State of California
Environmental Protection Agency
AIR RESOURCES BOARD

AMENDMENTS TO CALIFORNIA'S CAP-AND-TRADE PROGRAM

FINAL STATEMENT OF REASONS

July 2012

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State of California
California Environmental Protection Agency
AIR RESOURCES BOARD

Final Statement of Reasons for Rulemaking,
Including Summary of Public Comments and Agency Responses

PUBLIC HEARING TO CONSIDER PROPOSED AMENDMENTS TO THE CALIFORNIA CAP ON GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE MECHANISMS

Public Hearing Date: June 28, 2012
Agenda Item No.: 12-4-5

I. GENERAL

A. Action Taken in This Rulemaking

In this rulemaking, the Air Resources Board (ARB or the Board) is adopting amendments to the California Cap-and-Trade Regulation (Regulation) to allow for implementation of the market program. The amendments were developed pursuant to the requirements of the California Global Warming Solutions Act of 2006, also known as Assembly Bill 32 (AB 32). The amendments are codified at sections 95802, 95812, 95814, 95830, 95831, 95832, 95833, 95834, 95856, 95870, 95892, 95910, 95911, 95912, 95913, 95914, 95920, and 95921 of Title 17, California Code of Regulations (CCR).

In October 2011, the Board adopted the California Cap-and-Trade Regulation. The cap-and-trade program is a key element of California's climate strategy. It creates an aggregate greenhouse gas (GHG) emission limit on the sources responsible for 85 percent of California's GHG emissions, establishes a price signal needed to drive long-term investment in cleaner fuels and more-efficient use of energy, and affords those regulated by the program flexibility to seek out and implement the lowest-cost options to reduce emissions. The cap-and-trade program was designed to work in concert with other measures, such as standards for cleaner vehicles, low-carbon fuels, renewable electricity, and energy efficiency. The program also complements and supports California's existing efforts to reduce criteria and toxic air pollutants.

The rulemaking was initiated by the May 9, 2012, publication of two notices for a public hearing scheduled on June 28, 2012. A Staff Report: Initial Statement of Reasons, entitled “Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance

Instruments Issued by Linked Jurisdictions" (Staff Report or ISOR) was also made available for public review and comment starting on May 14, 2012. The notices reflected two sets of proposed amendments. The first set of proposed amendments, addressed in this FSOR, related to program implementation. The second set of proposed amendments (linkage amendments) relate to the establishment of a joint market program between California's and Quebec's programs. The linkage amendments would allow for the mutual acceptance of California and Quebec issued compliance instruments by each jurisdiction. During the week of June 28th, SB 1018 was passed by the California Legislature and signed by the Governor. SB 1018 added Government Code section 12894 which imposed additional requirements on ARB prior to any linkage with any other state, province or country. Specifically, section 12894(f) requires ARB to notify the Governor of any proposed linkage so the Governor can make certain findings. These findings include that the proposed linked jurisdiction's program is equivalent to or stricter than California's program, that California is able to enforce its laws to the extent permissible by the California and US Constitutions, that the linked jurisdiction's enforcement provisions are equivalent to or stricter than California's, and that the linkage does not impose any significant liability on California or ARB related to the proposed linkage. Therefore, the Board only acted on the implementation related amendments. The Staff Report contains an extensive description of the rationale for the proposal. These documents were also posted on May 9, 2012, on ARB's internet site for this rulemaking at:
http://www.arb.ca.gov/regact/2012/capandtrade12/capandtrade12.htm.

On June 28, 2012, the Board conducted a public hearing to consider the staff's proposal as set forth in the Staff Report. During the comment period that commenced on May 14, 2012, and ended at noon on July 3, 2012, the Board received 43 separate written comments on both sets of amendments. Many comment letters addressed both sets of amendments. At the hearing, the Board received oral testimony from 16 persons.

At the conclusion of the hearing, the Board adopted Resolution 12-27 which directed staff to finalize the proposed amendments related to program implementation. The Board also adopted Resolution 12-28, directing staff to take the necessary steps specified in SB 1018 to seek review of Québec's program by the Governor prior to a vote on the linkage-related amendments. Staff plans to return to the Board where the Board would consider the linkage related amendments at a future noticed public hearing.

This Final Statement of Reasons (FSOR) includes all comments directed toward both sets of the amendments, and ARB's responses to those comments. Where the amendments relate to the linkage amendments, the response identifies that no action was taken on those areas and no response is appropriate at this time. A separate FSOR will address the linkage related amendments and comments.

B. Fiscal Impacts

Implementation Amendments

The Executive Officer has determined that the proposed regulatory action would not create costs or savings, as defined in Government Code sections 11346.5(a)(5) and 11346.5(a)(6), to State agencies or in federal funding to the State. The proposed regulatory action would not create costs and would impose a mandate on State and local agencies, but would not create costs or impose a mandate on school districts.

Because the regulatory requirements apply equally to all covered entities and unique requirements are not imposed on local agencies, the Executive Officer has determined that the proposed regulatory action imposes no costs on local agencies that are required to be reimbursed by the State pursuant to part 7 (commencing with section 17500), division 4, title 2 of the Government Code, and does not impose a mandate on local agencies or school districts that is required to be reimbursed pursuant to section 6 of Article XIII B of the California Constitution.

The Executive Officer has determined that representative private persons and businesses would not be affected by the cost impacts from the proposed regulatory action. Pursuant to Government Code section 11346.5(a)(7)(C), the Executive Officer has made an initial determination that the proposed regulatory action would not have a significant statewide adverse economic impact directly affecting businesses, and little or no impact on the ability of California businesses to compete with businesses in other states.

C. Consideration of Alternatives to the Implementation Amendments

There are no reasonable alternatives to the implementation amendments. Although some commenters suggested alternatives to the information collected, staff believes these alternatives do not adequately protect the cap-and-trade program from fraud and other potential manipulations of the market.

II. SUMMARY OF COMMENTS MADE DURING THE 45-DAY COMMENT PERIOD AND AGENCY RESPONSES

Chapter II contains all comments submitted during the 45-day comment period and the subsequent Board hearing that were directed at the proposed regulation or to the procedures followed by ARB in proposing the regulation, together with ARB's responses. The 45-day comment period commenced on May 9, 2012, and ended on June 27, 2012, with additional comments submitted at the June 28, 2012, Board hearing on the proposed regulation.

We received 43 letters on the proposed regulation during the 45-day comment period, and 16 oral testimonies during the June 28, 2012, Board hearing. Commenters included representatives from the electricity sector, financial services providers, and trade groups. To facilitate ease of use, comments are categorized into one of 16 sections below, and are grouped for response wherever possible.

Table II-1 below lists commenters that submitted comments during the 45-day comment period up to and at the Board Hearing, identifies the date and form of their comments, and shows the Abbreviation assigned to each.

A. LIST OF COMMENTERS

Table II-1: Comments Received During the 45-Day Comment Period

Abbreviation	Commenter
AB32IG	Shelly Sullivan, AB 32 Implementation Group Written Testimony: 06/27/12
ACR	Belinda Morris, American Carbon Registry Oral Testimony: 06/28/12
AHAM	Charlotte Skidmore, Association of Home Appliance Manufacturers Written Testimony: 06/27/12
BREATHECALIFORNIA	Andy Katz, Breathe California Oral Testimony: 06/28/12
CALCHAMBER	Brenda Coleman, California Chamber of Commerce Oral Testimony: 06/28/12
CALPINE1	Kassandra Gough, Calpine Corporation Written Testimony: 06/21/12
CALPINE2	Kassandra Gough, Calpine Corporation Oral Testimony: 06/28/12
CBD	Brian Nowicki, Center for Biological Diversity Written Testimony: 06/27/12
CERP	Kyle Danish, Coalition for Emissions Reduction Policy Written Testimony: 06/27/12
CHEVRON	Stephen Burns, Chevron Corporation Written Testimony: 06/27/12
CMUA1	Tony Andreoni, California Municipal Utilities Association Written Testimony: 06/26/12
CMUA2	Tony Andreoni, California Municipal Utilities Association Oral Testimony: 06/28/12
CPEMUS	Zoltan Nagy-Kovacs, CP Energy Marketing (US) Inc. Written Testimony: 06/25/12
EDF1	Erica Morehouse, Environmental Defense Fund Written Testimony: 06/27/12
EDF2	Erica Morehouse, Environmental Defense Fund; Michelle Passero, The Nature Conservancy; Alex Jackson, Natural Resources Defense Council; Jennifer Martin, Center for Resources Solutions Written Testimony: 06/27/12
EDF3	Erica Morehouse, Environmental Defense Fund; Alex Jackson, Natural Resources Defense Council Written Testimony: 06/27/12
EDF4	Erica Morehouse, Environmental Defense Fund Oral Testimony: 06/28/12
FREEMANW	W. M. Freeman Written Testimony: 07/03/12

FREEMANH	H. H. Freeman Written Testimony: 07/03/12
GA	Michael Gardner, Gypsum Association Written Testimony: 06/27/12
IEPA	Amber Riesenhuber, Independent Energy Producers Association Written Testimony: 06/27/12
IETA	Katie Sullivan, International Emissions Trading Association Written Testimony: 06/24/12
LADWP1	Jodean Giese, Los Angeles Department of Water and Power Written Testimony: 06/22/12
LADWP2	Cindy Parsons, Los Angeles Department of Water and Power Oral Testimony: 06/28/12
LEHR	George Lehr Written Testimony: 07/03/12
LP	Carla Banks, La Paloma Generating Company Written Testimony: 06/27/12
MSCG	Steve Huhman, Morgan Stanley Capital Group Written Testimony: 06/13/2012
NCPA	Susie Berlin, Northern California Power Agency Written Testimony: 06/27/12
PEB	Sean Lane, PE-Berkeley/Olympus Power Written Testimony: 06/27/12
PFT1	Paul Mason, Pacific Forest Trust Written Testimony: 06/27/12
PFT2	Paul Mason, Pacific Forest Trust Oral Testimony: 06/28/12
PGE1	Judi Mosley, Pacific Gas & Electric Written Testimony: 06/18/12
PGE2	Kate Beardsley, Pacific Gas & Electric Oral Testimony: 06/28/12
SAVNIK	Angela Savnik, Written Testimony: 07/03/12
SCE1	Nancy Chung Allred, Southern California Edison Written Testimony: 6/22/12
SCE2	Frank Harris, Southern California Edison Oral Testimony: 6/28/12
SCPPA1	Norman Pedersen, Southern California Public Power Authority Written Testimony: 06/18/2012
SCPPA2	Norman Pedersen, Southern California Public Power Authority Oral Testimony: 06/28/2012
SEMPRA1	Tamara Rasberry, Sempra Energy Utility Written Testimony: 06/22/12

SEMPRA2	Tamara Rasberry, Sempra Energy Utility Oral Testimony: 06/28/12
SMUD1	William Westerfield, Sacramento Municipal Utilities District Written Testimony: 06/27/12
SMUD2	William Westerfield, Sacramento Municipal Utilities District Oral Testimony: 06/28/12
SOLARTURBINES	Craig Anderson, Solar Turbines Oral Testimony: 06/28/12
TWS1	Ann Chan, The Wilderness Society Written Testimony: 06/27/12
TWS2	Ann Chan, The Wilderness Society Oral Testimony: 06/28/12
UCS	Barbara Haya, Union of Concerned Scientists Written Testimony: 06/27/12
VALERO	Patrick Covert, Valero Written Testimony: 06/27/12
WEC	Doug Davie, Wellhead Electric Company Written Testimony: 06/27/12
WHELTON	Dave Whelton Written Testimony: 07/03/12
WPTF	Clare Breidenich, Western Power Trading Forum Written Testimony: 06/27/12
WSPA1	Catherine Reheis Boyd, Western States Petroleum Association Written Testimony: 06/27/12
WSPA2	Mike Wang, Western States Petroleum Association Oral Testimony: 06/28/12

B. ELIGIBILITY

B-1. Comment: Limitation of Participation to US Companies

Under the proposed rules, ARB essentially proposes to limit participation in the California market to “US companies”. MSCG views this decision to be problematic and fraught with the risk of unintended consequences. First, the ARB must provide more definition with regard to what constitutes a “US Company”. Is US incorporation required? Does it depend on the citizenship of the stockholders of the company? How about a country with a US subsidiary but a parent incorporated in another country? Second, ARB should consider whether exclusion of “foreign” companies is really in the best interests of the program. For example we would note that many large investors in and developers of US renewable resources are foreign companies. Is it really good public policy to exclude these entities from participation in the program? Third, has ARB considered the possibility that an entity with a compliance obligation may not be a US company? That would create quite a headache trying to resolve that dilemma.

Although MSCG considers it unlikely that it will not be able to qualify, under whatever final definition of a “US company” ARB might adopt, that is not 100% clear. For example, MSCG’s parent company is 20% owned by a foreign entity. For all of the reasons discussed above, and in the interest of avoiding adverse unanticipated consequences, we believe that barring non-US companies outright should be reconsidered. A better approach to addressing legitimate concerns would probably be to focus on requiring participants to have a US presence. This might be done in a way similar to the way that businesses are often required to establish a California presence, e.g. by establishing an agent for service of process, if a physical office is not maintained in the state.

We further note that, however a “US company” is ultimately defined, many such companies have worldwide operations, and may very well perform certain tasks required for compliance, or other participation in the allowance markets, in other countries. For example, MSCG has offices in both London and Budapest where certain functions related to transaction administration might plausibly be assigned. We would note that, relating back to our objections to supplying personal information in the prior section, an employee authorized to direct movement of allowances among accounts might very well be stationed in one of those locations, and would be highly unlikely to have a US bank account.

The underlying point is, as a general principle, ARB should not design its regulations so as to force market participants to restructure their administrative staffing assignments without a compelling reason, and no such reason exists here. Therefore, we strongly urge ARB to think about how its regulations might impact companies’ unobjectionable business practices, particularly with regard to country of residence of task performers, and avoid any interference in those practices without a compelling need. We submit that no such need exists with regard to the country of residence of authorized officers, directors, agents or representatives. (MSCG)

Response: The regulation does not use the term "U.S. company" in setting out the criteria for eligibility to register into the cap-and-trade program. Section 95814(a)(3) states that an entity must be located in the United States in order to register as a voluntarily associated entity. Section 95802 provides a definition of "entity." Staff is well aware that there are entities operating in California or the United States which may, for example, be subsidiaries of companies located outside the United States. The regulation allows these subsidiaries to register. Thus, the public policy issues raised in the comment do not actually arise.

Staff disagrees with the comment's assertion that the Board is forcing entities to reorganize. As explained in the ISOR for this regulation, staff must structure eligibility so that the Board has enforcement capability with those who participate in the program. While a multinational entity may "plausibly" assign functions related to the California Cap-and-Trade market to employees located outside the United States, it is not reasonable for ARB to sacrifice the enforceability of the program to accommodate such a desire.

C. REGISTRATION

Publicly Owned Utilities (POUs)

C-1. (multiple comments): Clarify registration information requirements as they apply to POUs.

Comment: POUs such as the members of SCPPA are not incorporated entities; rather, they are municipal entities. As such, they do not have a date and place of incorporation, they do not necessarily have people with the job titles "directors" and "officers", which have specific meanings for incorporated entities, and they do not have voting securities. (SCPPA1)

Comment: Section 95830. Registration with ARB – Account Representative designation
In Section 95830(c)(1) ARB now requires the names and addresses of the entity's directors and officers. Although the rule itself does not clearly state how an entity should decide which directors and officers are required to be registered, the Initial Statement of Reasons (May 9, 2012) states that the language is needed to ensure that delegations of account representatives and account viewing agents pursuant to Section 95832 are made by persons with authority to legally bind an entity. LADWP recommends that the Statement of Reasons include a statement that recognizes the governing structure of a municipal entity, such as the following: The General Manager of a Publicly Owned Utility (POU) will designate a person to represent the POU for registration into the cap-and-trade program. LADWP also recommends that in the Statement of Reasons, the ARB recognize that the proposed regulations will require this representative of the POU to exercise a certain level of discretion in the rule per California Government Code Section 820.2. (LADWP1)

Comment: Section 95830. Registration with ARB—Corporate Associations not applicable to POU

In addition, there are requirements that an entity provide corporate association information and list the names and contact information for persons controlling over 10 percent of the voting rights attached to all the outstanding voting securities of the entity. POUs such as LADWP are not incorporated entities but municipal utilities; thus, such requirements are not applicable to LADWP. For clarification, LADWP recommends that the following language be added as new provision 95830(c)(1)(j): The entity name, address and name of the representative of the POU complying with this requirement is sufficient. (LADWP1)

> **Response:** Staff recognizes that a POU's organizational structure is different from that of most other entities that will register. Staff made changes to section 95833(a)(5) to take the differences in organizational structure into account when defining a direct corporate association. Staff used the terms "directors" and "officers" to refer to functions that are commonly understood to be undertaken within business entities, not necessarily titles. If any requirements do not apply, the information does not need to be submitted.

Registration Denial

C-2. Comment: Given the importance of registration for participating in the emissions market and complying with the cap-and-trade program, any circumstances in which an applicant may be denied registration should be clear. Subsection (i) of section 95830(c)(1)(I) is problematic in this regard. The Regulation does not specify what sort of information, if provided by an applicant, would result in registration being denied under this subsection. Nor does subsection (i) include a requirement for a determination by the Executive Officer, unlike subsections (ii) and (iii).

Subject to our comment in section III.A above, the information that must be provided under sections 95830(c)(1)(A)-(H) is relatively straightforward and, so long as it is accurate and complete, would not appear to provide any reasonable basis for denying registration. Subsections (ii) and (iii) of section 95830(c)(1)(I) address accuracy and completeness. The ARB should not have the broad ability to deny an application for registration "based on information provided" if that information is complete and accurate. (SCPPA1)

> **Response:** ARB would deny eligibility based on information provided when that information confirms that the entity is not eligible to register. If all requirements for registration in the regulation are met, the applicants would be eligible for registration.

Confidential Information

C-3. **(multiple comments):** Strengthen protection of confidential information.

Section 95830(g) provides that information about individuals collected under certain sections of the Regulation "will be treated as confidential by the Executive Officer and the accounts administrator to the extent possible, and except as needed in the course of oversight, investigation, enforcement and prosecution." Given the significant volume and sensitivity of the information about individuals collected under the relevant sections of the Regulation—including personal bank account details—it is very important to strengthen this information protection provision. As the information collected is of similar sensitivity to that collected for taxes, the confidentiality provision in the California Revenue and Taxation Code may serve as a guide. Section 14251 of that code provides as follows:

> All information and records acquired by the Controller or any of his or her employees are confidential in nature, and except insofar as may be necessary for the enforcement of this part or as may be permitted by this article, shall not be disclosed by any of them. Except insofar as may be necessary for the enforcement of this part or as may be permitted by this article, any former or incumbent Controller or employee of the Controller who discloses any information acquired by any inspection or examination made pursuant to this article is guilty of a felony, and upon conviction shall be imprisoned pursuant to subdivision (h) of Section 1170 of the Penal Code.

Certain concepts in this provision, particularly the consequences for breaching the confidentiality requirement, should be incorporated into the confidentiality provision in the Regulation to ensure that appropriate weight is given to this requirement.

