October 22, 2013

Submitted electronically to http://www.arb.ca.gov

California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Re: Comments of CP Energy Marketing (US) Inc. on Proposed Regulatory Amendments to ARB Cap and Trade Regulations

CP Energy Marketing (US) Inc. ("CPEM") appreciates the opportunity to provide comments to the Air Resources Board ("ARB") Proposed Amendments to the California Cap and Trade Program posted September 4, 2013.[1]

1. CONDUCT OF TRADE.

CPEM strongly urges ARB to reconsider the proposed modifications on Conduct of Trade found in § 95921. CPEM appreciates ARB's desire to have information necessary to perform its market monitoring function. However, CPEM submits that the proposed regulations calls for a level of transactional detail that is beyond the scope of what is needed, creates unnecessary burdens on transactions, and potentially exposes highly confidential information. ARB already has enforcement tools at its disposal sufficient to keep a careful reign on the market. ARB already has full access to the balance of compliance instruments in various parties' accounts, will know the prices bid by all parties at auction, and will know the price paid for compliance instruments traded on CITTS. If any trade triggers a concern, ARB already has authority to request access to underlying contractual documents at that time. Requiring all parties to submit extensive documentation for routine trades, when there is no indicia of any kind of a market issue, is unnecessarily burdensome on both market participants and ARB Staff. This proposal to require such detailed information be provided through CITSS is particularly troubling given the proposed language of the CITSS User Agreement, Section 1.4, which specifies that ARB may disclose information provided by users to the public "to the extent that disclosure is not prohibited by California Law." To the

[1] Posted September 4, 2013, http://www.arb.ca.gov/regact/2013/capandtrade13/capandtrade13.htm

extent the ARB does require filing of this information, the regulations should be modified to reflect that all information shall be maintained on a strictly confidential basis, shall be exempted from the California Freedom of Information Act to the maximum extent allowed by law, and shall not otherwise be disclosed absent compelling need and legal requirement.

With respect to the specific text, CPEM offers the following comments:

Section 95921(a)(3) (B) and Definition 130 "Execution Date"

Section 95921(a)(3)(B) has been modified to subject parties to violation or penalty if a transaction is completed "More than three days after ***the execution date or*** termination date of the transaction agreement for which the transfer request is submitted." (Emphasis supplied). New definition 130, in turn, defines "Execution Date" as "a provision of a transaction agreement that requires the transfer of compliance instruments on or before a date specified in the agreement."

CPEM submits that the definition of "execution date" and the reference in Section 95921(a)(3) are inappropriate and can lead to substantial confusion. In standard commercial parlance, the "execution date" of an agreement is the date on which both parties have legally committed to the agreement, or a specified date near such time. Indeed, "Execution Date" is often a defined term in agreements to transfer carbon instruments (see, for example, the Form of Master Allowance/Offset Credit Purchase Agreement (California) published by San Diego Gas & Electric Company, and available http://www.sdge.com/ghg-offset-credit-rfo-september-2013). Creating a newly defined term that means something materially different than the term in standard commercial use can lead to unnecessary confusion. The proposed regulations specifically contemplate that, under some transactions, a transfer request may be set to take place more than three days from the date the parties enter into a transaction. Please see, for example, proposed section 95921(b)(4), which clearly demonstrates that the regulations are not intended to require transfer of carbon instruments within three days of the execution date, as that term is normally used. Rather than attempt to redefine "execution date" from its standard meaning, CPEM recommends adoption of the term "Agreement Transfer Date" (as proposed in the October 18, 2013 comments filed by the Southern California Public Power Authority).

Section 95921(a)(3) (C) New Section 95921(a)(3)(C) specifies that parties to a transfer will be in violation if the transfer process ***is completed*** more than three days ***after transfer of consideration*** from the purchaser of the compliance instrument. CPEM believes this standard is unworkable. The transfer process itself can take three days. Requiring the process to be ***completed*** prior to that time essentially means that the process must be ***started prior to payment*** for the instruments to ensure no violation would occur – a commercially unreasonable outcome. Counterparties often agree that payment must be made sufficiently prior to delivery to insure that all monies have cleared. Commercially, there should be no reason why a party can not pay in advance a fixed price for carbon instruments that will delivered over the course of time. Such a transaction could lower costs for all parties by avoiding concerns about payment risks, the need to hold alternative security, etc. CPEM submits that, if a time window is included, it should be based on the time the transfer is ***initiated***, not completed.

