Comments of the Western Power Trading Forum
to the California Air Resources Board
on 45-day Proposed Cap and Trade Regulation Amendments

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The Western Power Trading Forum[1] (WPTF) welcomes the opportunity to provide input to the California Air Resources Board (CARB) on the 45-day proposed amendments to the Cap and Trade Regulation.

WPTF's comments below address CARB's proposals for

- revision of the price containment reserve and implementation of an allowance price ceiling,
- the "direct environmental benefits" (DEB) criteria for offsets,
- accounting for outstanding greenhouse gas emission (GHG) in the Energy Imbalance Market (EIM), and
- new provisions for revocation of linkage agreements.

Cost Containment

WPTF believes that the staff's proposal to amend the existing price containment reserve and implement a hard price ceiling, as required by AB398, is reasonable and strikes the correct balance between competing interests of stakeholders and the objectives established in AB398.

Setting the initial spread between the price ceiling and the auction reserve at $65 and setting the prices for the two tiers at the mid and three-quarter point of this spread will maintain continuity relative to price expectations under the current program and provide certainty for long-term investments. WPTF also considers staff's proposed distribution of allowances between the two tiers and the price ceiling to be appropriate because it will result in a supply of allowance within the two reserve tiers that is roughly equal to the supply in the current three reserve tiers, plus an additional supply of allowances at the price ceiling.

With respect to the price ceiling, WPTF supports the restriction of price ceiling sales to California covered entities and only up to the quantity of instruments needed for the next compliance event. However, it is not clear why the price ceiling sale would be offered after the first tier of the reserve has been completely depleted, rather than after both tiers have been depleted. Additionally, WPTF remains concerned that CARB has not proposed a mechanism for ensuring additional emissions reductions if Price Ceiling Units must be issued. We encourage CARB to initiate a new rule-making as soon as possible to develop options for achieving additional emission reductions if price ceiling breached.

Offsets

AB398 requires CARB to reduce the limit on use of offset from 8% of an entity's compliance obligation under the current program to 4% in 2021 and increase the limit to 6% in 2026.

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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 80 members participating in power markets within California and elsewhere across the United States.

Additionally, half of the offsets used by an entity after 2020 must be sourced from projects that provide "direct environmental benefits in the state (DEBs). WPTF supports the staff proposal to apply the new quantitative limits relative to the years in which emissions occur, rather than the year in which offsets are surrendered for compliance. This interpretation will align the offset limits to the actual compliance obligations.

On implementation of the DEBs criteria, staff have proposed that any offset project that is physically located within the state, or that reduced GHG emissions in the state, would automatically be considered to provide DEBs. For projects located outside the state, CARB would review projects on a case-by-case basis based on the submission of additional documentation by project developers.

WPTF considers this approach to evaluating whether an offset project meets the DEB's standard to be reasonable. However, we are concerned about the proposal to apply the standard to offsets surrendered as of 2020, even for offsets issued prior to 2020. Staff argue in the Initial Statement of Reasons that this does not constitute a retroactive application of the mandate because offsets issued prior to 2020 that do not meet DEBS criteria would continue to be eligible for compliance after 2020. While it is true that non-DEBs offsets will continue to be valid, their value for compliance use will diminish due to the quantitative surrender restrictions. For this reason, we urge CARB to take additional steps to minimize any impacts on covered entities. Specifically, WPTF recommends that staff expedite the process for out-of-state projects to apply for DEBs status. Additionally, staff should create and maintain list of DEBs-eligible projects on the website. Lastly, staff should ensure that the Compliance Instrument Tracking System Service enables covered entities to easily identify offsets from non-eligible projects, so that covered entities may prioritize surrender of those offsets.

GHG Emissions in the EIM

For several years, the California Independent System Operator (CAISO), CARB and stakeholders have worked to develop changes to the EIM algorithm that would ensure that electricity imports to California and their associated emissions are correctly accounted. The CAISO's recently adopted proposal to restrict the quantify of an external resources output that can be 'deemed delivered' to California to the increment above that resource's base schedule will reduce the incidence of secondary dispatch, and thus 'outstanding EIM emissions', but will not solve the problem completely. For this reason, WPTF expects and supports continued discussion of GHG accounting in the context of the CAISO's 2019 initiative to extend the day-ahead market.