In addition, the confidentiality provision in the Regulation should not be limited to information collected during the registration process. Confidential information may also be collected under the relevant sections of the Regulation at any time after registration, if a new or replacement primary account representative, alternate account representative, or account viewing agent is appointed.

This provision should clarify that only the Executive Officer, the accounts administrator and their employees will have access to this information, except in the defined circumstances. The reference to "the extent possible" should be deleted—the confidentiality obligation should be absolute, other than in the defined circumstances. The information management systems used by the entities with access to this information should ensure its confidentiality.

Finally, the defined exceptions—oversight, investigation, enforcement and prosecution—should be limited to those actions taken by the ARB pursuant to this Regulation. Confidential information provided under this Regulation should not be available for enforcement of another ARB regulation or for unrelated programs of the accounts administrator. (SCPPA1)

Comment: Section 95830(g) Information confidentiality
The rule states that the registration information collected for individuals "will be treated as confidential by the Executive Officer and the accounts administrator to the extent possible [emphasis added], and except as needed in the course of oversight, investigation, enforcement and prosecution."

LADWP recommends that the proposed phrase "to the extent possible" be struck from the provision as the level of confidentiality CARB undertakes is not discretionary.
SB 1386, as codified in California Civil Code Section 1798 requires agencies that store sensitive personal information, including government agencies engaged in business activities to notify California residents when that data has or may have been accessed without authorization. Civil Code Section 1798 also requires businesses that own or license personal information about a California resident to implement and maintain security procedures and practices to protect personal information from unauthorized access, destruction, use, modification or disclosure. Thus, there are specific requirements that CARB must implement in order to treat registration information as confidential. (LADWP1)

> **Response:** The regulation identifies information that is to be handled as confidential by ARB staff. Staff adheres to policies on confidential information and incompatible activities that are based on the Government Code provisions. Staff may be subject to disciplinary, civil, and criminal penalties, as appropriate, for revealing confidential information. All ARB staff acknowledges this policy and complete annual training on privacy protection. For this reason, staff did not include provisions of the type recommended by the comment. ARB takes its responsibility to protect confidential information very seriously. There have been many programs in the past that have required the agency to protect confidential information. As ARB implements the cap-and-trade program, staff will be implementing several procedures to protect confidential personal information, including, but not limited to, limited access file rooms and signed statements from staff that they understand the potential legal and civil actions for divulging confidential information. To the extent possible, ARB has tried to limit the amount of personal information required with the need to ensure integrity in the tracking system.

D. ACCOUNT REPRESENTATIVES

Account Representatives

D-1. Comment: The primary and alternate account representatives should be designated at the sole discretion of the account holder, and it should not be necessary for those individuals to be directly employed by the account holder. (Section 95832) There are many reasons why smaller entities will find it economically and administratively feasible to designate an outside entity to administer its allowance accounts, and the regulation should not include any prohibitions against such a designation. For example, several of NCPA's members are publicly owned electric utilities with minimal staff. The administrative burden associated with Cap-and-Trade Program compliance cannot be assumed by the current limited staff, nor it is feasible to hire new personnel. Instead, these smaller entities may want to take advantage of economies of scale and have their compliance instrument accounts administered by a third party, such as NCPA. Such an approach still provides direct accountability, but does not impose additional cost burdens on these smaller entities. (NCPA)

> **Response:** Section 95832 does not require the primary and alternate account representatives to be employees of a registered entity. However, staff does not agree with the comment's suggestion that employees of a registered entity may serve as account representatives for entities which are not part of the same direct corporate association. Such representatives could not comply with the requirements of sections 95914 and 95921, which deal with improper practices concerning auctions and trading.

D-2. Comment: Number of Individuals Associated with an Account

IETA commends ARB for allowing the designation of more account representatives. This amendment will enhance the ability of entities to efficiently manage their accounts. (IETA)

> **Response:** Staff appreciates the support. No further response is needed.

D-3. Comment: The ARB Should Clarify the Designations of Authorized Account Representatives

Section 95832 of the Proposed Regulation Order for Linkage provides that each regulated entity will have a single primary account representative and no more than four alternate account representatives. SCE appreciates the increase in the number of account representatives, but suggests that the total number of alternate account representatives be increased to five in order to allow for internal redundancy and control checks throughout the transfer process. (SCE1)

> **Response:** At this time, staff believes that five total representatives is sufficient for any entity in the tracking system. Staff will monitor this requirement and remain open to stakeholder concerns that may require allowing additional account representatives through a future regulation amendment.

D-4. Comment: SCE also requests the following clarifications to certain portions of this section.

- "Agreement": Sections 95832(a)(3) and 95832(c)(2) reference an "agreement" in the context of selecting account representatives. It is unclear what this "agreement that is binding" represents, and what the criteria for terms and conditions of such agreements are. Unless it is an ARB-provided pro forma agreement, concerns could arise regarding consistency among all the covered entities, and potential exposure for other entities.

- “Ownership Interest”: Sections 95832(a)(2) and 95832(a)(3) reference “ownership interest with respect to compliance instruments.” How is this concept defined? For a large company, it not certain who “all persons who have an ownership interest” would be. SCE requests clarification on this point. (SCE1)

  Response: The comment concerning section 95832(a)(3) and (c)(2) are out of the scope of the changes being proposed to the regulation, so no response is needed. The changes made to those sections only change the word “authorized” to “primary.”

  The comment concerning the use of the term “ownership interest” in section 95832(a)(2) refers to an organization, not an individual. ARB understands this to refer to the entity assigning the account representative. The reference in section 95832(a)(3) refers to the persons responsible for the account that are the ones employing the account representative. The term “ownership interest” refers to the interest of an entity in the allowances held in the account assigned to the entity.

Attestations

D-5. (multiple comments): Section 95832. Designation of Representatives and agents

Sections 95832(a)(6) and Section 95832(d) refer to attestation requirements of the primary account representative, alternate account representative and officers of an entity. During the second round of 15-day changes to the cap-and-trade regulation, the phrase "to the best of my knowledge" was deleted. CARB's response in the Final Statement of Reasons states, "...it appears that "to the best of my knowledge and belief' was inadvertently deleted. Unfortunately, we cannot fix this at this time. However, the intent is to hold the Authorized Account Representative to the "best of my knowledge and belief' standard. We will correct this omission when the regulation is amended in the future."

Thus, LADWP recommends that CARB re-insert the phrase in Section 95832(a)(6) and Section 95832(d) as follows:

Section 95832(a)(6): "...I also certify under penalty of perjury of the laws of the State of California that to the best of my knowledge and belief all information required to be submitted to ARB is true, accurate, and complete."

Section 95832(d): "...Based on my inquiry of those individuals with primary responsibility for obtaining the information, I certify under penalty of perjury under the laws of the

State of California that to the best of my knowledge and belief the statements and information submitted to ARB are true, accurate, and complete." (LADWP1)

Comment: Section 95832 – Attestations. PG&E supports the change in 95832(a) of additional alternate authorized account representatives and the addition of account viewing agents. However, with respect to the attestations in the registration section, PG&E requests that ARB revise the attestations language with the "to the best of my knowledge and belief" standard as indicated in last year's Final Statement of Reasons (FSOR), which stated: "[I]t appears that 'to the best of my knowledge and belief' was inadvertently deleted. Unfortunately, we cannot fix this at this time. However, the intent is to hold the Authorized Account Representative to the 'best of my knowledge and belief' standard. We will correct this omission when the regulation is amended in the future." (FSOR, p. 1679, Oct. 2011.) PG&E asks that this language be added back into the regulations in sections 95832(a)(3), 95832(a)(6), and 95832(d).

Comment: Attestation: In order to further refine Section 95832(d), SCE suggests the following modifications:

> ". . . I certify under penalty of perjury under the laws of the State of California that to the best of my knowledge and/or as represented to me by those individuals the statements and information submitted to ARB. . .;"
> ". . . I am aware that there are significant penalties for knowingly and/or intentionally submitting false statements and information."

These modifications are consistent with the intent of Section 95832(d) to ensure that the entity filing the report takes responsibility for the attestation. Currently, the proposed language transfers the obligation for attesting to personal knowledge of each data element onto the individual signing the attestation. It is unreasonable to place criminal sanctions upon one individual for a failing elsewhere in the filing entity's organization, given the size of their organizations, the volume of data to be reported, and the varied roles of those compiling the reports. SCE's proposed adjustments will still serve the ARB's purpose of ensuring that each compliance entity has an individual responsible for ensuring the correctness of each report, but without placing an outsized burden of guaranteeing each item of data under threat of criminal sanctions. (SCE1)

Comment: Section 95832: Attestation Requirements And The Designation And Delegation Procedures For Account Viewing Agents Should Be Revised. Attestations should be "to the best of my knowledge and belief." (SCPPA1)

> **Response:** The attestations referred to in the comment are contained in the existing text and staff has not proposed any changes to them as part of this rulemaking. The comments are therefore out of the scope of the proposed changes, and no response is required. However, staff believes including the suggested text would make the regulation harder to enforce and could allow a situation in which individuals may be able act in a nefarious manner in the market program without real fear of potential legal consequences. The responsibility to

delegate appropriate individuals in the roles of account representatives resides with the organizations.

Account Viewing Agents

D-6. Comment: Section 95832: Attestation Requirements And The Designation And Delegation Procedures For Account Viewing Agents Should Be Revised.

The designation and delegation procedures for account viewing agents appear to overlap and should be clarified. (SCPPA1)

> **Response:** Staff does not see any overlap between the process for designating account viewing agents and any other designation or delegation processes. The account representatives and an officer of the company are involved in the procedure only to make, confirm, or change the designation.

D-7. Comment: While it is important that the identity of primary account representatives and alternate account representatives be verified in a reasonable manner as discussed above, there does not appear to be a need for account viewing agents to be subject to the same requirements. These agents cannot undertake any transactions on the tracking system—they can only view it (section 95832(h)(1)). They cannot commit fraud involving compliance instrument transfers. SCPPA considers that extensive Know-Your-Customer requirements should not apply to account viewing agents. (SCPPA1)

> **Response:** The comment is correct that the Account Viewing Agents (AVA) cannot take any action on an account. However, staff imposed the same Know-Your-Customer (KYC) requirements on the AVA's as on the account representatives to address two other security concerns. First, the AVAs have access to market sensitive data on the tracking system. This would include records of transfers to and from other accounts on the system. This would give the AVA sensitive information on trades with other market participants that could be used outside the ability to transfer allowances. Second, the KYC information is needed to assist the market monitors to identify potential collusion by detecting instances when individuals may attempt to hide their involvement with more than one registered entity.

E. KNOW-YOUR CUSTOMER REQUIREMENTS

Personal Information Requirements for KYC Process are Onerous

E-1. (multiple comments): The additional information required to be provided to the financial services administrator is problematic.

Section 95912(d)(5) requires account representatives to provide certain information before they are able to participate in an allowance auction, including the Know-Your-

Customer requirements and additional information to be provided to the financial services administrator ("FSA"). See section VII above for SCPPA's concerns regarding the Know-Your-Customer requirements. For the same reasons, SCPPA is also concerned about the information listed in Appendix A to the Regulation, which must be provided to the FSA under section 95912(d)(5)(B). The information required is similar to, but goes further than, the Know-Your- Customer requirements. (SCPPA1)

Comment: Registration Requirements for Officers, Directors, Representatives and Agents

MSCG strongly believes that the requirements for personal information from company representatives is grossly excessive, is largely unprecedented in any similar US situation, and is not necessary to achieve the otherwise legitimate objectives of the ARB for accountability and fraud prevention. Providing driver's license and passport information is simply not necessary, and disclosing personal bank account information is simply egregious. No entities with similar concerns, such as the Regional Greenhouse Gas Initiative ("RGGI"), the Financial Industry Regulatory Authority ("FINRA"), the National Futures Association ("NFA"), or the U.S. Environmental Protection Agency ("EPA") (for Sox and Nox emissions allowance trades), require this sort of personal data for either trading rights or administrative access to accounts.

To the extent that these proposed requirements are motivated by a fear of "fly-by-night" entities engaging in inappropriate or illegal activities and then "vanishing", the concern might be understandable. However, for large, publicly traded entities like MSCG, there is no question of being able to find and hold them accountable for any transgressions. To the extent that their duly appointed representatives commit any violations, their employers are fully responsible for their conduct, even if the individual cannot be located.

For these reasons, MSCG strongly urges ARB to reconsider and eliminate the various proposed requirements for company personnel to supply personal information. In the alternative, to the extent that ARB has legitimate concerns about being able to hold "small" entities responsible, it may be appropriate to devise a bifurcated set of rules, with more extensive requirements applicable to personnel of entities that do not have strongly established corporate presences. For example, it might be sensible to exempt employees of publicly traded and/or SEC, CFTC or Federal Reserve regulated entities from personal data requirements. (MSCG)

Comment: Consider removing onerous requirements for personal information. IETA believes requiring that individuals disclose excessively onerous information, such as personal bank account information, to gain access to the tracking system is unnecessary. When a company registers in the California program, ARB will be provided detailed information about this company, such as tax ID numbers, affiliates, officers, etc. A registered entity is accountable for the actions of its representatives entrusted with its account authorization. It should be left to the prerogative of individual companies to conduct background checks on their own employees. Accordingly, IETA recommends ARB consider eliminating provisions requiring overly onerous information disclosure for individuals. At the very last, IETA urges ARB to consider differentiating requirements for individuals who are applying for access to accounts for two distinct purposes: 1) strictly viewing purposes; and 2) purposes that include additional responsibility (i.e. a primary account representative). For individuals falling in the former category, IETA recommends eliminating the provisions that require disclosure of overly onerous personal information. (IETA)

Comment: The Know-Your-Customer requirements are intrusive and impractical. Section 95834 requires all individuals seeking access to the tracking system, which would include primary account representatives, alternate account representatives, and account viewing agents, to provide extensive personal information (including passport numbers and personal bank account details) to the Executive Officer. SCPPA understands that the ARB wishes to be able to confirm the identity of individuals to avoid the problems with fraud and market manipulation that have occurred in the European emissions trading system. However, the proposed Know-Your-Customer requirements are intrusive. It would be difficult for an entity to require up to 10 of its staff to provide this personal information to the ARB. If it obtains all this personal information, the ARB should recognize the potential for significant liability if there is a breach of the security of the ARB's records. (See SCPPA's comments in section III.C above on strengthening the protection of confidential information.). (SCPPA1)

Comment: The process for submitting information should be clarified.
The Regulation should clarify the process for providing the Know-Your-Customer information as it relates to the registration process set out in sections 95830–95832. It should also be clarified that each individual will only be required to provide this information once, not every time that person wishes to access the tracking system. (SCPPA1)

Comment: ARB has included "Know-Your-Customer" (KYC) requirements in the revised regulations. The KYC provisions contain requirements that an entity must meet before it can receive access to the tracking system. The provisions require every individual to provide documentation of their name, photograph, date of birth, primary address and driver's license or passport number. The name, address and contact information of their employer must also be presented. CERP believes that in large part these requirements are sensible and serve to protect the cap-and-trade system from fraud or misuse. However, in one instance CERP notes that the KYC requirements seem excessive. In the proposed regulation, individuals must provide an open bank account number in addition to other forms of identity confirmation. Requesting such private information raises understandable security concerns; moreover, there are alternative and perhaps more effective ways to confirm an individual's identity than through bank account information. CERP urges ARB to omit this requirement in a final rule. (CERP)

Comment: ACCOUNT REPRESENTATIVES AND KNOW-YOUR-CUSTOMER PROVISIONS ARE UNDULY RESTRICTIVE AND MUST BE REVISED

The provisions regarding account representative designations should be clarified and the onerous personal disclosure provisions set forth in § 95834 and Appendix A should be modified.

The Proposed Revisions create a new definition for a “primary account representative” that “means an individual authorized by a registered entity through the registration process outlined in section 95832 to make submissions to the Executive Officer and the tracking system in all matters pertaining to this article that legally bind the authorizing entity.” (§ 95802(a)(206))

Section 95830(c)(3) requires that an “entity must designate a primary account representative, at least one and up to four alternate account representatives pursuant to section 95832.” If these individuals are going to have access to the tracking system, they are required to comply with all of the “Know-Your-Customer” (KYC) requirements set forth in section 95834.2 Participants in the auction and allowance reserve auction are also required, pursuant to the Proposed Revisions in § 95912(d)(5)(B) and § 95913(c)(2), respectively, to comply with additional personal disclosure mandates.

The provisions regarding account representative designations should be revised to strike the requirements to submit the information from section 95835 and Appendix A. In addition, the personal disclosure provisions set forth in § 95834 and Appendix A are onerous and should be modified. Instead of requiring individuals to provide CARB and its contractors with this information, registered entities should be required to attest to the identity of the individuals they have designated to act on their behalf. Such a solution would address all of CARB’s concerns regarding ensuring the identity of individuals participating in the Cap-and-Trade Program, without subjecting these individuals to the needless disclosure requirements. (NCPA)

Comment: Beyond supporting the new provisions for consolidated accounts, SCPPA proposed more than a dozen revisions to the proposed amendments that would further reduce the administrative burden of the Cap and Trade Program on covered entities. Particularly, we propose revisions to the new "Know Your Customer" requirements. The new Section 95834 requires all individuals seeking access to the tracking system to provide extensive personal information, including personal bank account information. These requirements are so intrusive they will likely make it difficult for a covered entity to find employees that will be willing to submit the required information to the ARB.

There are several ways in which the "Know Your Customer" requirements could be revised to avoid the intrusiveness, while fully ensuring the security of the tracking system. We recommended specific alternatives in our comments. I hope to see 15-day language on the table in the lobby this morning that would reflect some of SCPPA's comments, both on the "Know Your Customer" requirements and also the other points that we raised, which I won't go into now, in our written comments.

Unfortunately, I have not seen any proposed 15-day language, but I hope there will be some way that the Board can take our written comments on, again, more than a dozen points into account. (SCPPA2)

Comment: The second issue you already heard about, the "Know Your Customer" requirements. We are also concerned about the quantity of information being required to be provided. So our request with that is that ARB either look to comparable markets and perhaps streamline the approach or outline the security provisions that you all have in place to ensure that this information is protected, consistent with industry standard. (PGE2)

Comment: We are very concerned that the personal information requested from the system registrants is quite burdensome. We understand the importance of protecting the system from fraud and threat. But Section 95834 requires much more information than we believe ARB needs to accomplish this objective. (SEMPRA2)

Comment: CMUA appreciates recent changes to the regulation, and we are pleased to voice our continued support for AB 32 and the Cap and Trade Program.

However, our members do have concerns with the proposed "Know Your Customer" or KYC requirements. This was mentioned by SCPPA and we have a few members that will also be mentioning this. We have also provided written comments to the Board.

CMUA understands that the ARB wants to be able to confirm the identity of individuals and to avoid any issues with fraud and market manipulation that occur in an emissions trading system.

However, the KYC requirements are intrusive and it would be difficult for our members to require their staff to provide personal information to the ARB. (CMUA2)

Comment: I'll start by expressing SMUD's support for the Cap and Trade Program and most of the proposed amendments before you today. However, we have real concerns about the "Know Your Customer" requirements.