With respect to both Section 95921(a)(3)(B) and Section 95921(a)(3)(C), CPEM expressly requests, that, in the event these proposed changes are not deleted, the ARB clarify that parties to an existing transaction will not be penalized (or otherwise be held in violation) to the extent they act in good faith under the terms of agreements that existed prior to the effective date of this proposed rule. For example, the ARB should clarify that a party to an existing transaction that calls for payment to be made seven days prior to delivery of compliance instruments will not be subject to penalty.

Section 95921(a)(4) New section 95921(a)(4) specifies that "an entity may not submit a transfer request to another registered entity without an existing transaction agreement with that party authorizing a transfer." CPEM believes this provision is unnecessary. If it is included, ARB should clarify that such agreement need not be a formal written document. Many registered entities are sophisticated parties that routinely operate in energy and commodity markets, and frequently close transactions based on oral agreement (generally recorded), instant message, or other form of communication. Such transactions may rely on a master agreement for additional terms and conditions, may rely on interpretation under the Uniform Commercial Code, and/or may rely on other legal principles, such as course of dealings between the parties.

Section 95921(b)(1) New section 95921(b)(1) requires the entity entering information for a transfer request to provide the identification of the two primary account representatives and/or alternate account representatives for both the source account (§95921(b)(1)(A)) and the destination account (§95921(b)(1)(B)). CPEM submits that this is not necessary: the system already holds the identity of these persons, and checks and balances are in place to ensure that the correct persons exercise their respective obligations. Perhaps more importantly, the entity entering the transfer request for the ***source account has no basis for knowing, and may not be entitled to know, who is authorized to act for the destination account***. Adding this requirement adds an unnecessary level of complexity to agreements, as it would require parties to update counterparties of any changes to their internal delegations, etc.

Section 95921(b)(3)(B) New Section 95921(b)(3)(B) requires that a transfer request for an over the counter agreement include a "Date of settlement," and notes that, if there are financial or other terms to be settled after the transfer request is approved, the date those terms are to be settled should be entered as the settlement date. The ARB should recognize that many terms to be settled may be subject to floating dates or dates triggered by other events. As such, ARB should clarify that, if the settlement date is not fixed in the contract, an estimated settlement date may be provided, without subjecting the reporting entity to liability if the date changes.

Section 95921(b)(4)(B) New Section 95921(b)(4)(B) requires that a transfer request for an over the counter agreement with delivery to take place in the future include a "date the transaction agreement terminates." As with the date of settlement discussed above, termination dates are often not fixed, and the agreement may extend until all parties have performed their obligations. As such, ARB should clarify that, if the termination date is not fixed in the contract, an estimated termination date may be provided without subjecting the reporting entity to liability if the date changes.

Section 95921(b)(4)(C) New Section 95921(b)(4)(C) requires that, if a transaction agreement provides for further compliance instruments transfers, the transfer request must specify whether the transfers are monthly, quarterly, annual or unspecified. ARB should

clarify that a transfer request may indicate "unspecified" for transactions with other specified terms (such as biannual or biennial) without violating the regulations.

Section 95921(b)(4)(D) New Section 95921(b)(4)(D) requires that, if a transaction agreement provides for transfers of other "products" such products must be specified. ARB should clarify the definition of "products."

Section 95921(f)(1)(A) New Section 95921(f)(1)(A) specifies that "[a]n entity may not hold allowances in which a second entity has any ownership or financial interest." CPEM recommends that this section be modified as set forth below to clarify that this section is not intended to limit an entity's ability to enter into secured transactions or financing agreements in which allowances may be used for collateral.

> 95921(f)(1)(A) specifies that "[a]n entity may not hold allowances in which a second entity has any ownership or financial interest**. These prohibitions do not apply to financial interests created for financing or collateral purposes.**

2. COMPLIANCE INSTRUMENT RETIREMENT ORDER

Section 95856(h) New section 95856(h) specifies a mandatory compliance instrument retirement order under which the Executive Officer will withdraw compliance instruments from an entities' Compliance Account. CPEM believes it is appropriate for the regulations to specify a compliance retirement order to be used as a default, if no other order is specified by a covered entity, and believes that the proposed order is appropriate for that purpose. However, CPEM strongly believes a compliance entity should have the flexibility to specify a different order to meet its own business needs. Specifically, CPEM requests that Section 95846(h)(1) be modified as follows:

> **(1)** When a covered entity or opt-in covered entity surrenders compliance instruments to meet its annual compliance obligation pursuant to section 95856(d), the Executive Officer will retire them from the Compliance Account **in the order proposed by the entity, and if no such order is proposed,** in the following order.

3. AUCTION INTENT TO BID NOTIFICATION

Section 95912(f); Section 95913(e). New Section 95912(f) specifies that an entity that "intends to participate" in an auction must inform the Auction Administrator at least 30 days prior to an auction of its intent to bid in an auction. Similarly, new Section 95913(e) provides that an entity must inform the reserve sale administrator at least 20 days prior to a reserve sale of its "intent to bid." CPEM requests that the ARB clarify that this indication of intent does not represent a binding commitment to participate in such auctions. For example, an entity may, more than 30 days prior to an auction, intend to participate, but prior to such auction find an over-the-counter transaction under which it can purchase the compliance instruments required at a fixed price, thereby avoiding auction risk, and rendering its auction participation unnecessary. CPEM recommends that Section 95912(f) be revised, as set forth below, with a corresponding change to Section 95913(e):

> Auction Intent to Bid Notification Requirements. An entity that intends to participate in an auction must inform the Auction Administrator at least 30 days prior to an auction of its intent to bid in an auction, otherwise the entity may not participate in that auction**. Informing the Auction Administrator of an intent to bid does not commit the entity to participate in the auction.**

4. ISSUANCE OF ARB OFFSET CREDITS

Section 95981 Section 95981, Issuance of ARB Offset Credits, has been revised to include additional specificity regarding the mechanics under which an Offset Project Operator or Authorized Project Designee may submit a request for issuance of ARB offset credits. CPEM recommends these provisions be clarified in two respects. First, CPEM understands that, in addition to the Offset Project Operator and Authorized Project Designee, an offset Holder also may initiate a request for issuance of ARB offset credits. This fact should be made clear in the regulations. Second, CPEM understands that, regardless of whether a request is made by an Offset Project Operator, an Authorized Project Designee, or a Holder, circumstances exist in which an entity only desires to have a portion of the eligible credits from a project be issued as ARB Offset Credits. ARB should clarify, and specify the mechanism for, allowing the requesting entity to specify the portion of a project for which offset credits should be issued.

5. REGISTRATION WITH ARB – ACCESS TO INFORMATION

Section 95830(c)(1)(l) New Section 95830(c)(1)(I) provides that an entity registering with the ARB must provide names and contact information for "for *all* persons employed by the entity in a capacity giving them *access to* information on compliance instrument transactions or holdings, or involving them in decisions on compliance instrument transactions or holdings" (emphasis supplied).

CPEM submits that this section is overly broad, unnecessary, and should be eliminated or clarified. As drafted, "*all* persons with *access to* information" could cover a substantial number of persons – perhaps the majority of a company's employee pool -- despite the fact that the vast majority of such employees only have access to minor pieces of information, and may not have access to or knowledge of the registrant's account balances, strategies, or other information. By way of example, a records archive administrator or file clerk may have access to a transaction document regarding compliance instruments. A regulatory analyst may be asked to determine whether an early action offset will be subject to revocation. A credit analyst may review a counterparty's credit status for a particular transaction. A computer technician may have *access* to corporate records, although it would be impermissible for them to use such access. Requiring a registrant to provide names and contact information for employees with just *access to* such information, without any test of relevancy, is inappropriate.

Moreover, without at least some test for materiality, requiring a registrant to keep such a list up to date within 10 working days of any change, as required by the Section 95830(f)(1), is extremely burdensome, as an employee may on occasion perform a function providing access to information – even non-material information – that could trigger the very broad rule accidentally. Consider, for example, a maintenance person temporarily re-assigned for one week for vacation coverage to internal mail delivery/copy room functions. Would a registered entity be required to submit a regulatory filing within 10 days of that event? CPEM does not believe that other regulators – the CFTC, FERC, the SEC, or similar bodies, require this type of information for compliance, and do not believe it is necessary or appropriate here. And, as discussed below with reference to Section 95923, attorneys (including attorneys employed by a cap and trade entity) are subject to regulation under state

(and/or provincial) bars, have ethical obligations to protect client confidentiality, and are subject to strict conflict of interest rules. At the least, CPEM requests that this section be modified as follows:

> "Names and contact information for all persons employed by the entity **(other than legal counsel)** in a capacity giving them access to **material** information on compliance instrument transactions or holdings, or involving them in **material** decisions on compliance instrument transactions or holdings, **and which, by virtue of their job function, allows them to affect material transactions and strategy.**"

6. RECONGITION OF EARLY ACTION OFFSET CREDITS –ODS

Section 95990(e)(2)(G) New Section 95990(e)(2)(G) specifies that, for early action offset projects developed under the Climate Action Reserve U. S. Ozone Depleting Substances Project Protocol version 1.0, each reporting period, and/or each destruction event ***may*** be considered an independent project. CPEM requests clarification that such projects also may be listed as a single project, with multiple reporting periods. CPEM recommends the draft language be revised as follows: "For early action offset projects developed under the Climate Action Reserve U. S. Ozone Depleting Substances Project Protocol version 1.0, each reporting period, and/or each destruction event may **either** be considered an independent project **or may be listed as a single project with multiple reporting periods**.

7. DISCLOSURE OF CAP AND TRADE CONSULTANTS AND ADVISORS

Section 95923 New Section 95923 sets forth new disclosure requirements for "Cap and Trade Consultants and Advisors," which are defined as a person or entity that is not employed by an entity registered in the cap and trade program, "but is paid for information or advice related to the Cap-and-Trade Program specifically for the entity registered in the Cap-and-Trade Program."

CPEM requests that ARB clarify draft section §95923 in a variety of respects. First, CPEM believes the phrase "advises or consults with the entity regarding compliance with the Cap-and-Trade Program specifically for the entity registered in the Cap-and-Trade Program" is too broad as drafted, and could improperly capture consultants advising on non-material issues.

Second, CPEM requests that ARB clarify that this disclosure provision does not apply to attorneys, who are subject to regulation under state (and/or provincial) bars and have ethical obligations to protect client confidentiality and are subject to strict conflict of interest rules. Outside counsel frequently advise entities regarding compliance matters, some of which may be confidential and sensitive, and such attorneys may not be permitted under state bar rules to disclose that fact to other entities, including other existing or prospective clients. Moreover, to the extent outside counsel is engaged to provide advice with respect to compliance with ARB regulations, disclosing this fact to the ARB, as would be required pursuant to draft Section 95923(b)(2), may operate as a waiver of the attorney–client privilege, rendering access to counsel ineffective. Given the overbroad definition discussed above, and given that attorneys are subject to express regulation with respect to client confidentiality and conflict of interest, and the longstanding public policy of encouraging the opportunity to seek advice of counsel, CPEM requests that Section 95923(a) be modified as follows:

> A "Cap-and-Trade Consultant or Advisor" is a person or entity **(other than an attorney providing legal advice)** that is not an employee of an entity registered in the cap-and-trade, but is paid for information or advice related to the Cap-and-Trade Program specifically for the entity registered in the Cap-and-Trade Program **in a manner that the Consultant or Advisor receives confidential information regarding the entity's auction or compliance instrument holding strategy**.

CPEM also requests that the ARB clarify whether a "Cap-and-Trade Consultant or Advisor" as used in Section 95923(a) is the same or different than an "auction bid advisor" as used in new section 95914(c)(2)(B) or an "advisor regarding auction bidding strategy" as referenced in 95914(c)(3). If these definitions are the same, then CPEM submits that new Section 95923 is entirely unnecessary, as such entities are already required to be disclosed to the Executive Officer. If such advisors are different, then CPEM requests specific clarification as to when the different definitions of advisor apply. And, as discussed above, CPEM requests that the ARB clarify that the definition of advisor as used in Section 95914 does not include attorneys subject to regulation under state (and/or provincial) bars that have ethical obligations to protect client confidentiality and are subject to strict conflict of interest rules.

8. CONCLUSION

CPEM greatly appreciates the time and effort of ARB and its staff in the ongoing efforts to update the Cap and Trade Regulations to ensure a successful program, with a robust and fair market and regulatory certainty for participants. CPEM asks that ARB give consideration to the comments set out above as it determines appropriate modifications moving forward. To the extent that ARB declines to modify the proposed regulations to address the issues raised herein, CPEM respectfully requests that ARB articulate in full its rationale in the Final Statement of Reasons, and include detailed guidance to facilitate the market's ability to comply with the regulations.