Despite the intention of CAISO and stakeholders to continue to find a long-term solution to the GHG accounting problem, CARB staff now intend to eliminate the 'bridge solution' whereby allowances that are unsold from auction are retired to address EIM outstanding emissions and replace it with the so-called "EIM Purchaser" approach. As WPTF understand this EIM Purchaser approach, CAISO and CARB would continue to quantify emissions associated with secondary dispatch, but rather than retire allowances to account for these emissions, CARB would administratively assign a carbon obligation to California entities that purchase power from the EIM. The quantity of the compliance obligation for each EIM purchaser would be calculated by summing for each 5-minute interval the quantity derived by dividing each of the entity's negative deviation (i.e. the day-ahead scheduled load minus real-time metered load) by deviations of all California entities and multiplying the resulting by outstanding EIM emissions in that interval. Because an EIM purchaser is defined as an entity that purchases electricity through the EIM either to serve California load, or to deliver or sell to an entity, or on behalf of an entity, that serves California load, this approach would also assign a carbon obligation to California generators that have a negative deviation from day-ahead schedules in real-time.

WPTF strongly opposes the EIM purchaser proposal for several reasons. First, the EIM purchaser approach would provide no substantive benefit over the bridge solution in terms of GHG accounting accuracy or the carbon price signal, as both approaches would result in the same quantity of allowances being removed from the market, and neither approach addresses actual deficiencies in the EIM design.

Second, while we recognize that the bridge solution was intended as an interim solution until such a time that a long-term algorithmic solution could be developed and implemented in the EIM, it is premature to move away from it now. The partial solution that the CAISO has developed will reduce the magnitude of EIM outstanding emissions, and the CAISO will continue to address the GHG accounting issues in a new stakeholder initiative next year.

Third, the approach completely violates the underlying philosophy of carbon pricing – that entities can reduce their compliance obligations by altering their GHG emitting activities in response to the carbon price signal. Under the EIM purchaser approach, California entities that participate in the real-time market would potentially be subject to additional carbon obligations due to market conditions and factors over which they have absolutely no control. Because both the quantity of negative deviation and the quantity of outstanding emissions in any interval will often be a consequence of external factors and EIM dispatch, entities participating in the real-time market will not be able to predict and hedge against any additional compliance obligation. This is patently unfair.

Fourth, the EIM purchaser approach would result in carbon obligation for many entities that currently are not covered entities. This includes load-serving entities without generating assets that do not import electricity, as well as California renewable generators. This creates additional administrative burden and unfairly penalizes these entities.

Fifth, if carbon obligation on generators for negative deviation are sufficiently high, the EIM purchaser approach would create an incentive for California generators to ignore CAISO dispatch instructions and instead dispatch to the day-ahead schedule. The EIM purchaser approach would also impair the CAISO's efforts to get variable renewable resources to participate in the day-ahead market, as this would subject a renewable resource to a carbon penalty whenever its real-time dispatch does not meet its forecast/scheduled dispatch.

Given the clear costs and lack of benefits of moving to the EIM purchaser approach, WPTF urges CARB to rescind the proposal. We understand from conversations with staff that CARB is unable to maintain the bridge solution as currently implemented beyond February 2019 because the majority of allowances that remained in the Auction Holding Account have been moved to the Allowance Price Containment Reserve. Because of the CAISO's modification of the algorithm to restrict the output of an EIM participating resource that can be deemed delivered to the California, we expect that the quantity of EIM outstanding emissions – and thus the quantity of allowances that would need to be retired under the bridge solution – will be substantially lower next year. None-the-less, if there are not sufficient allowances available in the Auction Holding Account to cover EIM outstanding emissions, CARB should instead retire allowances allocated to electric distribution utilities.

Linkage:

Staff have introduced several provisions to authorize the steps that CARB took in response to Ontario's cancellation of its cap and trade program this summer. These include a provision giving the Executive Officer authority to suspend, revoke or repeal an approved linkage if a linked partner takes an official act to revoke its program, and the authority to modify auction dates and notifications.

WPTF supports staff effort to provide clarity around procedures for revoking linkage and appreciates the regulatory confirmation that all compliance instruments issued by Ontario that are held in accounts of California and Quebec entities remain valid for compliance. With respect to the new provision that authorizes the Executive to issue or cancel allowances to maintain environmental integrity, WPTF requests that staff explain how a determination would be made as to the need to maintain environmental integrity. We also recommend that CARB include additional language in the regulation stating that any cancellation of allowances necessary to maintain environmental integrity not be made from entity holding or compliance accounts.