Quite frankly, when our traders heard about these requirements, they were shocked. Some of our traders had been on the trading floor for 10, 15, or 20 years and they tell me this is the first time that any regulator has requested personal, sensitive, and potentially compromising information in order to trade commodities. And that is what we're talking about here, because greenhouse gas allowances are environmental commodities in a closed market. (SMUD2)

Comment: Section 95834. Know your customer Requirements

LADWP recognizes the need to verify the identity of individuals who apply for accounts as part of registration in the cap-and-trade program. However, the type of information proposed to be requested, including date of birth, driver's license number, passport number and open bank account documentation would create significant liability both for employers and employees in the event of a breach of security. As discussed previously, CARB is required to undertake a significant task of adopting security procedures in order to protect this confidential information.

LADWP recommends that the level of information required from account representatives and agents be consistent with the United States Environmental Protection Agency's requirements under the Acid Rain program, which requires agents to answer several questions known only by the agent (e.g. in what city did you work your first job, what city was your high school located at, what is your favorite sport, etc.). This registration would be provided electronically and the individual would be required to provide this information once. Once registration is completed, the individual would receive a password and in order to change the password (Acid Rain Program requires password changes every 90 days), the individual would be prompted to answer one of the registration questions. (LADWP1)

Comment: Secondly, LADWP is very concerned about the "Know Your Customer" requirements that will require our employees to disclose their personal information while acting on behalf of the entity which is the LADWP. These requirements are very intrusive and could result in significant liability in the event that personal information is compromised. (LADWP2)

Comment: CARB Should Amend The Unnecessarily Intrusive Know-Your-Customer Requirements
The Clean-Up Amendments propose extensive "Know-Your-Customer" requirements. Prior to the accounts administrator providing access to the tracking system to any individual (including any individual representing a covered entity), the EO must determine that the individual has complied with the requirements, which includes the individual providing documentation of the individual's date of birth, a passport number or driver's license number, and an open bank account in the United States.

Calpine is concerned that the Know-Your-Customer requirements are unduly intrusive. CARB is requesting that individuals representing covered entities produce a set of personal data that is sufficient for identity theft. If CARB proceeds with these requirements, Calpine requests that CARB explain, in detail, the safeguards it intends to create to prevent the submitted information for individuals representing covered entities from being compromised. Calpine takes seriously the obligation to safeguard its employees' personal information and seeks assurance from CARB that it will protect such information if needed to participate in the Cap-and-Trade Program. (CALPINE1)

Comment: Know-Your-Customer Requirements And Financial Services Administrator. Section 95834 (Know-Your-Customer Requirements) requests significant personal information from individuals in a capacity requiring access to the tracking system, even from those who are employees of compliance entities, where the threat of fraud is minimal. SDG&E and SoCalGas understand that the ARB's intent is to protect the Cap and Trade system from fraud or theft, however, we believe that section 95834 requires much more information than ARB needs to accomplish this objective.

In addition to the excessive requirements of section 95834, the regulation adds sections 95912(d)(5)(B) and 95913(c)(2) that require even more extensive information be provided to the financial services administrator. Sections 95912(d)(5) and 95913(c) should be eliminated from the regulation. Appendix A requests more information than section 95834 without protections or limitations on the use by the financial services administrator. If the sections are not deleted, then there should be ARB guidance that clarifies that the personal information requested by the financial services administrator in these sections, beyond what is contained in 95834, is only required of individuals desiring to participate on their own behalf and registered as voluntary associated entities and NOT for employees of covered entities.

The data requested on individuals in Appendix A includes residence address, phone number, email, Social Security number, date of birth, citizenship, employer name, employer address, copy of a valid identity card issued by a state or province with an expiration date, copy of a government-issued identity document, copy of a passport, and documentation of an open bank account. With that amount of information, if such records were hacked or stolen, identity theft would be easy to accomplish. This detailed information would be in the possession of the financial service administrator, rather than a government agency, with no stated protections or limitations on the use of the data. SDG&E recently had employee data that was provided to a third party hacked, so it is a very real threat. Requiring the provision of such extensive personal data to a financial institution creates an unnecessary risk of privacy violations.

It should be enough for the financial services administrator to know that a primary or alternate account representative has complied with the rigorous process of registering with CARB. Individuals should not need to re-register with another entity. Even if there is a compelling reason to require individuals to re-submit personal information, the financial services administrator does not need more information than ARB regarding the primary or alternate account representative since it is registered entities that are participating in the auction. The registered entities are putting up the bid guarantees that the financial services administrator is validating. Analysis of the bid guarantee does not relate to the primary or alternate account representative in any way unless they are personally registered as a voluntary associated entity. Further, any winning bids will result in allowances being transferred to the registered entity, not the primary or alternate account representative, unless they are also the voluntary associated entity. Since the risk of fraud does not exist, there is no need to ask primary or alternate account representatives to provide any more information than required in section 95834 unless they are also the registered entity. The ARB guidance document should clearly state that sections 95912(d)(5)(B) and 95913(c)(2) and Appendix A information apply only to primary or alternate account representatives who are also the registered entity. (SEMPRA1)

Comment: "Know Your Customer" (KYC) requirements should minimize collection of individual's confidential information

WSPA recognizes the need to ensure the identity of individuals accessing the tracking system. However we believe that KYC should (1) recognize the differences between a representative of a covered entity and a representative for a non-covered entity and, (2) minimize collection of individuals confidential information only to the extent required to ensure the identity of the individuals. Requiring information beyond what is required solely to determine identity is unnecessarily intrusive.

As an example, assume that a covered entity has assets which include one or more processes or other operations in California. In this situation, ARB holds those covered entities responsible for complying with numerous C/T requirements, including significant compliance obligations. If these covered entities have the capacity to manage these operational and compliance activities, then they should be assumed to also have the capacity to ensure the identity of their employees who the entities authorize and attest are acting on their behalf. Therefore documentations, such as an open bank account in the US and/or Canada, addresses of permanent residents, and passport numbers which are particularly intrusive, should not be necessary for an authorized representative for a covered entity.

Recommendation: Add an additional paragraph to Section 95834(b) as (10) below:
95834(b) The individual must provide documentation of the following:
(1) Name;
(2) The address of the primary residence of the applicant, which may be shown by any of the following:
(A) A valid identity card issued by a state with an expiration date;
(B) Any other government-issued identity document containing an individual's primary address; or
(C) Any other document that is customarily accepted by the State of California as evidence of the primary residence of the individual;
(3) Date of birth;
(4) Employer name, contact information, and address;
(5) Either a passport number or driver's license number, if one is issued;
(6) An open bank account in the United States;
(7) Employment or other relationship to an entity that has registered or has applied to register with the California Cap-and-Trade Program if the individual is listed by an entity registering pursuant to section 95830;
(8) A government-issued document providing photographic evidence of identity of the applicant which may include:
(A) A valid identity card or driver's license issued by a state with an expiration date and date of birth; or
(B) A passport; and
(9) Any criminal conviction during the previous five years constituting a felony in the United States. This disclosure must include the type of violation, jurisdiction, and year.

(10) An individual representing a covered entity is required to provide documentation only as required in Section 95834(b)(1), (4), (8), and (9). (WSPA1)

Comment: Disclosure of Employee or Agent Personal Information Is Unnecessary to Achieve the Stated Goals of the Regulation or Protect the Integrity of the Market.

NCPA understands and shares CARB's concerns with protecting the integrity of the Cap-and-Trade Program generally, and allowance transfers in particular. However, the provisions in the Proposed Revisions that require the disclosure of personal information about the individuals designated as primary and alternate account representatives are unreasonable and unnecessary. (NCPA)

Comment: These requirements constitute a significant invasion of privacy and are unnecessary. First, in general, the rationale for these requirements, as set forth in the ISOR, is the fact that the provision of this information is "to establish the identity of the person attempting to participate in the cap-and-trade program." (ISOR, pp. 148-150). However, the ISOR does not provide a sufficient rationale for why this much information is required, or why this information must be submitted to CARB (and, in the case of those participants that will be part of the Reserve auction or primary account representatives, the financial services administrator). There are significantly far less intrusive means by which CARB and its contractors can establish the identity of program participants. The most efficient and effective means of doing so is to require the registered entity to attest to the identity of the individuals they have designated as their primary and alternative account representatives.

Additionally, the ISOR states that the requirements of Appendix A are necessary to "ensure that all individuals participating in the financial transactions that accompany Reserve sales have completed identity verification procedures before committing the entities they represent to financial obligations." (ISOR, p. 177) Again, as noted above, it is the responsibility of the registered entity to verify the identity of its agents, and not CARB. If an entity is going to give authority for financial transactions to an individual, they must take responsibility for that individual, and can do so by providing CARB with an attestation of that person's identity. Ascertaining the identity of a registered entity's account representatives is not the responsibility of the auction administrator or CARB, but rather of the entity that registers with CARB.

The very title of section 95834—"Know-Your-Customer"—is a misnomer, as the account representatives designated by the registered entities are not "customers," but rather employees or agents of that entity. As such, they have a direct and ongoing relationship with the registered entity, and are not merely purchasing goods or products on a periodic basis. As such, it is the responsibility of the registered entity to vet the background and necessary information of the individuals that it designates as its primary and alternate account representatives.

Second, in addition to being a significant invasion of privacy, in this age of identity theft and computer security breaches, the fact that this much personal information will be maintained in not one, but two additional databases poses a considerable security threat to the individuals. It is also a deterrent to the designation of qualified individuals that do not want to provide this level of personal information to CARB and the financial services administrator. There are neither references to security measures that will be employed to maintain the confidentiality of the information provided, nor restrictions on the uses of the information once it is disclosed. Provisions stating that the agency will maintaining the confidentiality of information “to the extent possible” (see section 95830(g)) are inadequate. It is neither CARB’s, nor the auction administrator’s, nor the financial services administrator’s responsibility to collect and maintain this kind of information.

Third, the requirements are unnecessarily discriminatory. Is an individual without a passport, license, or a bank account precluded from being a designated representative? If so, what is the direct and necessary link between those two requirements and validation of the truthfulness, honesty, or veracity of the individual? The ISOR provides no rationale for why this level of information is necessary to establish the individual’s identity, nor its relevance to the ability to participate in the Cap-and-Trade Program.

Fourth, as it pertains to the Reserve Auction, the mere fact that these individuals are going to be participating in the Reserve Auction means that they are the designated representatives of entities with a compliance obligation. CARB has even greater recourse against covered entities under the regulation, and therefore, the amount of information required of entities participating in the reserve should be even less—not more—stringent than the information required of auction participants that may not even have a “stake in the game.” It is not up to CARB to ensure the identity verification of the individuals binding an entity to a financial transaction, but rather that is the responsibility of the entity itself.

Fifth, this requirement is going to severely impact the number of individuals that would even be willing to participate in such a capacity, as many are likely to personally object to the required disclosures. In essence, CARB is asking for comprehensive background checks on all individuals that will be given access to the tracking system. These provisions seek a great deal of information from registered entities and individuals, and would involve sharing that information with CARB and its third party vendors. As a practical and legal matter, NCPA objects to the of the proposed revisions that would requirement participants to provide this information. The tedious nature of collecting and forwarding such extensive information is going to impact all covered entities and market participants, and may also result in limiting the number of individuals that would be willing to participate in the program, as they are forced to share very personal information with third parties. Many individuals will balk at being required to provide a third party with this level of personal information, which could distort the playing field and adversely impact California entities.

Furthermore, the provisions relevant to felony convictions are problematic in the potential to create disparate treatment between the linked jurisdictions. Section 95834(a)(4) provides that “individuals with a criminal conviction in the five previous years constituting a felony in the United States are ineligible for registration and participation in the Cap-and-Trade Program." Appendix A requires the documentation of any felony convictions during the previous 5 years. In the ISOR, the rationale for this section provides that it is "needed to protect program participants from harm by preventing individuals with criminal activity from participating." (ISOR, p. 147) NCPA believes that the conviction of some crimes should reasonably preclude an individual from participating in a market. However, it is important to ensure that such provisions are applied in a way that gives appropriate consideration to situations where different partner jurisdictions might be governed by different penal systems.

Finally, it is imperative that California entities—especially covered entities that must acquire allowances or face significant financial penalties—not be prejudiced in their participating in the auction vis-à-vis Québec participants. These kinds of requirements should be implemented only after there has been a demonstrated need for them. Such a need could be determined by the Market Simulation Group as they address various market behaviors. (NCPA)

Comment: Account Representatives Should Not Have to Provide Personal Information to CARB.

In the proposed changes to section 95832(a)(1), the "business and primary residence addresses, e-mail addresses, and phone numbers" of primary account representative, any alternate account representatives and any viewing agents must be provided. For all of the reasons set forth above, the Proposed Revisions should be changed to strike the requirement to submit any personal information, including residence addresses, for all account representatives. This is especially necessary for the newly created "account viewing agent," which is "an individual authorized by a registered entity to view all the information on the entity's accounts contained in the tracking system." (§ 95802(a)(1)) The ISOR notes that this "change is needed to ensure identification of the individuals involved in the tracking system." (ISOR, p. 129) As provided in section 95832(h)(1), however, the account viewing agent will only be able to view "information contained in the tracking system involving the entity's accounts, information, and transfer records" but has no "authority to take any other action with respect to an account on the tracking system." Accordingly, it is neither justified, nor necessary, for CARB to require any additional information regarding the account viewing agents. (NCPA)

Comment: The Origin and Common use of KYC Information from the Banking Industry is Inappropriate to the Need to Identify Authorized Account Representatives in the Cap & Trade Program.

Based on discussions from the ARB Workshop of May 22, 2012, it is SMUD's understanding that the "Know Your Customer" requirements were included in the proposed amendments at the request of Deutsche Bank. It is also SMUD's understanding that Deutsche Bank has required such information in its contract with ARB for financial services to support the allowance auction and various allowance holding accounts. While such protections may be required of institutions entrusted with financial securities, these protections are not required of commodities traders. It appears to SMUD that Deutsche Bank may have incorporated requirements imposed upon it by the Securities and Exchange Commission ("SEC") into its dealings with the ARB. In early 2011, the SEC approved a proposal by FINRA, the Financial Industry Regulatory Authority, to adopt Know Your Customer rules. The new FINRA Rule 2090 was modeled after a former New York Stock Exchange rule, and requires securities firms doing business in the United States to use "reasonable diligence" in regard to opening and closing financial accounts, to know "the essential facts" concerning each customer and the authority of each person acting on behalf of such customers. The purpose of these rules is to ensure investor protection and to promote fair dealing and ethical sales practices. Generally speaking, these rules apply to individuals and institutions who handle other people's money, such as "Introducing Brokers" and "Swap Dealers", in securities markets and banking. These rules were not written for commodity traders who trade for their own accounts, or those of their employers.

Another purpose of Know Your Customer policies is to prevent individuals from using financial institutions such as banks for illicit or illegal purposes. For example, in 1997 the Federal Reserve (the "Fed") republished its Bank Secrecy Manual, wherein it urged banks to adopt Know Your Customer policies to protect banks from criminal exposure. The Manual reads in pertinent part: Even though not presently required by statute, it is imperative that financial institutions adopt "know your customer" guidelines or procedures to ensure the immediate detection and identification of suspicious activity at the institution." While the Fed finds it appropriate for banks to adopt KYC policies for opening and closing bank accounts, the Cap & Trade Program is a closed system, unlike the currency system in the banking industry. Registering entities cannot, for example, move allowances from the illegal drug trade through an ARB allowance Holding Account, to be sold at a later time to a gun running operation overseas. Allowances are simply not that fungible. The need of banks to know their customers flows from the fact that currency is legal tender and can be used for a myriad of purposes and goods. Emission allowances are created by ARB, tracked in accounts that will be monitored by ARB, and for the very limited use of paying ARB for the right to emit GHG emissions. There is simply no parallel security risk by Covered Entities, or other registered entities, on whose behalf Authorized Account Representatives trade. (SMUD1)

Comment: In addition to adding costs to the California market through linkage to Québec, the general rulemaking proposes to add new constricting requirements and further entrenches policies that create an imbalance between market oversight and market effectiveness. Although several helpful provisions were added by the general amendments including increasing the account representatives and consolidating accounts, these changes are not adequate to overcome the excessive and intrusive restrictions on time limits for trading and Know Your Customer ("KYC") requirements. (CHEVRON)

Comment: Know-Your-Customer Requirements (Section 95834 and Appendix A)
PG&E has serious concerns regarding the Know-Your-Customer provisions of the regulations that would require the collection and submission to ARB of extensive personal data of PG&E employees. Neither the Regional Greenhouse Gas Initiative (RGGI) program nor the Western Renewable Energy Generation Information System (WREGIS) tracking systems require this level of information of participants. It is unclear why the ARB needs this extensive personal information in order to prove identity, and PG&E has concerns about the security of such private data being provided to ARB. PG&E would like to recommend that ARB remove the Know-Your-Customer Requirements of the registration process and follow registration requirements similar to WREGIS and RGGI.

Additionally, PG&E is concerned about the additional requirements in section 95912(d)(5), which states that any primary or alternate representative submitting bids for Reserve Sales must also submit additional information required by the financial services administrator contained in Appendix A. Not only is much of the information required similar to the Know-Your-Customer Requirements, but it is also more concerning as it requires additional personal information such as social security numbers, copies of identity cards issued by a state, government-issued identity documents, and a copies of passports. Again, these requirements are neither consistent with RGGI nor WREGIS, and require a level of information that raise security and privacy concerns for our employees. (PGE1)

Comment: SCE PROVIDES RECOMMENDATIONS TO IMPROVE THE REGULATION PROVISIONS ADDRESSING REGISTRATION AND ACCOUNTS

The Revised Registration and Know-Your-Customer Requirements Pose Serious Logistical, Privacy, and Confidentiality Challenges

In addition, Section 95834(b) requires any individual that is given access to the tracking system to comply with the proposed “Know-Your-Customer” provisions. Such individuals must provide, among other things, the address of his or her permanent residence, birth date, passport numbers, driver license numbers, and bank account numbers, all certified by a notary public. Again, although accurate identification of participants in the tracking system is essential, requiring this level of personal information is too onerous and intrusive (especially for large, publicly-traded companies such as SCE and EIX) and does not seem reasonably calculated to lead to the ARB’s goal of preventing fraud.

Moreover, to collect this information, the ARB will have to undertake a substantial administrative burden to maintain the privacy of this information, which is protected by statute. California Civil Code Sections 1798 et seq. require state agencies that collect personal information to abide by certain requirements, including notice of data collection and breach, maintenance of records, administrative and physical safeguards, and conditions of disclosure. Similar rules form a patchwork of privacy regulations across the United States that could be triggered for the ARB by individuals trading from outside of California. The Know-Your-Customer provisions collect an excessive amount of personal information that is unnecessary to accomplish the ARB's goals. SCE advises the ARB to revise this regulation language to remove the collection of this level of personally identifiable information.

Section 95830(g), entitled "Information Confidentiality," states that registration information will be treated as confidential by the Executive Officer and the accounts administrator. This provision raises a number of important questions:

- How will ARB guarantee the confidentiality of the information?
- Why is confidential treatment restricted to just the "Executive Officer and the accounts administrator"? This confidentiality should apply to all individuals with access, including
- ARB employees, officers, contractors, and consultants.
- Why does ARB state it will only keep information confidential "to the extent possible"?
- Will ARB be audited for compliance with information confidentiality requirements
- (preferably by an outside agency)?
- What are the codes of conduct, processes, and protocols for ARB's compliance with the confidentiality requirements?
- How will ARB monitor its own systems and processes to ensure confidentiality? How will violations be identified?
- If confidentiality is violated, what recourse is available? Will there be penalties, fines, other punitive actions, or subsequent corrective actions implemented?

Protecting the confidentiality of this information is a significant endeavor. The ARB has a duty to the compliance entities to ensure that the confidentiality process is robust and clearly explained. (SCE1)

Comment: WPTF recognize that the know-your-customer provisions are modeled on similar provisions developed in the European Union Emissions Trading System in response to incidents of fraud and theft of compliance instruments in that program. However, the European Commission directive establishing these requirements makes critical distinctions between the documentation requirements for *nomination* of account representatives and the documentation requirements for account *registration* that are not reflected in CARB's approach. For nomination of account representatives, the EU requires notarized documentation of the identify and address of the nominee, but does not require bank account information or other employment information. In contrast, bank account information is required for account registration by a trading entity (not a covered entity) or by an individual ('natural person' in the Directive's language). In the latter case, the directive also requires employment information.

WPTF considers the proposed requirement that entity-nominated account representatives provide bank account information and employment information to be inappropriate. WPTF agrees that it is in CARB's interest to verify the identity of individuals nominated to serve as account representatives and supports a requirement for provision of documentation of identity and address. However, we do not believe it is appropriate or necessary for CARB to impose additional criteria. Rather, the entity's judgment in selecting and nominating individuals to serve as account representatives should be sufficient. In the case of individual or entity account registration as a voluntary associated entity, additional information requirements would be appropriate.

WPTF is also concerned that the proposed requirement that hard-copy documentation must be submitted in person by the nominated individual or registering individual. This requirement is unnecessary and would impose excessive costs on out-of-state entities. We note that the EU requires documentation to be notarized, but does not require in-person delivery. CARB should adopt the same approach. (WPTF)

Comment: Beyond supporting the new provisions for consolidated accounts, SCPPA proposed more than a dozen revisions to the proposed amendments that would further reduce the administrative burden of the Cap and Trade Program on covered entities. Particularly, we propose revisions to the new "Know Your Customer" requirements. The new Section 95834 requires all individuals seeking access to the tracking system to provide extensive personal information, including personal bank account information. These requirements are so intrusive they will likely make it difficult for a covered entity to find employees that will be willing to submit the required information to the ARB. (SCPPA2)

Comment: IETA's April 2012 submission to ARB addressed the Know-Your-Customer (KYC) requirements for which ARB had specifically asked for stakeholder input. Aside from the addition of a criminal record provision, ARB has left KYC requirements largely as written in the March 2012 Discussion Draft, to the concern of IETA members.

As previously expressed to ARB, we believe the proposed KYC requirements too heavily emphasize market oversight at the expense of market participation. We believe that only slight adjustments to the current draft KYC requirements will help to ensure widespread and successful participation in ARB's program without sacrificing market security. IETA's recommended changes to the proposed KYC requirements are summarized below. (IETA)

Comment: Consider a policy that removes requirements for publicly traded companies that comply with U.S. Securities and Exchange Commission (SEC). SEC regulated companies are closely regulated by multiple Federal Agencies. Furthermore, they are required to disclose a host of detailed information that is readily researchable. IETA believes ARB could work in conjunction with the SEC to: 1) ensure appropriate market oversight; and 2) maximize participation by avoiding requiring publicly traded companies that comply with SEC to disclose similar information twice. Therefore, IETA recommends that ARB considers exempting publicly traded companies that are in compliance with the SEC from ARB's KYC requirements. (IETA)

Comment: Electronic document submission should be allowed. The KYC requirements in place in the European Union Emissions Trading Scheme (EUETS), like the requirements proposed in ARB's draft amendments, require notarized documentation. However, in contrast to the EU ETS, ARB does not grant itself the additional authority to use electronic mechanisms to check disclosed information. This requirement is unnecessary and could prove to be excessively costly. Requiring identity verification to be conducted in-person also limits the ability of a company to nominate other representatives, if necessary (and without the need to travel). Therefore, IETA recommends that ARB authorize the use of electronic mechanisms to check any personal information. (IETA)

Comment: The requirements could be changed to reflect the requirements of the Acid Rain Program.

A more reasonable approach would be to require account representatives and account viewing agents to disclose only the type of information required under the Acid Rain program run by the US Environmental Protection Agency. This program requires agents to answer several questions known only by the agent. (For example: In what city was your first job? What was the name of your high school? What was the name of your first pet?)

Once this process is completed, the individual would receive a password to enable them to access the tracking system in the future, and to enable the system to track which individuals have accessed the system at what times. For additional security, representatives could be required to change their password periodically (the Acid Rain Program, for example, requires password changes every 90 days). In order to change the password the individual could be prompted to answer one or more of their security questions. (SCPPA1)

Comment: The ARB's requirements could apply only if the registered entity has not undertaken an equivalent checking process prior to employing the relevant representative.

If the ARB does not wish to adopt a model similar to the Acid Rain Program and instead wishes to retain requirements similar to those in the Regulation, the ARB should give registered entities an opportunity to provide information to the ARB on the processes those entities use to vet potential employees. For example, POUs typically require potential employees to go through a screening process. We can provide examples of these processes if required. The screening process may include providing fingerprints through the Live Scan program, which transmits fingerprints to the California Department of Justice and the Federal Bureau of Investigation for a review of the applicant's criminal record. If an account representative was employed after passing these requirements, the ARB should rely on these procedures and should not impose any additional requirements on that person.

If registered entities do not have acceptable screening methods in place, or if they do not provide information on their screening methods to the ARB, the ARB could continue to request that representatives of those entities provide the information in section 95834. (SCPPA1)

Comment: Québec's approach to personal bank account details should be adopted. If none of the above methods are adopted, at a minimum section 95834(b)(6) requiring disclosure of personal bank accounts should be revised to follow the approach taken in Québec's revised cap and trade regulation. (SCPPA1)

Comment: Consider a policy that removes requirements for publicly traded companies that comply with U.S. Securities and Exchange Commission (SEC). SEC regulated companies are closely regulated by multiple Federal Agencies. Furthermore, they are required to disclose a host of detailed information that is readily researchable. IETA believes ARB could work in conjunction with the SEC to: 1) ensure appropriate market oversight; and 2) maximize participation by avoiding requiring publicly traded companies that comply with SEC to disclose similar information twice. Therefore, IETA recommends that ARB considers exempting publicly traded companies that are in compliance with the SEC from ARB's KYC requirements.

Electronic document submission should be allowed. The KYC requirements in place in the European Union Emissions Trading Scheme (EUETS), like the requirements proposed in ARB's draft amendments, require notarized documentation. However, in contrast to the EU ETS, ARB does not grant itself the additional authority to use electronic mechanisms to check disclosed information. This requirement is unnecessary and could prove to be excessively costly. Requiring identity verification to be conducted in-person also limits the ability of a company to nominate other representatives, if necessary (and without the need to travel). Therefore, IETA recommends that ARB authorize the use of electronic mechanisms to check any personal information.

Consider Potential Participation Implications Prompted by US Bank Account Requirements. Finally, we believe that proposed requirements for individuals to hold a bank account in the U.S. for access to the tracking system is potentially problematic, particularly for multinational corporations who may register as Voluntary Auction Entities (VAEs) through a U.S. office branch, but whose trading desk may be located in another country. In such instances, traders within these registered companies may not have US bank accounts and would be unnecessarily prevented from accessing the tracking system. While moving forward with rule-making and implementation activities, we recommend ARB to consider possible participation implications associated with regional bank account constraints. (IETA)

Comment: CMUA understands that the Air Resources Board (ARB) wants to be able to confirm the identity of individuals to avoid the problems with fraud and market manipulation that have occurred in the European emissions trading system. However, the KYC requirements are intrusive. It would be difficult for a POU to require their staff to provide this personal information to the ARB. Furthermore, any breach of security within ARB's records would pose significant liability.

A more reasonable alternative would be to require account representatives and account viewing agents to disclose only the type of information required under the U.S. EPA's Acid Rain program. This program requires agents to answer several questions known only by the agent—similar to what many online venders currently require when a customer is logging in to their account. After completing this process, the individual agent would receive a password to enable access to the tracking system while enabling the system to track individuals accessing the system. Furthermore, if the password has a 90-day life for example, additional security could be embedded in the system to force the user to change their password, requiring the person to answer key security questions already on file.

If a model similar to the U.S. EPA Acid Rain program is not satisfactory to the ARB, then the ARB should give registered entities an opportunity to provide information to the ARB based on what the individual entity uses to evaluate new employees. For example, some POUs require new employees to undergo a thorough screening process to evaluate any criminal record.

Finally, as mentioned in ARB's June 19, 2012, *California Cap-and-Trade Program Implementation, Frequently Asked Questions* (FAQ), CMUA supports the ARB's consideration of allowing a letter from the account representative's bank documenting an open bank account. This process is similar to Québec's approach which requires a confirmation from a financial institution that the natural person has an account with the institution. This avoids disclosure of actual bank details, which is one of the most objectionable parts of the KYC requirements. Furthermore, account viewing agents should not be required to provide the same information as account representatives, since these agents cannot complete any transactions within the tracking system and so there is no risk of fraud.

CMUA stresses that the KYC requirements would be difficult for POU employees and prefer that the ARB consider the alternatives mentioned above. We appreciate the efforts of the ARB to make the Cap & Trade Program secure, while helping to reduce the overall administrative burden on market participants. (CMUA)

Comment: Chevron is sympathetic to the concept of KYC requirements, and recommends that they could be tailored in a number of ways to better promote market efficiency and respect personal confidentiality.

- KYC requirements should recognize the difference between a representative of a covered entity and a representative for a non-covered entity. Covered entities have the capacity to ensure the identity of their employees who are authorized to act on their behalf. Documentation requirements such as an open bank account in the US or Canada, address of permanent residence, and passport number should not be necessary for an authorized representative for a covered entity.

- In addition, KYC requirements for publicly traded companies are redundant and should be eliminated. SEC regulation of these companies effectively accomplishes the same objectives of KYC requirements. Thus, compliance with these requirements is unnecessary for these Companies, particularly since the California requirements are actually slightly more onerous than the EU ETS requirements.

- In any event, entities should be permitted to comply with KYC requirements through electronic submission and verification procedures. On the other hand, Chevron appreciates and supports ARB's efforts to introduce flexibility into the market administration process, such as the expanded account representative provisions. (CHEVRON)

Comment: Furthermore, any breach of security within ARB's records could pose significant liability. We suggested alternatives to what was proposed in our comment letter. And many of our members suggested alternatives as well.

One recommendation was to require agents to disclose the type of information required under the U.S. EPA acid rain market trading program, which has been in existence for years. This program uses security imbedded within the system's program. CMUA stresses that the proposed KYC requirements would be difficult for POU employees and prefer alternatives that do not require personal information to be disclosed.

We also do share the concerns raised by Supervisor Roberts as making sure that the system is functional for our members. This is extremely vital to our members. (CMUA2)

Comment: There are numerous examples in commodity markets of trading platforms that can be used to assure ARB that employees or agents of registered entities are authorized to trade on behalf of their organizations. SMUD mentioned above the digital certificate system used by the California ISO. Another model is the internet-based market used to trade energy contracts, known as ICE. SMUD uses ICE to trade hundreds of millions of dollars in power and gas contracts every year. ICE requires that SMUD approve a list of traders, then issue a user name and password for each authorized trader. Those users individually have credit limits and the organization has credit limits as a whole. Positions cannot be put on in excess of those limits, nor can individuals trade on behalf of the organization without permission. The organization has the responsibility for trader activity, not the trader. The organization provides the information necessary to satisfy ICE, and other market participants, that it can trade. ICE has operated successfully for years without requiring confidential, personal information from traders. (SMUD1)

Comment: An alternative form of employee identification is a digital certificate. For its power market, the California ISO issues a digital certificate, which is installed on the trader's business computer. The digital certificate is unique to that trader and is necessary to make a trade and access other California ISO applications. The digital certificate, and unique password, can only be issued by a Certificate Authority, who is the California ISO for energy trades. For example, for SMUD to obtain a digital certificate, the point of contact in SMUD sends the ISO an application for access with the employee name and SMUD address, SMUD phone extension, and SMUD employee email address. No confidential, personal information is involved. Prior to renewal of the digital certificate, the ISO sends an expiration notice, which the SMUD point of contact either renews or cancels. The point of contact also cancels existing certificates when employees leave. The ISO sends the digital certificate directly to the individual via email, which checks the employee name against the SMUD global address list. The ISO copies the point of contact on this email, so if employee status were to change in the time from the request date, the point of contact can immediately cancel the certificate. The ISO will not issue a digital certificate unless the request comes from the authorized point of contact, who was delegated to that position by a SMUD manager.

Digital certificate identification assures counterparties, and the California ISO, that trades are only made by authorized representatives, without disclosing personal information of the trader to the ISO. A similar process could be used by the ARB with equal security, which would make disclosure of personal information unnecessary to confirm the identity of the Authorized Account Representative. The digital certificate also adds the level of security that would impede the possible hacking of the carbon market applications. Adoption of a digital certificate system would address security concerns underscored by the seven million Euro loss sustained in Europe in January of 2011. Unidentified access to a user-name-and-password-only low level of security application is a high level concern but is not what's at issue here. Trading of GHG allowances and access to ARB Holding Accounts will be activities of business-identified employees.

Clearly, the Air Resources Board does not need the information sought under sections 95834 and 95912(d)(5) (referencing Appendix A) to confirm the identity of Account Representatives or their delegates. Specifically, the ARB does not need to obtain: (1) home address demonstrated by government-issued identity card, (2) date of birth, (3) passport, (4) driver's license, (5) criminal conviction record, (6) personal phone number, (7) email address, (8) social security number, (9) documentation of citizenship, and (10) documentation of an open bank account; all to simply identify an individual. Although this information makes identification more convenient for ARB staff, the information sought is not necessary for ARB to carry out the stated purpose of these regulations. The information requests listed in sections 95834 and 95912 represent the very type of indiscriminate collection and maintenance of personal information the Legislature sought to eliminate by enacting the Information Practices Act. (SMUD1)

Comment: Know-Your-Customer requirements should not apply to account viewing agents.

While it is important that the identity of primary account representatives and alternate account representatives be verified in a reasonable manner as discussed above, there does not appear to be a need for account viewing agents to be subject to the same requirements. These agents cannot undertake any transactions on the tracking system —they can only view it (section 95832(h)(1)). They cannot commit fraud involving compliance instrument transfers. SCPPA considers that extensive Know-Your-Customer requirements should not apply to account viewing agents. (SCPPA1)

Comment: However, we believe that ARB has plenty of reasonable alternatives and, in fact, does not need to do its own investigation of our employees. No other commodity platforms require this personal information to confirm that our employees are who we say they are.

In SMUD's comments, we discussed several reasonable alternatives that are less intrusive and equally effective. For example, California ISO issues additional certificate which is installed on the trader's business computer. The digital certificate is unique to each trader and is necessary to make the trade or to access ISO applications. No confidential, personal information is involved.

In our communications back and forth between the ISO and SMUD to ensure that the trades used by -- are only made by authorized SMUD representatives and would address the problems that have been seen in other trading schemes.

A similar process could be used by ARB with equal security, which would make disclosure of personal information unnecessary to confirm the identity of our authorized account representatives. So we urge you to reject this specific proposal on the "Know Your Customer" requirements and adopt a less intrusive alternative. And we hope to see some 15-day language to address this. (SMUD2)

Comment: LADWP encourages ARB to look to EPA's acid rain program as a model for developing ARB's emission tracking system. EPA's registration structure is also used for reporting of greenhouse gas emissions to both EPA and CARB. If the EPA registration structure is good enough for reporting of greenhouse gas emissions, which serves as the basis for the cap and trade compliance obligations, we think it should be good enough for the compliance instrument tracking system as well. (LADWP2)

WPTF recommends that CARB align the know-your-customer provisions in the regulation with those of the EU in order to facilitate entity compliance. Specifically, we recommend that:

- Documentation requirements for nomination of account representatives should be different from those for account registration. Bank account information and criminal background checks should not be required for nomination of account representatives, as these individual will have been subject to whatever checks the entity considers appropriate as a condition of employment.

- Additional documentation should be required as part of the registration process for legal-entities that seek to be voluntary associated entities. This documentation should include bank account information and instruments establishing the legal entity.

- CARB should provide an option for provision of documentation via mail or electronically, rather than require in-person delivery. (WPTF)

Response: Staff appreciates the acknowledgment by most commenters that the KYC requirements are intended to provide integrity in the market program.

Integrity of the cap-and-trade market program hinges on ARB's ability to enforce the regulation and mechanisms to prevent the types of security threats that have plagued existing emissions trading programs, such as the EU ETS. Staff believes that ensuring the identity of individuals that will have access to the tracking system and only allowing individuals that do not have recent criminal convictions is appropriate to protect the financial investments of market participants in the compliance instruments in their accounts. Recent federal enforcement actions related to the California energy crisis in the 2000s have also highlighted the need to identify specific individuals who may be associated with regulated entities and engage in market manipulation activities. In developing the KYC requirements in the regulation, staff considered the volume and financial value of the compliance instruments in the market. Staff also reviewed the existing requirements in several trading programs and settled on the requirements that are being designed and considered by other comparable emissions trading programs.

The KYC requirements apply to all individuals who will have accounts in the tracking system. This includes account representatives and account viewing agents associated with regulated entities and voluntary market participants. Staff believes it is important to verify the identity of every individual who will be able to take action in the system or view information in the system. In both cases, individuals will have access to market sensitive information about their own entities and transaction counter parties for all trades related to their accounts. This information can be used for collusion with unassociated entities or market manipulation.

The KYC information is only required to be submitted once at the time of registration. This process is not ongoing each time an individual needs to access the system once their registration has been approved. The KYC information can be hand delivered or mailed to ARB staff. Staff is not requiring in-person delivery of the required information.

The type of information being requested is:

1. Name
2. Primary residence – proof through government issued ID card with an expiration date
3. Date of birth – proof can be same as item 2

4. Proof of either passport or driver's license – proof can be same as item 2
5. Photographic evidence of individual – proof can be same as item 2
6. Proof of open bank account in the United States – not account balances or account numbers
7. Employer name and contact
8. Disclosure of felony conviction during prior 5 years
9. Attestations to acknowledge personal liability for actions taken in CITSS

Staff does not believe these requirements are onerous or so narrow that they will adversely limit the number of individuals that can comply and register for accounts in the tracking system. Contrary to some comments, staff is not requesting specific bank account numbers or balances, only proof of open bank account because banks conduct their own KYC process. All copies of documentation to show proof of these requirements must be notarized. Most banks provide notary services.

Some commenter's expressed concern on the sharing of sensitive information with the Financial Services Administrator (FSA). Individuals associated with entities will not be required to provide additional information, such as social security numbers, to the FSA. Only individuals who are voluntary participants will be required to provide such information to participate in the quarterly auctions. The Reserve Auctions are only for covered entities, and their account representatives do not need to provide additional information to the FSA.

Staff does not agree that the suggested approach of working with the SEC is both practical and meets ARB's security needs. First, not all registered entities will be filing the information with SEC. ARB staff would then need two sets of rules. In addition, ARB staff would have to determine which set of rules applies to each registered entity.

Security of confidential and personal information is of primary concern and importance to the California Air Resources Board (ARB) and ARB's cap-and-trade program. ARB has several policies and procedures in place to ensure the security of all personal information provided by program participants. Additionally, there are penalties for violating the Information Practices Act, both for an agency, which may be sued, and for an employee, who may be disciplined, including termination, or may be guilty of a misdemeanor, with a penalty of up to a $5,000 fine and/or one year in jail.

All ARB programs including the cap-and-trade program adhere to the California Air Resources Board Information System (CARBIS) Privacy Policy established for ARB. Details of this policy are available at: http://www.arb.ca.gov/html/conditions.htm#privacy. ARB's policies require that programs comply with all state and federal regulations that address the maintenance, security, and disclosure of personal information and the protection of privacy. In addition, section 95830(g) of the regulation explicitly provides that the specific information is treated as confidential, including that information submitted pursuant to the KYC provisions, designation of representatives and agents, and reporting of directors and officers and persons controlling specified voting rights.

ARB's cap-and-trade program has established procedures for safeguarding confidential information. These procedures pertain to the handling and safeguarding of all personal information submitted under the cap-and-trade program and all information that may be entitled to confidential treatment under California law. These procedures address receipt, storage, access, and disclosure of confidential information.

ARB has also instituted additional physical security measures to protect confidential data including: storage of information in a room for this purpose only with access limited to a small number of staff with card key control access, and structural reinforcement of the storage room to prevent unauthorized access. These strategies ensure that only a small number of authorized staff will ever access files, all access will be recorded and no files will be left in a non-secure location. Regular data review and scheduled and random inspections of all work areas will verify proper execution of these policies.

E-2. (multiple comments) These are not securities. These are not negotiable instruments that are traded in an open market requiring banking industry control.

In comments that we filed yesterday, SMUD laid out a number of arguments for why we feel that the ARB has over-reached in requiring disclosure of sensitive and confidential information. And we discussed in those comments a number of legal and policy problems with the proposal.

For one, we believe that the ARB is prohibited under California Information Practices Act from collecting this personal information and disclosing it to its banker, Deutsche Bank.

Second, requiring SMUD to disclose this information exposes it to potential liability for invasion of privacy court actions. This regulation would force SMUD to abandon its information security policies designed to detect the legitimate privacy concerns of employees. (SMUD2)

Comment: Requesting detailed personal information from employees of covered entities may violate employees' right to privacy under the California Constitution. (SEMPRA1)

Comment: The California Information Practices Act Precludes the ARB from Collecting and Maintaining the Personal Information Sought in Sections 95834 and 95912.

The proposed amendments to sections 95830(c)(2), 95834(b), and 95912(d)(5) (referencing Appendix A) violate the California Information Practices Act (the Act). The Act prohibits state agencies, such as ARB, from collecting personal information that is not relevant or not necessary to accomplish a purpose of the agency required or authorized by the California Constitution or statute. The Act protects an individual's right to privacy from the indiscriminate collection, maintenance, and dissemination of personal information. The Act implements strict limits regarding the collection and maintenance of personal information.

Under the Act, the term "personal information" includes: any information that is maintained by an agency that identifies or describes an individual, including, but not limited to, his or her name, social security number, physical description, home address, home telephone number, education, financial matters, and medical or employment history. It includes statements made by, or attributed to, the individual.

The "Know-Your-Customer" information listed in section 95834(b) and in Appendix A constitutes "personal information" under the Act because each request is for "information…that identifies or describes an individual." The data requested includes information expressly included in the Act's definition of "personal information" including: the individual's name, home address, social security number, employment history, driver's license number, and bank account information. Since ARB is a state "agency" under the Act, it is subject to the Act's "strict limits" regarding the maintenance and dissemination of personal information. Consequently, ARB is prohibited from collecting the personal information sought in section 95834 and 95912 (referencing Appendix A), and sharing that information with Deutsche Bank, its banking contractor, if the information is not necessary for the Board to accomplish the Air Resources Board's statutory purpose.

According to the ISOR, the stated rationale of requiring the personal information is to identify the representatives of the covered entities who will participate in the cap and trade auctions. The employee information sought by ARB to be delivered to Deutsche Bank is not necessary to identify the representatives of the registered entities because the registered entities themselves can confirm the identities of their employees, and because the ARB will approve the entities' registration and hold them financially accountable. This is routinely done for traders in both the electric power and natural gas markets. (SMUD1)

In summary, the KYC requirements proposed to sections 95830(c)(2), 95834(b), and 95912(d)(5) (referencing Appendix A) are unnecessary and inappropriate to fulfill the need for ARB to ensure the identity of authorized account representatives with access to allowance auctions and allowance holding accounts. Requesting this information as a condition for participation in the Cap & Trade Program is not authorized by law, and potentially subjects registered entities such as SMUD to employee lawsuits for violations of state privacy protections. It also violates the values and policies of SMUD. Therefore, SMUD urges the ARB to reconsider these regulations and adopt more customary practices for secure commodity trading in the energy industry. (SMUD1)

Comment: The Information Sought by the Air Resources Board in Sections 95834 and 95912 of the Proposed Amendments Subject Registering Entities to Liability for Invasion of Privacy Tort Actions.

The information requested by the ARB in sections 95834 and 95912(d)(5) opens up registering entities to potential liability from employee invasion of privacy tort actions. Specifically, the California Constitution explicitly guarantees an individual right of privacy. The California Constitution provides:

All people are by nature free and independent and have inalienable rights. Among these are enjoying and defending life and liberty, acquiring, possessing, and protecting property, and pursuing and obtaining safety, happiness, and privacy. (Emphasis added).

An individual's right to privacy is an inalienable right guaranteed explicitly by the California Constitution and such a right is legally enforceable. The ARB's collection of the information sought in sections 95834 and 95912(d)(5) represents the kind of intrusion that the Legislature sought to protect with the Constitutional Amendment including: "(1) 'government snooping' and the secret gathering of personal information; (2) the overbroad collection and retention of unnecessary personal information by government and business interests; (3) the improper use of information properly obtained for a specific purpose, for example, the use of it for another purpose or the disclosure of it to some third party; and (4) the lack of a reasonable check on the accuracy of existing records."

Because ARB provides no compelling interest necessary to warrant such an invasion of employee privacy, disclosure of this information by SMUD or other obligated entities risk civil actions by employees for violation of their constitutional right of privacy. The California Court of Appeals for the First Appellate District has held that the "custodian of private information has the right, in fact the duty, to resist attempts at unauthorized disclosure and the person who is the subject of it is entitled to expect that his right will be thus asserted…[a]nd, of course, the custodian of such private information may not waive the privacy rights of persons who are constitutionally guaranteed their protection." In sum, SMUD and other registering entities are not only concerned about wrongful disclosure and invasion of privacy, but are required to resist attempts at such unauthorized disclosures. (SMUD1)

Comment: SMUD's Standard District Policies (SDPs) and District Administrative Procedures (DAPs) Preclude SMUD from Disclosing the Information Sought by the Air Resources Board in Sections 95834 and 95912(d)(5).

Pursuant to SMUD SDPs and DAPs, SMUD may not be able to disclose the information requested in sections 95834 and 95912 of the proposed amendments. Employee personnel information is defined by SMUD SDP 6.2.101 as "any information that personally identifies a SMUD employee including, home address, home phone number, cell phone numbers, birth date, health benefits, dependents, social security numbers, driver's license numbers, direct deposit banking information or financial accounts, personnel actions, background investigations, Department of Justice (DOJ) criminal history records checks, and personnel risk assessments." SMUD classifies employee personnel information as sensitive and confidential information, and is therefore subject to SMUD information security policies. SMUD employees must limit access to, and use of, sensitive and confidential information according to "need to know" and "minimum necessary" principles. SMUD will only disclose sensitive and confidential information if the use of the information is necessary to carry out official SMUD duties, and the disclosure is the minimum amount necessary to carry out official SMUD duties. SMUD's Board of Directors has adopted these policies in order to protect the legitimate privacy concerns of our employees.

The information sought by the ARB is neither necessary to carry out official ARB duties, nor would the disclosure be the minimum amount necessary to carry out official SMUD duties. Therefore, SMUD requests that these amendments be withdrawn to avoid a conflict with SMUD's information security policies. (SMUD1)

> **Response:** ARB is permitted, under the authority of AB 32, to collect such information as necessary to implement the regulation. The Information Practices Act limits the type of information only to what is 'relevant and necessary to accomplish" an agency purpose. (California Civil Code section 1798.14.) The information required to be submitted pursuant to the KYC provisions is required to ensure the integrity of the cap-and-trade program. The Information Practices Act governs *how* ARB may use the information and how it may be shared, stored or collected, not *whether* ARB may collect information reasonably necessary to implement its regulations. To be clear, staff believes it is collecting the minimum amount of personal information necessary to implement the regulation. The proposed regulations require the submission of the individual's name, primary address, as shown on a valid state identification card, date of birth, employer name, passport or driver's license number, if issued, proof of an open bank account (ARB is not requesting actual information about the bank account, only that one exists), relationship with the entity that has registered with the program, a valid photo identification, and identification of any criminal conviction in the past five years.

Ownership Structure

E-3. Comment: Section 95830(c)(1)(B) should be amended so that it requires listing of 2 or 3 of the entity's officers who are: i) responsible for the conduct of the authorized account representatives, ii) alternate account representatives, and iii) account viewing agents. Listing of all the directors and officers of a large entity may be a very long list, which will be difficult to keep current, and is unnecessary to ARB's program oversight. Moreover, it is unclear why a list of persons controlling over 10% of the voting rights is necessary.

Recommendation: Revise section 95830(c)(1) as follows:
(A) Name, physical and mailing addresses, and contact information, and type of organization, date and place of incorporation;
(B) Names and addresses of the entity's directors and officers of at least three of the entity's directors and officers who are responsible for the conduct of the authorized account representatives, alternate account representatives and account viewing agents.
(C) Names and contact information for persons controlling over 10 percent of the voting rights attached to all the outstanding voting securities of the entity;
(D) A business number, if one has been assigned to the entity by a California state agency; California Air Resources Board;
E) A U.S. federal tax Employer Identification Number, if assigned;
(F) Data Universal Numbering System number, if assigned;
(G) Statement of basis for qualifying for registration pursuant to sections 95811, 95813, or 95814;
(H) Identification of all other entities registered pursuant to this article with whom the entity has a corporate association, direct corporate association, direct or indirect corporate association pursuant to section 95833, and a brief description of the association; and
(I) Identification of all entities registered pursuant to this article for whose benefit the entity holds compliance instruments pursuant to section 95834; and Applicants may be denied registration: (i) based on information provided; or (ii) if the Executive Officer determines the applicant has provided false or misleading information; or (iii) if the Executive Officer determines the applicant has withheld information material to its application. (WSPA1)

Response: ARB is collecting information on individuals owning more than 10 percent of a company's voting rights, along with information on officers and directors, to be able to identify potential undisclosed corporate associations through common owners, officers, and directors. Staff conversations with ARB's market monitor have confirmed the importance of such information. However, since these individuals do not need to comply with the Know-Your-Customer requirements of section 95834, staff does not believe the requirement is overly intrusive.

E-4. Comment: Environmental Defense Fund (EDF) and the Natural Resources Defense Council (NRDC) appreciate that even as CARB begins the process of considering linking to Québec, CARB is also continuing to learn from other emissions trading programs and listen to the market monitor to improve and strengthen the program. As noted in the April 9, 2012, workshop on these amendments the proposed know-your-customer provisions are partially in response to lessons learned from the EU ETS system. (EDF3)

Response: Thank you for your support.

E-5. Comment: Section 95830 of the Proposed Regulation Order for Linkage revises some of the registration requirements, introducing additional information about an entity's officers and requiring compliance with the "Know-Your-Customer" requirements outlined in Section 95834. SCE supports the ARB's desire to improve the security and integrity of the tracking system, but cautions again that the new provisions may raise logistical difficulties as well as privacy concerns. For example, Section 95830(c) requires a covered entity to provide the names and addresses of the entity's directors and officers without specifying whether it is referring to business addresses or personal addresses. Releasing the personal addresses of all the directors and officers of SCE, or its parent company, Edison International ("EIX"), raises enormous security and privacy concerns. Moreover, for a large, publicly-traded entity such as EIX or SCE, this information is constantly changing.

SCE does not support requiring compliance entities to provide the names and addresses of all of their directors and officers. This language should be removed. Alternatively, SCE recommends (1) removing the requirement of providing addresses, and (2) clarifying that entities provide this information one time only, at the start of the compliance obligation that commences January 1, 2013. Moreover, the ARB should provide a clear definition of "directors and officers" to avoid confusion from out-of-state entities. (SCE1)

> **Response:** Generally, section 95830 will require disclosure of "primary residence" when requiring personal address. When the section requires "address," staff understands that the choice of primary residence or business address is left to the discretion of the registrant. In addition, while it is likely that an officer or employee of a company may use the business address of the registering entity, a director would likely be an individual outside the company, and so would have a different address.
>
> Staff will separately provide instructions on how to submit information submission
> .

F. CORPORATE ASSOCIATIONS AND ACCOUNT CONSOLIDATION

Direct Corporate Associations

F-1. (multiple comments): Direct Corporate Associations And Affiliate Transaction Rules

It is unclear if ARB intended Section 95833(c) on affiliate rules to treat entities subject to state and federal affiliate transactions rules as separate entities or as a single entity with respect to purchase and holding limits. California affiliate transactions rules require entities such as SDG&E to act independently of its sister company, SoCalGas, and independently of Sempra Energy unregulated affiliates, Sempra Generation and Sempra International. The ISOR states the intent of section 95833 to be as follows: Under the regulation, entities are required to disclose any corporate associations with other registered entities and unregistered entities that may control registered entities. This disclosure aids market monitoring. Staff also structured auction purchase limits and holding limits to apply to corporate associations as if they were single entities, since they are presumed to coordinate market activity. [Emphasis added]

While subsection (a) of 95833 Disclosure of Corporate Associations makes all four of Sempra's affiliates have a "direct corporate association," there are complete restrictions on information flow between SDG&E, SoCalGas, and the unregulated affiliates as far as procurement activities in gas and electricity markets required by the CPUC affiliate transaction rules that prevent any coordination. For this reason, SDG&E, SoCalGas and its unregulated utilities will be opting out of consolidation. However, there is still some confusion as to whether or not the limits will need to be shared amongst our direct corporate associations. For purposes of purchase limits and holding limits, section 95833(c) should be modified to make clear that if affiliate transaction rules require procurement entities to act independently and preclude disclosure of confidential market information, then they should be treated as independent entities for purposes of procurement limits and holding limits.

If ARB does not modify the regulation to make this clarification, then ARB should provide guidance that 95833(c) means entities with federal or state affiliate transactions rules requiring entities to act independently with regard to procurement should be treated as separate entities for purposes of the purchase and holding limits under the regulation. (SEMPRA1)

Comment: And my last comment is on Section 95833(c) on affiliate transaction rules. This is an issue we brought up in our original comments on the original proposed regulation that you voted on in 2010 and again in 2011. And we are very concerned that the affiliate transaction rules — it's not clear if it's the Board's intent to treat entities like investor-owned utilities as a separate entity or if we are a single entity with our unregulated sister company affiliates with Sempra Energy Corporation. California law prohibits coordination between regulated entities. And the unregulated entities of corporation. And we think it would be helpful for that section to be modified and make it clear that federal and State affiliate transaction rules require these types of entities to be treated independently. (SEMPRA2)

> **Response:** After consultations with the utilities, ARB added section 95833(c), which provides that entities that are subject to state or federal regulations shall not be required to disclose information or take other actions that would violate those rules. Staff has always maintained that the language prevents certain activities, such as the default consolidation. It is staff's expectations that entities in the situation described in the comment would use the opt-out procedure to structure their accounts in a manner consistent with the state and federal regulations with which they must comply.

F-2. Comment: Additional Recommended Changes and Clarifications for Registration Requirements (Sections 95830, 95832, and 95833)
Section 95830(c)(1)(H) – Clarification on Identification of Direct and Indirect Corporate Associations. Section 95830(c)(1)(H) requires the identification of

corporate associations, direct corporate associations, and indirect corporate associations, which are defined in section 95833.

We recommend clarifying that the definitions of corporate association and direct corporate association in sections 95833 (a)(1)-(3) require connection through only one entity, and do not include entities that are connected indirectly through one or more intermediate entities. We also note that, as defined, “corporate association” does not include “indirect corporate associations.”

Finally, we note that registrants may not have enough information to identify all indirect corporate associations because they may need to obtain detailed information regarding third parties’ corporate structure, which is typically considered confidential business information. We recommend that ARB revise this section to permit registrants to rely on internally-available information and corporate structure information set forth in publicly-available annual filings made with the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the California Public Utilities Commission. (SCPPA1)

> **Response:** No clarification of section 95833(a)(1)-(3) is needed because the definitions are clear. Whether the entities have a corporate, indirect, or direct corporate association with registered entities, even if through unregistered entities, they must all meet the disclosure requirements of section 95833(d).
>
> Regarding the ability of an entity to identify a corporate association, the comment is based on the premise that an entity is unfamiliar with its own holdings. Furthermore, the comment asserts that even if one entity has an interest in a second entity it may not be able to acquire sufficient information about the second entity to verify the extent of its interest. Certainly, the entity is able to use its regulatory filings to document its corporate associations, if those documents contain the complete record of all of the entity’s associations.

Consolidated Accounts

F-3. Comment: Section 95914(d) addresses the allocation of shares of the auction purchase limit among entities with a direct corporate association. This section does not recognize that entities with a direct corporate association may choose to have their accounts consolidated under section 95833, effectively becoming one entity for the purposes of the Regulation. Entities with a direct corporate association with consolidated accounts should not be required to allocate shares of the auction purchase limit among themselves. The auction purchase limit applies to the ‘consolidated’ entity as a whole, and there is no need to divide it between members of the corporate association, since all allowances purchased by the consolidated entity will be delivered into one account. (SCPPA1)

> **Response:** If members of a direct corporate association choose to consolidate their accounts pursuant to section 95833, then they will no longer exist as

separate registered entities, and the requirement in section 95914(d) to specify a distribution of the purchase limit will no longer apply.

F-4. (multiple comments): Section 95833: Account Consolidation Procedures Should Be Streamlined.
SCPPA welcomes the option for POUs to consolidate their accounts.

SCPPA greatly appreciates the inclusion of new section 95833(a)(5) of the Regulation, which allows POUs to claim a “corporate association” with their electricity generating facilities in California and their electricity imports. A POU can then consolidate its accounts for those facilities into one set of accounts under section 95833(f), avoiding the risk of having allowances stranded in the compliance account of any one facility. This significantly improves the operation of the cap and trade program for POUs. (SCPPA1)

Comment: Regarding the non-linkage changes to the cap and trade regulation, we submitted a written comment that strongly supports a new section that allows electric utilities to consolidate their accounts for their various generating facilities and their imported electricity. For many, consolidated accounts will reduce the administrative burden of the Cap and Trade Program and will have potential benefits for all participants in the Cap and Trade Program. (SCPPA2)

Comment: First, LADWP supports the amendments which allows publicly-owned utilities to consolidate their facility and entity accounts into a single account. Publicly-owned utilities are vertically integrated so they operate both in-state generating facilities as well as electricity distributing customers. Being able to consolidate those accounts will resolve the difficulty of having to predict how to divvy up the allowances into separate accounts prior to the actual emissions occurring.

Emissions for electricity-generating facilities vary significantly from year to year depending on a number of factors, including outages, wet or dry years, and availability of electricity from other resources. Dealing with individual accounts would be very challenging from a compliance perspective, and the rule does not allow the transfer of allowances between accounts. Therefore, we appreciate this amendment and support it. (LADWP2)

Comment: Consolidation of Accounts between Entities with Direct Corporate Association
IETA commends ARB for proposing to switch from a facility-level to a corporate-level process for accounts by allowing for consolidation of accounts with direct corporate association. (IETA)

Comment: SECTION 95833(F) AND SECTION 95833(A)(5) APPROPRIATELY ALLOW THE CONSOLIDATION OF ACCOUNTS

NCPA supports the Proposed Revisions that clarify the relationship of POUs and JPAs relevant to corporate associations (§ 95833(a)(5)) and further allow for the creation of a single, consolidated set of accounts. (§ 95833(f)) The ability of covered entities that both own/operate electricity generation facilities and import electricity to be able to consolidate their accounts is going to be a crucial tool in cost and risk management for compliance purposes. Even though each of these functions as a separate "reporting facility" under the Mandatory Reporting Regulation, they are part of the utilities' comprehensive procurement/resource planning activities. Without a provision that allows the utilities to hold a single set of accounts, utilities would not be able to manage their compliance instrument surrenders in a timely or efficient manner, and could end up with stranded excess instruments in one compliance account and a shortfall in another compliance account in any given compliance period. Such an outcome would not only place additional cost burdens on the utility, but could also result in driving up the cost of compliance instruments when entities seek to supplement their shortfall with allowances from the auction despite the fact that "extra" allowances remain unretired in other compliance accounts. The proposed amendment would address this problem. (NCPA)

> **Response:** Thank you for your support.

F-5. Comment: Entities should be able to request or refuse consolidation of accounts during registration.

Section 95833(f) of the Regulation sets out a process for the consolidation of the accounts of entities in a corporate association. An entity must submit a notice by October 1, 2012, if it wishes to have its accounts consolidated (section 95833(f)(2)). An entity must also submit a notice if it wishes to opt out of consolidation (section 95833(f)(3)). This process requires an unnecessary number of notices. It would be more efficient if the registration forms to be completed by each entity under section 95830 included, in the section on corporate associations, a section where the entity can specify whether it wants the accounts of its corporate association to be consolidated. (SCPPA1)

> **Response:** Section 95833(f) provides deadlines for the submission of the required information, but it does not prevent the information from being submitted sooner or with other information submissions. Staff is implementing a streamlined process that would allow the consolidation to occur at the time of the registration under section 95830.

F-6. (multiple comments): Section 95833. Disclosure of Corporate Association LADWP supports CARBS' inclusion of language which allows POUs to consolidate their facility and entity accounts into one account. Consolidation of accounts will alleviate the difficulty of POUs such as LADWP having to predict how to properly divide allocated allowances prior to receiving their allowances. Throughout a compliance year, emissions on a facility level could be significantly different than expected due to forced outage, planned outage, hydro conditions, renewables integration, etc. Having individual source compliance accounts would have introduced compliance challenges for POU covered entities if they were unable to transfer between compliance source accounts.

LADWP recommends that CARB clarify that those entities that opt to consolidate their accounts into one account also will have their compliance obligations consolidated. The Mandatory Reporting Rule verifies GHG emissions on a facility and entity level basis whereas the cap-and-trade rule ensures that the number of allowances an entity surrenders matches its GHG emissions. (LADWP1)

Comment: If accounts are consolidated, liability should also be consolidated. If entities forming part of a corporate association have their accounts consolidated pursuant to section 95833(f), the Regulation should clarify that the compliance obligations of the entities in that association are also consolidated, for the purposes of the surrender of allowances and the determination as to whether sufficient allowances have been surrendered. There should be one total emissions liability figure for all entities forming part of the corporate association, rather than a separate liability for each entity. (SCPPA1)

> **Response:** The entity holding the consolidated account will be responsible for the compliance obligations incurred by any entity agreeing to have its account consolidated with other accounts. Section 95833(f)(4) creates a single compliance account to enable compliance for all member entities of the consolidated account. The entity responsible for the consolidated account will be responsible for the combined compliance obligations.

F-7. Comment: Section 95833(f) – Consolidation of Accounts for Direct Corporate Associations. PG&E supports the new approach to enable entities to consolidate accounts that are part of a direct corporate association. This approach will reduce complexity and simplify the compliance process. PG&E seeks clarification as to whether entities that are part of a direct corporate association could opt-in and then at a later point opt-out of having a consolidated account.

Additionally, PG&E would like to request that entities that have direct corporate associations have the ability to group accounts that they would like to have consolidated to account for different lines of business that exist at large companies. PG&E also recommends amending the titles of section 95914(d) and section 95920(f) to replace "corporate associations" with "direct corporation associations," to reflect the new approach to consolidation of accounts. (PGE1)

> **Response:** Section 95833(f)(3) allows an entity to opt out of consolidation with some other members of a direct corporate association. Staff understands that a group of entities that opts out of a consolidated account may apply to create a second consolidated account. Staff will implement a process to accommodate this structure.

F-8. Comment: We would also like ARB to clarify whether it would be possible for entities that are part of a corporate association to consolidate accounts upon request. ARB has identified several relevant policy considerations behind its consolidation provisions in its ISOR, all of which may apply to entities in a corporate association just as they would apply to an entity in a direct corporate association.

Consolidation is the default rule for direct corporate associations under the May 9th Proposal, but there are no provisions whatsoever for the consolidation of corporate associations. The regulations do not specifically exclude such a measure, but we believe there should be a more clear procedure for the voluntary consolidation of corporate associations into a single set of accounts, in order to address the policy considerations mentioned above. (CHEVRON)

> **Response:** Section 95833(f)(3) allows an entity to opt out of consolidation with some other members of a direct corporate association. The intent of the language is to only apply to direct corporate associations and not just corporate associations seeking a voluntary consolidated account.

Holding Limits

General

F-9. (multiple comments): PG&E recognizes that the cap-and-trade regulation adopted in 2011 included regulatory language regarding Beneficial Holdings that contained challenging information disclosure and trade conduct requirements. As such, PG&E supports the deletion of this regulatory language and the associated requirements.

However, the current Holding Limit calculation continues to unfairly constrain PG&E and other entities with a large GHG exposure due to the nature of our electric portfolio, which includes both utility owned generation and contracted electric generation with third parties through “Tolling Agreements.” Therefore, PG&E recommends changes to the Holding Limit and Limited Exemption as described below.

Adjust the Holding Limit and Limited Exemption to Not Unfairly Disadvantage Large Entities and Entities with a Broad Electric Portfolio (Section 95920(d))
PG&E remains concerned that the current holding limit unfairly disadvantages entities with a large compliance obligation in their ability to procure sufficient compliance instruments on behalf of certain counterparties with which they have contracts for the delivery of electricity.

PG&E believes there are several potential solutions that could address our concerns and would like to work with staff and others concerned about the holding limit provisions to discuss potential options.

As mentioned in PG&E's April 13, 2012, comments on the discussion draft (see Attachment A, p. 3), one potential solution is to (1) apply the limited exemption to allowances in both the holding account and compliance accounts, and (2) calculate the limited exemption based on the greater of the amount permitted in the current regulation section 95920(d)(2) (i.e., the most recent emissions data report that has received a positive or qualified positive emissions data verification statement) or a percentage of the entity's annual allowance allocation from ARB, since the allocation correctly contemplates that GHG exposure for some entities may extend beyond their compliance obligation. (PGE1)

Comment: Because serious questions remain about the impact that a one-size fits all holding limit will have on the largest covered entities, CARB should not apply the holding limit during the first compliance period (2013–2014) to any covered entity or direct corporate association whose annual compliance obligation exceeds the holding limit. Additionally, the Board should amend the proposed holding limit calculation for future vintage allowances purchased at advanced auctions and the holding limit penalty provisions. (CALPINE1)

> **Response:** Staff addressed the size of the holding limit and limited exemption in the FSOR to the existing regulation that was filed with the Office of Administrative Law in 2011. The proposed regulation does not change the calculation of the holding limit or the limited exemption, so the comment is out of the scope of the proposed changes, and no further response is needed.
>
> To the extent that the comment addresses the needs of covered entities to accumulate the allowances they need for compliance, staff has added a procedure as section 95920(d)(3), to allow covered entities to petition for an increase in their limited exemption to accommodate an increase in emissions.
>
> In addition, the Market Simulation Group will be evaluating through the simulations for the California market using equilibrium models the concerns related to holding limits that may inform potential future regulatory amendments to adjust the holding limit.

F-10. Comment: CERP opposes ARB's proposal to require holding limits to be calculated separately for each future vintage year. This proposal would greatly increase the complexity of monitoring compliance with the holding limits for entities that acquire allowances from future vintage years. Moreover, it is not clear that any market flaws would result from the accumulation of allowances within a single future vintage year. Rather, ARB suggests that the proposal is driven by the concern that registered entities that acquire future vintage allowances may have difficulty complying with the holding limit once those future vintage allowances become current year allowances. This, however, is an entirely foreseeable compliance issue that registered entities are capable of addressing on their own by adjusting their account balances over time. It is neither necessary nor desirable for ARB to address this concern by imposing an arbitrary and complex set of vintage-specific holding limits for acquisitions of future vintage allowances. (CERP)

> **Response:** Staff does not agree with the suggested change to remove provisions related to the future vintage holding limits. However, as part of program monitoring, staff will continue to evaluate the impacts of holding limits and propose any future regulatory amendments, as needed. In addition, the Market Simulation Group will be evaluating through the simulations for the California market using equilibrium models the concerns related to holding limits that may inform potential future regulatory amendments to adjust the holding limit.

Penalties for Holding Limit Violations

F-11. Comment: We support the inclusion of a grace period when holding limits are exceeded. However in order to provide business certainty and fair treatment for all, any grace period should include exemption of the compliance entity from the threat of fines and penalties. (CHEVRON)

> **Response:** ARB does not agree with the suggested change. The regulation does not call for automatic imposition of a penalty in all cases where the holding limit is exceeded. ARB has statutory penalty authority that instructs ARB to set penalties based on specified criteria. The proposal in the comment would prevent ARB from imposing a penalty regardless of the circumstances, which may involve serious effects on the market.

F-15. Comment: The Proposed Revisions should be edited to clarify that the imposition of penalties pursuant to section 95920(b)(6) are only proper after the auction participant has had an opportunity to cure the violation pursuant to section 95920(b)(5). (NCPA)

> **Response:** The regulation stipulates that "penalties may be applied whenever the holding limit is exceeded…." This means that the five business day cure period does not automatically include exemption from the threat of fines and penalties. Therefore, this clarification is not appropriate for the intent of the provision.

F-16. Comment: Administration of Account Limits
MSCG strongly approves of and appreciates the additions to the administrative practices with regard to holding limits. In particular we believe the "notice to cure" approach is "best practice" and that the 5-day time available is reasonable. (MSCG)

> **Response:** Thank you for the support.

F-17. Comment: A4. Adjust Holding Limit Cure Period to 30 Business Days (Section 95920(b)(5)(B)) PG&E acknowledges the need to address Holding Limit violations not discovered until after a transfer request is recorded, or if the Holding Limit is exceeded at the beginning of a compliance year when allowances purchased at advance auction now fall under the current vintage Holding Limit. However, the 5 business day cure period is too stringent and may be unworkable for some entities with internal governance processes and/or additional regulatory oversight. (PGE1)

> **Response:** Staff disagrees with the comment for several reasons. First, the holding limit changes only once every year, and the value will be published in advance. Registered entities need only compare their purchases with the limit. Second, covered entities have a limited exemption which they can use to shelter all of the allowances they need for compliance. Thus, the holding limit is applied only to their speculative holdings.
>
> Finally, the claim to need more time to sell allowances held in violation of the holding limit is not persuasive. The potential for harm to the market form an entity exceeding its holding limit is substantial.

F-18. **Comment:** Penalties for breaching the holding limit should only be imposed after notice and a cure period.
Section 95920(b)(6) provides that an entity may be penalized if it exceeds the holding limit or even if it merely files transfer requests that would violate the holding limit. Although there is a need to enforce the holding limit provisions, imposing penalties in these circumstances may be unreasonable. This is particularly so given that the holding limit and limited exemption calculations are not very straightforward, that each compliance instrument transfer will take up to three days to complete (but may be quicker), and as a result it may be difficult for an entity that is active in the market to know from moment to moment whether it is in breach of the holding limit. Furthermore, expensive penalties may not be necessary given that there is already a provision for the Executive Officer to take the excess allowances and auction them (section 95920(b)(5)), resulting in the entity losing valuable allowances, which is in itself a penalty. (SCPPA1)

> **Response:** Staff disagrees with the comment for several reasons. First, the holding limit changes only once every year and the value will be published in advance. Registered entities need only compare their purchases with the limit. Second, covered entities have a limited exemption which they can use to shelter all of the allowances they need for compliance. Thus, the holding limit is applied only to their speculative holdings.
>
> Second, the length of time needed to complete the transfer process should not pose a problem, so long as entities have sufficient internal controls to track their purchases. Third, the removal of allowances from an account is intended as a last resort in case an entity refuses to remedy its violation of the holding limit in a timely manner. It is not viewed as a substitute for penalty. Finally, ARB's statutory penalty authority governs how ARB will set penalties to reflect the severity and duration of the violation, along with other factors, such as

compliance history. Penalties may be automatic, but they will reflect the nature of the violation.

F-19. (multiple comments): RELATED HOLDING LIMIT VIOLATIONS
Related to the elimination of beneficial holdings, Sections 95911(e)(3)(B) and 95913(g)(3)(A), which reject bids in the current auction or the price containment reserve auction that exceed the holding limits, should be eliminated or guidance should be provided to account for post-auction contractual transfers to third parties that are conditional on receiving allowances from the auction. 95912(j)(3) states,

Upon determining that the payment for allowances has been deposited into the Air Pollution Control Fund or transferred to entities that consigned allowances, transfer the serial numbers of the allowances purchased into each winning bidder's Holding Account, or to its Compliance Account if needed to comply with the holding limit;

This portion of the regulation is at odds with rejecting bids that exceed the holding limit since 95912(j)(3) would only occur if the holding account limit is exceeded. The guidance document should indicate Sections 95911(e)(3)(B) and 95913(g)(3)(A) do not apply if the bidder indicates it will transfer allowances to its compliance account or to another entity per an existing contract if successful in the auction. (SEMPRA1)

Comment: We also have concerns with the holding limit violation language in Sections 95911(e)(3)(b) and 95913(g)(3)(a). I won't go into details about that. It's very complex, but it's also found in our comments towards this regulation. (SEMPRA2)

> **Response:** Section 95912(j)(3) reflects the fact that the purchasing entity can shield allowances placed in its compliance account from calculation of the holding limit. The rejection of bids during the auction process will reflect the existence of the limited exemption, so there is no conflict between the regulation sections cited in the comment. Bidding entities need to plan ahead to enable themselves to purchase any allowances and not be in violation of the holding limits regardless of whether or not they will move those newly purchased allowances into their compliance account or to another entity. The regulation clearly prohibits taking custody of allowances on behalf of another entity.

F-20. Comment: Penalties for Holding Account Violations
Section 95920(b)(6) should be modified to assess penalties only if an entity fails to cure the perceived holding account violation within five days. With the potential time lag for allowance transfers from bilateral transfers, exchange transfers or transfers to compliance accounts, it is not reasonable to assume that at any given time a holding account violation has in fact occurred. For example, a transfer request from an exchange to an electric utility may be made at the same time as a transfer request by the electric utility to another compliance entity or to its compliance account. At a given moment, the entity could be in a perceived holding account limit exceedence, but when all potential transactions are taken into account, there may not be an actual violation. These types of simultaneous transactions may be common for electric utilities with

contractual obligations for the purchase of allowances for a generator and with small holding account limits relative to compliance obligations.

95920(b)(6) states, "Penalties may be applied whenever the holding limit is exceeded or transfer requests are filed with the accounts administrator that would violate the holding limit." [Emphasis added]. The transactions would not be real violations per 95920(b)(3), "Compliance instruments transferred out of an exchange clearing holding account will count against the holding limit of the destination account listed in the transfer request submitted by an exchange clearing holding account at the time the transfer request is confirmed." [Emphasis added]

If the regulation is not modified, then ARB should issue a binding guidance document that exempts from penalties all post-auction and post-transaction transfers to an entity's compliance account or to a compliance entity for which it has a contractual obligation to buy compliance instruments. (SEMPRA1)

> **Response:** Staff disagrees with the first point in the comment, that the potential time lag in the transfer process should require ARB to use a cure period before penalties can apply. Transfer requests are based on transaction agreements reached between entities. Entities have complete knowledge of and control over the scheduling of these transactions, so any entity with adequate internal controls should have no problem complying with the holding limit.
>
> The regulation does allow auction purchases to be placed in an entity's compliance account. This avoids a holding limit violation by placing the allowances within the limited exemption. ARB does not intend to exempt post-auction transfers from the holding limit. The holding limit is enforced during the auction settlement process, which cannot include transfer requests that do not yet exist.

Limited Exemption

F-21. (Multiple comments): As of June 1, 2012, the most recent verified emissions report will be for 2010, as the verification statement for the 2011 report is not due until September 1, 2012. The 2010 electricity transactions report does not include emissions, only megawatt hours of electricity imported, exported, wheeled, and purchased or sold within California. Therefore, it is not appropriate to use the 2010 reports to establish the limited exemption, as the 2010 reports lack emissions data for imported electricity.

Furthermore, given that allowances will not be distributed until September 14, 2012 (section 95870(d)), and the first auction will take place on November 14, 2012 (section 95910(a)(1)), there appears to be no need to establish a limited exemption in June 2012. Instead, it would be more appropriate to wait until the 2011 reports have been verified, and establish the limited exemption. (SCPPA1)

Comment: Section 95920 Trading – date change of notifying proper account
The proposed rule (Section 95892(b)(3)) revised the date that a POU informs the Executive Officer of the accounts in which the allocation is to be placed to account for the change to the first auction date. That date has been changed from June 1 to September 1, 2012. LADWP requests that Section 95920(d)(2)(8) on page 164 be revised similarly as follows in order to reflect the change to the first auction date:

On September 1, 2012, the limited exemption will equal the annual emissions most recent emissions data report that has received a positive or qualified positive emission data verification date. (LADWP1)

> **Response:** The comment addresses text that is outside the scope of the proposed changes, so no response is required.

F-22. Comment: Clarify Limited Exemption Petition (Section 95920(d)(3))
PG&E supports the process that permits entities to petition to adjust the limited exemption.

However, PG&E requests clarification to the timing implied by the regulations.
(3) Petition to Adjust the Limited Exemption
(A) Prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating an increase in emissions for that year over the previous year and request a temporary increase in the limited exemption until verified data for that year are available.

PG&E would like to confirm that the petition process will enable entities to update the limited exemption for 2011 verified emissions regardless of when the regulation becomes effective. The current language is unclear in that the regulation states that "prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating an increase in emissions for that year…" (Section 95920(d)(3)(a).) The original version of the regulations initially set the limited exemption based on 2010 emissions (i.e., the most recent verified emissions as of June 1, 2010) and then maintained this exemption until an update on October 1, 2013 with 2012 emissions. Therefore, it is extremely important that the new petition process allow for an update in the interim to account for 2011 verified emissions reports. Without this opportunity to update, the limited exemption would not be adjusted to account for emissions associated with new facilities that came online in 2011 that have a significant compliance obligation. PG&E would like to request that the Guidance Document allow for the petitioning and inclusion of verified 2011 emissions for facilities in the limited exemption category. (PGE1)

> **Response:** Staff disagrees with the comment. Covered entities will not begin accumulating a compliance obligation until January 1, 2013, at which point they will have a limited exemption equal to the 2011 emissions. The limited exemption will increase in October 2013 to include the 2012 emissions, yet covered entities will have incurred only a nine-month emissions obligation.

Moreover, they can petition for a larger exemption as of January 1, 2013. Consequently, staff does not agree that the covered entities need to file the petition during 2012.

Opposition to Holding Limits

F-23. Comment: WPTF, many other stakeholders, and market observers, including the California Legislative Analyst's Office, oppose the establishment of holding limits because of their dampening of market liquidity, because they limit the flexibility of capped entities with high emissions to manage compliance and hedge against allowance price risk, and because there is no empirical justification for their imposition.

WPTF once-again urges CARB to eliminate allowance holding limits in the cap and trade program. We support proposals to increase the frequency of allowance auctions as a means of addressing concerns about market power, in lieu of holding limits. (WPTF)

> **Response:** Holding limits are needed for covered entities because, absent a holding limit, any market participant would have the ability to accumulate sufficient instruments to exercise market power. Staff constructed the holding limit to balance the covered entity's need to accumulate with the potential for market power. Once the covered entity has accumulated instruments to cover its compliance needs, the holding limit treats it the same as any other market participant. Staff is open to considering increased frequency in auctions as the market matures and market participants gain experience with the program.

F-24. (Multiple comments): In general, IETA advocates for the removal of holding limits. However, if California regulators insist on the inclusion of holding limits in California's program design, IETA prefers ARB's original rules, which applied the limit for future vintage year allowances to all vintages within that compliance period. We believe that ARB's latest approach to holding limits (i.e., for the holding limit for future vintage year allowances to apply to each vintage year allowance) will provide an unnecessary restriction on companies, particularly large covered companies who will be challenged to meet compliance obligations with holding limits in place. (IETA)

Comment: CERP opposes ARB's proposal to require holding limits to be calculated separately for each future vintage year. This proposal would greatly increase the complexity of monitoring compliance with the holding limits for entities that acquire allowances from future vintage years. Moreover, it is not clear that any market flaws would result from the accumulation of allowances within a single future vintage year. Rather, ARB suggests that the proposal is driven by the concern that registered entities that acquire future vintage allowances may have difficulty complying with the holding limit once those future vintage allowances become current year allowances. This, however, is an entirely foreseeable compliance issue that registered entities are capable of addressing on their own by adjusting their account balances over time. It is neither necessary nor desirable for ARB to address this concern by imposing an arbitrary and complex set of vintage-specific holding limits for acquisitions of future vintage allowances. (CERP)

Comment: The holding limits have been increased to account for the increase in combined allowance budgets. Changing the holding limit to account for the increased combined allowance budget does not mitigate the underlying problem. WSPA has opposed the “one size fits all” holding limit applied regardless of an entity’s compliance obligation because it (1) it restricts liquidity in the market, (2) it creates opportunities for financial intermediaries to exercise market power, (3) it is without factual basis and is thus arbitrary, and (4) it does not take into account the need for different limits for larger compliance entities and does not provide a level playing field between market participants. Some entities that have corporate associations in Québec may find the holding limit restriction even tighter, relative to their compliance obligations. The California Legislative Analyst Office in their February 9, 2012 report recommends eliminating holding limits to improve the way the carbon market functions.

<u>Recommendation:</u> WSPA recommends eliminating the holding limits or at a minimum, consider increasing the holding limits for covered entities with compliance obligation so that these entities are allowed the currently proposed limit plus 50% of the difference between the entity’s compliance obligation and the currently proposed limit.

If, notwithstanding these comments, ARB elects to continue to place holding limits, WSPA further recommends that the holding limits for future vintage year allowances be applied to all vintages within that compliance period rather than for each year. We believe that applying the holding limit to each vintage year places an unnecessary restriction. (WSPA1)

> **Response:** Because of the concern that individual entity holdings of a single future vintage could be too high. Staff proposed applying the holding limits to each vintage while maintaining the overall size of the future vintage holdings allowed under the holding limit.
>
> ARB has not changed the calculation of the holding limit for current vintage allowances, so the comment requesting removal of the holding limit is outside the scope of the proposed regulation and no further response is required.

Support for Holding Limits

F-25. Comment: Similarly, the proposed changes regarding holding limits for future vintage allowances [moving from entire pool to each year; see §95920] and procedures on auction registration and revocation reflect CARB’s continued willingness to proactively take steps to ensure the market functions as designed.

EDF and NRDC support these changes in the regulation and take the position that these provisions will protect the integrity of the program and any incidental burdens they impose are justified. EDF and NRDC also appreciate that CARB is collecting information from the market monitor and is taking specific action based on this information to strengthen the program overall. The decision to hold a simulated auction in August and to hold the first allowance auction in November is a responsible decision by CARB that will help ensure that all elements of the auction program are in place, fully coordinated, and tested without resulting in any delay of the full launch of the program. (EDF2)

Response: Thank you for your support.

Allowance Accounts

F-26. (Multiple comments): Section 95831: Clarify Why Additional Accounts May Be Created and How They Will Be Filled.

Sections 95831(a) and (b) set out each type of account to be created under the cap and trade program, and specify which compliance instruments may be deposited into each type of account, and by which entity. New section 95831(d) provides that "Additional accounts may be created by the Executive Officer to implement the Cap-and-Trade Program."

Section 95831(d) appears to be designed to give the Executive Officer the flexibility to create new accounts if the Executive Officer deems it necessary. However, if new accounts are created, it would presumably be for the purpose of undertaking transactions with compliance instruments that are not currently provided for under the system of accounts and transfer rules established under sections 95831(a) and (b). Compliance instruments deposited in such new accounts would need to be taken from one of the accounts established under sections 95831(a) and (b). This could have significant—and perhaps unintended—impacts on the flow of compliance instruments between accounts and hence the functioning of the carbon market. Before being implemented, any such new treatment of compliance instruments should be subject to public review and comment by means of a new rulemaking process, rather than being able to be undertaken at the Executive Officer's complete discretion.

Therefore, section 95831(d) of the Regulation should be deleted. If new accounts are needed in the future a new provision can be inserted through a rulemaking process. Alternatively, section 95831(d) should be amended to provide limits on the ability of the Executive Officer to change the flow of compliance instruments, for example by setting out specific circumstances in which new accounts would be created and specifying where the compliance instruments in those new accounts would come from. (SCPPA1)

Comment: Section 95831. Account Types

CARB proposes a new Section 95831(d) which enables the Executive Officer to create "additional accounts" to implement the cap-and-trade program. LADWP assumes this means that CARB could create a new type of holding account in addition to the

Allocation Holding Account, Auction Holding Account, Retirement Account, Allowance Price Containment Reserve Account, Forest Buffer Account and Voluntary Renewable Electricity Reserve Account. LADWP believes that creation of a new type of holding account is a significant change in how CARB implements the regulation and could potentially affect the ability of a regulated entity to comply with the cap-and-trade regulation. As long as such a potential reasonably exists, this would warrant a new rulemaking process. LADWP recommends deletion of this broadly stated provision. (LADWP1)

> **Response:** The first comment is correct in its assumption that staff included section 95831(d) in the proposed changes to give the Executive Officer the ability to operate the tracking system. However, staff disagrees that to put allowances in these accounts would require ARB to "remove" them from another account created in section 95831. Staff included the provision because the additional accounts may be required to support the accounts created in section 95831. The regulation creates a set of accounts under the control of the Executive Officer and outlines many functions the Executive Officer must undertake using allowances in these accounts. However, as the regulation was written before the tracking system was constructed, the regulation does not specify a "conduit" through which the allowances will flow. This provision is included in case the tracking system requires the creation of intermediate accounts. Staff does not intend these potential accounts to divert allowances away direct allocations or allocations to auction.

G. TRADING

Beneficial Holdings

General

G-1. Comment: It is also important to note that the beneficial holding relationship would have exempted allowances purchased pursuant to a beneficial holding relationship from the LSE's holding limits. Now, it is our understanding that LSEs and other entities purchasing allowances on another regulated entity's behalf must comply with the holding limit requirements in Section 95914. With the added administrative simplicity intended by the new structure, this is a good outcome provided, as it appears, that an LSE has the flexibility to purchase allowances on behalf of a contract supplier without violating the holdings limits. Wellhead believes that this issue should also be clarified in the Final Statement of Reasons.

Of greatest importance, though, is that the modified regulatory language for the cap-and trade regulation would provide an avenue for utilities to address the Pre-AB 32 Contract Issue only if they adjust and amend the contract. CARB should provide both the CPUC and itself with an appropriate framework to resolve the issue themselves should the renegotiations not be completed before the first allowance auction in November 2012. (WEC)

> **Response:** The commenter is correct that the Beneficial Holdings language has been removed, but the regulation already prohibits an entity from holding allowances on behalf of another entity. Staff will continue to evaluate the issue related to long-term contracts and may propose future regulatory amendments, if necessary. Resolution 11-32 directs staff to continue to evaluate the issue of long-term contracts.

G-2. Comment: Beneficial Holding
In the most recent draft proposal, ARB is removing the ability to engage in "Beneficial Holding". The lack of ability to undertake this type of activity does not concern MSCG per se, as we had not contemplated engaging in that kind of activity. That said, our lack of concern is based on our understanding of a "Beneficial Holding" account as one where the account holder was merely acting as a custodian for another party who had complete and sole ability to direct disposition of the beneficially held allowances. In other words, a "Beneficial Holding Account" would have been a warehouse service.

We do have one potential concern over a possible interpretation, which we would urge ARB to address via explicit language in the text of the Regulation. That is, an account holder that has a contract to deliver allowances to a counterparty at some future time, will likely be accumulating allowances over time to fulfill that contract, among other purposes. Our reading of the "plain text" of the proposed Regulation is that this kind of accumulation would not be considered to be engaging in "beneficial holding", and indeed we believe this is both the right policy choice and the correct legal interpretation of the text, as written. That said, it would provide significant relief of anxiety among many parties if the ARB were to explicitly confirm this interpretation in the text of the regulations. (MSCG)

> **Response:** Staff agrees with the comment regarding the 'plain text' reading and believes no further clarification in the regulation is required. The creation of a forward contract does not constitute a beneficial holding if the purchaser does not gain an ownership interest in or control over a group of allowances until they are transferred into the purchaser's account at the time the forward agreement is settled.

Opposition to Changes in the Beneficial Holdings Regulation

G-3. (Multiple comments): The issue of beneficial holdings is directly related to allowance holding limits. If CARB does not eliminate holding limits, then beneficial holding provisions need to be included in the regulation so that the holding limits do not prevent electric utilities from covering their obligation for generation contracted from independent power producers and to ensure that compliance units purchased by the utilities on behalf of generators do not count against the generator's own holding limit until the units are actually transferred.

WPTF is not persuaded by staff concerns that beneficial holdings would complicate the design of the tracking system. Our understanding is that the U.S. Environmental Protection Agency's Emission and Allowance Tracking System—the platform on which the California Compliance Instrument Tracking System is based—allows for creation of entity sub-accounts. Use of a sub-account structure for beneficial holdings would enable tracking of units in the account, and, because it is already a function of the underlying software, would not require substantial recoding. Further, CARB could address market monitor concerns by requiring that units can only be moved from an agent's beneficial holding sub-account to a principals compliance account. This would prevent allowances designated as beneficial holdings from being resold or used for the agent's own compliance.

WPTF would prefer that holding limits be eliminated. If they remain, however, then WPTF strongly recommends that CARB include provisions for beneficial holding of utilities on behalf of contracted generation and ensure that these provisions are fair and non-discriminatory. (WPTF)

Comment: Section 95921(f)(1) is Problematic for Transactions that Occur between Electric Distribution Utilities and their Counterparties.

Section 95921(f)(1) now states that "an entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." This language prohibits transactions where an electric distribution utility acquires allowances on behalf of a generator pursuant to a contract between the two entities. For example, an electrical distribution utility may be in charge of the dispatch of a generator's unit and subsequently responsible for obtaining the respective allowances to satisfy that generator's compliance obligation; however, this language would prohibit that kind of contractual agreement. There must be some room for Electric Distribution Utilities to obtain allowances on behalf of their counterparties pursuant to the stipulations of their contracts.

IEP Recommendation: CARB should strike Section 95921(f)(1) as currently drafted. Alternatively, we support a structure that enables electric distribution utilities to meet their contractual obligations (and/or cover a compliance obligation if a pre-existing contract) and obtain allowances for the compliance purposes of an electric generator (e.g. their counterparty). (IEP)

> **Response:** Even though the tracking system may allow for the functionality of sub-accounts, that structure is not reflected in the regulation. Staff believes there is sufficient flexibility in the Regulation to allow for power providers to acquire and then deliver allowances to their generators. Staff also disagrees with the second comment's conclusion that removal of the beneficial holdings language necessarily makes the contractual arrangement described in the comment a violation of section 95921(f)(1). ARB staff understands the contracts to require the electricity purchaser to procure allowances to cover the emissions associated with the purchased electricity. Staff further understands that the contracts do not

give the generator any ownership interest in or control over the allowances as long as they remain in the electricity purchaser's account. Please see the related comments in this section (G-2, G-7, G-9) concerning other types of forward contracts, as they raise similar issues.

G-4. Comment: Deletion of the beneficial holding relationship does not remove an LSE's ability to purchase allowances for a generator, if the utility so chooses.
When Wellhead reviewed the changes to Section 95834 in Staffs March 30, 2012 "Discussion Draft", Wellhead was initially concerned that Staff proposed to remove a potential avenue for addressing the Pre-AB 32 Contract Issue. However, Wellhead appreciates staffs clarification during the April workshop that staffs intent was to achieve administrative simplicity by removing an unnecessary requirement to have an allowance transfer relationship approved by CARB. Wellhead requests that CARB confirm these statements in the Final Statement of Reasons for this rulemaking, so that stakeholders have clarity that transfers of allowances between a load serving entity ("LSE") and a generator for output and GHG emissions attributable to the generator could still take place in the context of the existing allowance transfer rules. (WEC)

> **Response:** Staff agrees in general with this comment. Staff does not believe the regulation would prohibit LSEs from procuring allowances and transferring those allowances to the generators. The contract could be structured to indicate a delivery of allowances to the generator on a certain date, while not violating the prohibition on holding allowances on behalf of another entity.

G-5. (Multiple comments): Modify Provisions Relating to Conduct of Trade (Section 95921)
PG&E requests modification to, or clarification of, the regulatory language in section 95921(f)(1): "An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." This language appears to prohibit electrical distribution utilities from procuring allowances pursuant to their transaction agreements. PG&E suggests the following modification:

(f) General Prohibitions on Trading.
(1) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity, except an entity may acquire and hold allowances and transfer them to another entity to address related obligations in electricity transaction agreements.

Alternatively, PG&E recommends that ARB clarify the intent of the "Prohibitions on Trading" language in its forthcoming Guidance Document. PG&E believes that the regulatory language that prohibits an entity from acquiring and holding allowances "on behalf of another entity" is not intended to apply to GHG obligations in contracts for electricity because the counterparties to these contracts do not have an interest in the allowances until they are transferred. PG&E also recommends that ARB clarify in the Guidance Document that a purchase of allowances matched with a transfer request is exempt from the prohibition on trading. (PGE1)

Comment: Section 95921(f)(1) is Problematic for Transactions that Occur between Electric Distribution Utilities and their Counterparties. Section 95921(f)(1) now states that “an entity cannot acquire allowances and hold them in its own holding account on behalf of another entity.” This language prohibits transactions where an electric distribution utility acquires allowances on behalf of a generator pursuant to a contract between the two entities. For example, an electrical distribution utility may be in charge of the dispatch of a generator’s unit and subsequently responsible for obtaining the respective allowances to satisfy that generator’s compliance obligation; however, this language would prohibit that kind of contractual agreement. There must be some room for Electric Distribution Utilities to obtain allowances on behalf of their counterparties pursuant to the stipulations of their contracts.

IEP Recommendation: CARB should strike Section 95921(f)(1) as currently drafted. Alternatively, we support a structure that enables electric distribution utilities to meet their contractual obligations (and/or cover a compliance obligation if a pre-existing contract) and obtain allowances for the compliance purposes of an electric generator (e.g. their counterparty). (IEP)

Comment: As the state's largest independent power producer, we have the greatest number of emissions among our fellow power producers. It's not because of our efficiencies, but because of our size. We have over 6,000 megawatts in the state. And we've invested $6 billion since 2001 to build clean efficient generation for California.

We submitted 25 pages of comments again last week. We've done it a number of times. And I know that staff could probably recite our issues because we've had a number of conversations about them. And yet, we've seen no changes to the regulations.

So it's through the lens of our obligation, the size of our obligation that we view these regulations and that we offer these comments.

We are not receiving any free allowances, and therefore we're going to be in the market purchasing every allowance that we need for every facility. And you heard earlier from SDG&E for every contracted facility we have as well.

You've heard parties comments about the removal of the beneficial holding relationship which was supposed to be a mechanism whereby the utility which has a tolling contract for our facilities—in other words, they run our facilities, we do not—could buy allowances and transfer them to Calpine or entities so we could retire them. That's been removed. It was imperfect as originally written, but I think a number of us had offered really helpful suggestions that have not been incorporated.

So here we are left with a very strict holding limit, a large compliance obligation, and now Calpine is going to be required to buy all of those allowances. You heard SDG&E

said we can't do it because of the holding limit being small for them. It's small for them, too. (CALPINE2)

> **Response:** Staff held a number of consultations with both generators and utilities regarding beneficial holdings. Both groups did offer amendments. However, when staff attempted to consolidate the two sets of recommendations, each side was able to point to provisions that did not work for them. Because of this, staff decided to remove the provisions. The Market Simulation Group will evaluate the holding limits to help inform on any potential future regulatory amendments for adjustment.

G-6. Comment: The Beneficial Holding Relationship Provisions Should Be Retained and Amended

The Clean-Up Amendments would delete the beneficial holding relationships provisions wholesale. In proposing this change, CARB Staff states that it "determined that the provisions compromised market monitoring efforts." Staff noted that the beneficial holdings provisions were intended to address the allowance procurement context arising from long-term electricity contracts. However, because the beneficial holdings provisions "did not seem to resolve the keys issues with the electricity contracts, staff determined that the benefit of keeping these provisions was less than the cost of building them into the tracking system and monitoring for abuses."

For such a significant change to the Regulation, CARB Staff does not adequately explain the basis for its proposal. First, CARB does not explain how exactly the beneficial holdings provisions would compromise market monitoring efforts. The Regulation requires that an entity, as part of a transfer request, report the holding account number and authorized representative of the entity for whom a compliance instrument is to be held in benefit prior to the tracking system recording any transfer of allowances. If the Compliance Instrument Tracking System Service ("CITSS"), as currently designed, cannot account for the information associated with beneficial holdings, then covered entities will have little confidence that such a system will be able to track other market transactions. In addition to the proposal below, CARB should work with stakeholders to identify the market monitoring concerns associated with beneficial holdings and improve the CITSS.

Second, CARB does not elaborate on the "key issues" that the beneficial holdings provisions failed to solve. Previously, Calpine indeed recommended that the Regulation be amended so that the allowances held by a utility on a generator's behalf not count against the holding limit of either the utility or the generator, provided the generator confirms that it will transfer the allowances to a compliance account within three days of receipt of such allowances from the utility. Calpine never suggested that this outstanding issue warrants deleting the beneficial holdings provisions in their entirety.

Finally, CARB does not even attempt to provide an alternative mechanism for addressing the unique allowance procurement context arising from long-term electricity contracts. If the benefit of the beneficial holdings provisions is less than their cost, as CARB Staff asserts, then the solution is to improve these provisions or construct a workable alternative, not delete the provisions entirely. The Clean-Up Amendments would leave investor-owned utilities ("IOUs") and generators in a much worse position than the Regulation would.

As Calpine recommended in its April 13, 2012 comments, CARB should retain, but revise, the beneficial holdings provisions so that allowances held by a utility on the generator's behalf count against the holding limit of neither the utility nor the generator. Alternatively, if CARB removes the beneficial holdings provisions from the Regulation, the Clean-Up Amendments' holding limit exemption petition procedure should be expanded, so that it also authorizes CARB to increase an IOU's limited exemption by the number of allowances purchased and held on behalf of contracted generators. Finally, at the very least, CARB should delete proposed section 95921(f)(l), which could prohibit much more lawful conduct than CARB Staff intended.

These proposals are described in more detail below.

1. CARB Should Amend the Beneficial Holdings Provisions to Provide That the Holdings Do Not Count Against the Holding Limit of the Agent or the Principal

Given the burdens caused by the holding limit, CARB needs to ensure that the largest covered entities have an adequate means of procuring the allowances they will need to meet their compliance obligations and, in the case of the IOUs, that they can also procure allowances on behalf of their contracted generators. While the beneficial holdings provisions need improvement, they at least account for the unique dynamic between IOUs and generators in long-term electricity contracts.

Absent the beneficial holdings provisions, the IOUs may have no means to procure allowances on behalf of both their own generating resources and unaffiliated generators for which the IOUs have contractual dispatch rights, especially in light of the Clean-Up Amendments' proposed section 95921(f)(l). The utilities could decide that, for those contracts where the utility has the right to either procure allowances or reimburse the generator for its own allowance procurement costs, it would procure no allowances. The generator would then be required to procure allowances, which would likely result in inefficient allowance procurement decisions because IOUs are in a better position to accurately estimate which generating units will be dispatched to meet demand based on their relative thermal efficiency, cost, and GHG emissions.

This problem would be compounded by the 15% auction purchase limit for covered entities. The auction purchase limit effectively forces large covered entities, like Calpine, to participate in every auction. Combined with the deletion of the beneficial holdings provisions, the auction purchase limit incents large covered entities to place bids at levels assured to exceed the auction clearing price, which could artificially raise the clearing price for all auction participants. The end result is a suboptimal carbon market and higher allowance prices, which will then be passed onto California consumers in the price of goods and services.

For these reasons, removal of the beneficial holding relationship provisions—absent an alternate mechanism for IOUs to procure allowances on behalf of contracted generators—will severely hinder the proper functioning of the allowance market. Rather than remove the beneficial holdings provisions completely, Calpine proposes that the existing beneficial holding provisions be restored, with amendments so that the allowances held by a utility on a generator's behalf count against the holding limit of neither the utility nor the generator, so long as the generator confirms that it will transfer the allowances to its compliance account within three days of receipt of such allowances from the utility. Specifically, Calpine proposes that the existing Regulation's beneficial holding relationships provisions be retained, with the following modifications:

§ 95834. Disclosure of Beneficial Holding Relationships.

(b) Disclosure of Beneficial Holding.

(4) In the case of an electric distribution utility holding allowances on behalf of a second registered entity with whom it has a contract for the delivery of electricity pursuant to section 95834(a)(3), such allowances will not count against the holding limit of either the electric distribution utility or the second registered entity, so long as the second registered entity confirms upon submitting the confirmation required by section 95834(b)(2) that it will transfer the allowances to a compliance account within three (3) business days of receipt from the utility.

2. Alternatively, CARB Should Expand the Petition Procedure for Adjusting the Limited Exemption to the Holding Limit In Order To Alleviate the Harsh Result of Deleting the Beneficial Holdings Provisions

The Clean-Up Amendments propose a new process, whereby a covered entity can petition the Executive Officer ("EO") to adjust the limited exemption to the holding limit based on evidence of an increase in emissions over the previous year. If CARB does not retain the beneficial holding provisions with appropriate revisions, as described above, Calpine would propose to expand upon the process provided by the Clean-Up Amendments, so that an electric utility could petition the EO to increase its limited exemption to the holding limit by the number of allowances the utility is holding on behalf of another covered entity with whom it has a contract for the delivery of electricity.

The purpose of the limited exemption is to assure that covered entities can obtain the number of allowances needed to assure compliance. As CARB Staff states in its rationale for the exemption petition procedure, "[t]he provisions are needed to deal with facilities that may experience an increase in emissions that would not be reflected in the limited exemption because the exemption is calculated on lagged emissions reports...The minimum increase is designed to limit the requests to increases that are so large that they could not be accommodated under the holding limit."

Consistent with these goals, Calpine's proposal would appropriately amend the procedure for expanding the limited exemption, so that utilities could also procure allowances on behalf of contracted generators whose dispatch they control and for whom they have therefore agreed to assume financial responsibility for GHG emissions. If accepted by the EO, this petition would adjust the limited exemption, even though the allowances so held by the utility would not (and indeed could not) be transferred to its compliance account (given that they will ultimately be transferred to the generator actually subject to the compliance obligation).

§ 95920. Trading.

(d) The holding limit will be calculated for allowances qualifying pursuant to section 95920(c)(1) as the sum of:
(1) The number given by the following formula
(2) A Limited Exemption from the Holding Limit is calculated as...
(3) Petition to Adjust the Limited Exemption.

(A) Prior to October 1 of any year, a covered entity may submit to the Executive Officer evidence demonstrating an increase in emissions for that year over the previous year or (2) that the covered entity is an electric distribution utility holding allowances it has acquired on behalf of a second registered entity with whom it has a contract for the delivery of electricity and request a temporary increase in the limited exemption until verified data for that year are available. In the case of an electric distribution utility holding allowances on behalf of a second registered entity pursuant to § 95920(d)(3)(A)(2), the limited exemption shall include, upon the approval of the Executive Officer, the number of allowances that the utility has acquired on behalf of the second registered entity, regardless that the allowances will not be transferred to the electric distribution utility's compliance account, as would otherwise be required by § 95920(d)(2)(A) to qualify for the limited exemption.

3. Section 95921(f)(l) Would Be Unworkable and CARB Should Not Adopt It

The Clean-Up Amendments propose a new section 95921(f)(l), which states that "[a]n entity cannot acquire allowances and hold them in its own holding account on behalf of another entity." CARB Staff states that the section "is modified to prohibit beneficial holdings" and that "[t]he change was needed to reflect the removal of all provisions allowing beneficial holding and to add an explicit prohibition of the practice."

However, the proposal, on its face, prohibits conduct separate from and in addition to beneficial holdings. Under the beneficial holding relationship provisions, after the principal in the relationship (i.e., the contracted generator) confirms that the agent (i.e., the electrical distribution utility) is authorized to act on its behalf, the allowances held by the agent will count against the holding limit of the principal. On the other hand, the proposed amendment would prohibit an entity from ever acquiring allowances on behalf of another entity regardless of whether the allowances count against the holding limit of the entity acquiring the allowances.

For instance, suppose an IOU acquires allowances and holds them in its own holding account pursuant to a contract with a generator for the future delivery of allowances proportional to the lOU's dispatch of the generator's units. Because the allowances are held in the lOU's holding account and count against the IOU's holding limit, this would no longer constitute a beneficial holding relationship. However, because the IOU and generator entered into the delivery contract, CARB might consider the IOU to be holding allowances "on behalf of' the generator in violation of the proposed section 95921(f)(l).

The proposed section 95921(f)(l) creates an unworkable double-bind for utilities and their contracted generators. As Southern California Edison ("SCE") stated in its comments on this proposal, "[t]he deletion of the Beneficial Holding language, combined with draft language prohibiting an entity from "acquir[ing] allowances and hold[ing] them in its own holding account on behalf of another entity," appear to prevent electrical distribution utilities from ever purchasing allowances that could later be transferred to the holding accounts of counterparties in order to satisfy their indirect compliance obligations." In this case, contracted generators would be forced to purchase allowances covering their entire compliance obligations. However, generators are in a much worse position in terms of estimating dispatch and, therefore, the allowances that they must acquire, leading to suboptimal purchase decisions and carbon market distortions.

Additionally, the likely annual compliance obligation for Calpine is greater than the holding limit. If Calpine were required to procure allowances covering its entire compliance obligation (because utilities cannot purchase allowances covering their indirect compliance obligations under section 95921(f)(l)), it likely would be forced to transfer millions of allowances to its compliance account, simply to comply with the holding limit. No other entity in California is so hampered by the Cap-and-Trade Program. As we have previously described and as described by the following section, this would essentially impose the same penalties CARB has reserved for bad actors upon Calpine for no other reason than its size in the California market.

Calpine recommends that the Board disapprove proposed section 95921(f)(l) when it considers the Clean-Up Amendments. Alternatively, Calpine supports the regulatory language suggested by SCE in its most recent comments. (CALPINE1)

> **Response:** Staff determined that the provisions on beneficial holdings complicated market monitoring efforts, including those that required tracking the true owners of allowances held in another entity’s account. More important, the beneficial holdings provisions were initially developed to deal with complications arising from electricity power purchase agreements. These contracts allowed utilities to assume the responsibility to provide the compliance instruments needed to cover emissions from generation. After conversations with generators

and utilities, staff concluded that the provisions did not resolve the issue sufficiently to justify the other difficulties identified. The Market Simulation Group will evaluate the holding limits to help inform any potential future regulatory amendments for adjustment.

Additional Clarity Requested on Beneficial Holdings Regulation

G-7. Comment: Chevron is concerned with changes to eliminate beneficial holdings and trading prohibition for covered entities to trade on each other's behalf. Not all covered entities will have the resources to create a trading desk and staff to follow the complicated rules that ARB has created for this market. Without a trading desk, these entities will be forced to use outside traders. We do not believe that it was the intention of ARB to force the use of traders if such companies absent the trading prohibition could otherwise provide services within their own organization and we request clarification on the language used. While it was drafted to address concerns held by the market monitor and public utilities, the current language could have the consequence of reducing market-making trading activities that would increase liquidity and otherwise improve the operation of the cap-and-trade system. Specifically, we believe that the prohibition should not apply to entities in disclosable corporate associations, since these disclosed relationships are transparent to the ARB and the market monitor. (CHEVRON)

Response: It is neither the intent nor the practical effect of the regulation to force entities to use outside traders. Staff believes that most covered entities will obtain most of their allowances from either direct allocations or the auction. The auction's single-price format was chosen specifically to be the easiest format for new market participants to use. The removal of beneficial holdings language has no effect on practices such as forward or other derivative contracts, so it is not clear how "market making" activities will be inhibited. Maintaining the beneficial holdings provisions would effectively exempt members of a disclosable corporate association from the holding limits.

G-8. Comment: PG&E believes that ARB continues to make progress on both the development and implementation of Cap and Trade Program. There are key amendments to the regulation being proposed today which further flush out extremely important implementation details. However, issues do remain, and I will highlight three key areas where we are requesting further work and consideration from staff and the Board.

The first is holding limits and the removal of the beneficial holding section. As was noted in the staff presentation, the beneficial holding section was removed. However, a substitute has not been provided yet.

PG&E's concern that the removal of this section and the lack of change to the current holding limit unfairly disadvantages entities such as PG&E that have an electricity portfolio consisting of both our utility-owned power plants and power plants under contract.

So while we do not oppose the removal of the beneficial holding section, we realize it's complex. We are eager to work with staff on substitutes for that. And we are asking for certainty regarding when the holding limit issue will be further addressed and resolved. (PGE2)

> **Response:** Staff does not agree that the removal of the beneficial holdings language disadvantages the utilities, as the removal does not prevent the utilities from purchasing allowances to satisfy the terms of their contracts. The regulation allows transfers of allowances form a utility to a generator, provided the contract does not suggest the generator has control over allowances in a utility holding account, or vice versa.

G-9. (multiple comments): With the elimination of beneficial holdings sections of the regulation, it looks as though an entity cannot acquire and hold allowances in its holding account on behalf of another entity according to Section 95921(f)(1)) shown below. This concerns SDG&E since we have contractual obligations to purchase allowances for entities with which SDG&E has tolling agreements.

95921 Conduct of Trade
(f) General Prohibitions on Trading.
(1) An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity, except when part of a disclosed beneficial holdings relationship pursuant to section 95834.

Both the definition of "hold" and the term "on behalf of another entity" are ambiguous, the ARB should revise the regulation to clarify these definitions or should provide guidance as to their meaning in a guidance document.

Allowance purchases by an electricity buyer for the seller as part of a contractual obligation should be allowed. However, the ambiguity of both the definition of "hold" and the term "on behalf of another entity," make it unclear whether or not these types of purchases are permissible. The ARB should update the regulation to allow for purchasing of allowances under contractual obligation in some fashion. This could be accomplished by recognizing these types of agreements as exempt from the prohibition in 95921 or by defining what is meant by "hold." If a regulation update is not possible, then the ARB needs to clarify what interpretations should be made in a guidance document. Without some type of clarification, covered entities are left with unanswered questions and the fear that they will be penalized if their own interpretation differs from the ARB enforcement team interpretation.

For example, one view is that allowances can be transferred to the electricity seller immediately after the auction or exchange transaction. This would avoid a violation of the regulation because, while the allowance is passing through the holding account, it is not being “held” in the normal meaning of the term. If this is the intent of the regulation, then the ARB should update the regulation or issue a guidance document stating the amount of time allowed to transfer the allowances (e.g., five days or three business days) out of the holding account before it is considered a holding violation. In addition, ARB should provide guidance on the price to be reported for the transaction—“Not Applicable” or $0, so that there is clear understanding that this transaction is a transfer and not an independent sale.

Does the phrase “on behalf of another entity” mean that any contract to deliver allowances in the future requires an immediate purchase and transfer (at the point in the future) to be legal? SDG&E has contracts where the CPUC allows the seller to transfer the GHG obligation to SDG&E. Does the legal interpretation of “on behalf of another entity” exempt such contracts since counterparties don’t have a specific legal interest in allowances of the seller until they are transferred to them? This should be clarified in the regulation or the guidance document.

Going further, does the legal interpretation of “on behalf of another entity” allow for forward contracts where the seller agrees to delivery of allowances at some point in the future to the buyer? These types of transactions are common in the energy industry and help to provide liquidity to the market. The ARB should make it clear in its regulation or in a guidance document that forward contracts are allowed. If the ARB sees these as financial transactions, then they should exclude financial transactions from the prohibition in 95921. Or is the legal interpretation of the regulation that any allowances being held by the seller at the point of the contract are now being held “on behalf of another entity”? Both markets and compliance entities need clear direction on what is allowed under the regulation, either stated directly in the regulation or through a binding guidance document (i.e., “binding” meaning ARB enforcement division is not allowed to create a separate view of the language). (SEMPRA1)

Comment: LANGUAGE REPLACING BENEFICIAL HOLDINGS
While IETA understands ARB’s rationale for eliminating beneficial holdings, we are concerned with the ambiguity of the language that remains to govern how accounts may be utilized. In particular, IETA is under the impression that ARB intends to allow situations whereby a broker may procure and accumulate compliance units to be later delivered to a client under contract. However, there is concern that the currently proposed language could be interpreted such that the above case could be deemed unacceptable. IETA kindly requests ARB to provide additional clarity in its proposed amendments to ensure that the above situation is explicitly approved.

In addition, IETA requests ARB to provide explicit language in the rules, stating that an advisor may participate in the market on its own behalf and/or advise more than one company without violating the regulation, to the extent such advisor acts in good faith and is not engaged in market manipulation. (IETA)

Comment: Also, as mentioned earlier by my colleague at Pacific Gas and Electric that the elimination of the beneficial holding section in Section 95921 will not allow San

Diego Gas and Electric to acquire and hold allowances for the entities we are contractually obligated to purchase allowances for. We would like the staff to revise that section to clarify this type of business transaction is permissible. (SEMPRA2)

Comment: Section 95921(f)(1): With the Removal of Beneficial Holding Relationships, the Language Must Be Amended to Allow Electrical Distribution Utilities to Satisfy Their Contractual Obligations

With the removal of the beneficial holdings construct, Section 95921(f)(1) is now unclear as to how an entity may acquire allowances and hold or possibly transfer them to another entity.

SCE agrees that the beneficial holdings regulation language was challenging and confusing and does not object to its deletion. But the problem that the beneficial holdings language was designed to address remains.

Beneficial Holding Accounts were designed to allow electrical distribution utilities to serve as an "agent" to hold compliance instruments on behalf of a "principal" in order to satisfy an electricity contract. As SCE has previously explained, IOUs such as SCE purchase a large portion of their customers' energy requirements through bilateral contracts with independent power producers ("IPPs") that require the IOUs to accept the responsibility for the cost of complying with the cap-and-trade program. This could require the IOU to provide compliance instruments to fulfill the IPP's compliance requirements. Thus, IOUs have a significant indirect GHG compliance obligation that is not covered by the limited exemption to the holding limit. SCE requests that the ARB clarify this language in order to enable IOUs to satisfy their contractual obligations and procure compliance instruments for eventual transfer to a contractual counterparty that would not challenge the IOUs' holding limits.

SCE is eager to work with ARB staff to either develop a replacement for the beneficial holdings construct or revise the holding limits. The ARB should clarify that holding compliance instruments "on behalf of" other entities applies solely to arrangements where the counterparty has a legal interest in the compliance instruments in question. ARB staff has suggested that it will collect ideas and market simulation data in the summer months before the first auction and develop a concept paper with proposals. SCE supports this plan and offers its assistance so that a measured and careful approach can be considered and introduced in the next round of regulation amendments. (SCE1)

> **Response:** Staff does not believe that removal of the beneficial holdings language necessarily makes the contractual arrangement described in the comment a violation of section 95921(f)(1). ARB staff understands the electricity purchase contracts to require the electricity purchaser to procure allowances to cover the emissions associated with the purchased electricity. Staff further understands that the contracts do not give the generator any ownership interest in or control over the allowances as long as they remain in the electricity

purchaser's account. Please see the related comments in this section concerning other types of forward contracts, as they raise similar issues.

In general, the creation of a forward contract does not constitute a beneficial holding if the purchaser does not gain an ownership interest in or control over a group of allowances until they are transferred into the purchaser's account at the time the forward agreement is settled. Staff has responded to several comments (G-2, G-3, G-7) on the beneficial holdings issue in this document that provides further explanations.

G-10. