to work with ARB moving forward in this pursuit.

6. MINE METHANE CAPTURE OFFSET PROTOCOL

IETA strongly supports the proposed compliance offset protocol for mine methane capture (MMC) projects. Offset credits represent a crucial cost containment mechanism to help the California cap-and-trade program achieve GHG emission reductions in an economically efficient manner. IETA encourages officials to approve and make effective the protocol as soon as possible.

We also support the expansion of the definition of "Offset Project Developer" within the MMC protocol discussion draft to include not just the mine operator but also the entity that owns or leases the equipment used to capture or destroy mine methane (section 3.3(d)(2)).

Generally, IETA supports ARB's efforts to develop new protocols that can provide offset credits to supply the market. In addition, we encourage ARB to update and expand existing protocols that can increase supply of already-proven, high-quality offset credits in the near-term.

7. OFFSETS ISSUANCE FEE FOR EARLY ACTION PROJECTS

Section 95990(e)(3) of the discussion draft stipulates that in order to list a reporting period of an early action project, developers must have paid the offsets issuance fee.

Under the current regulation, project developers can list a project once the verification is complete and wait to pay the issuance fee until ARB has actually completed their review (which is taking up to a year). The revised language in the discussion draft would require developers to pay the fee immediately (between $0.2 and $0.23 an offset) to the relevant registry and then potentially have the credits sitting there for an extended period of time.

This can be a significant cost especially as developers have to this point budgeted to pay issuance fees just prior to ARB-approved CCO offset issuance rather than at the start of the review process. For example, if a developer is planning to develop 500,000 CRTs, he/she would be paying out $100,000 up front and then have to wait for an unknown length of time before the ARB-approved CCOs are issued and available to sell in order to recoup the expenditure. This proposed language would mean a large sum of money has to be put up front, which is tied up during ARB's review process. This significantly impacts a developer's ability to then go out and invest in new projects.

IETA requests that ARB revert to the language in the current regulation that allows developers to pay the issuance fee at the point at which ARB has completed its review of CRTs to CCOs.

CONCLUDING REMARKS

IETA appreciates the opportunity to record our comments related to ARB's informal cap-and-trade 15-day discussion drafts. Not only is IETA intent on helping to support a fully-functional California carbon market, we are also committed to helping achieve the goals of AB 32 to develop inter-jurisdictional and regional linked markets in order to realize environmental goals in an economically efficient manner.

If you have any questions, or further clarification is required, please do not hesitate to contact Robin Fraser (fraser@ieta.org) or Katie Sullivan (sullivan@ieta.org).

Sincerely,

Dirk Forrister
President and CEO

IETA members

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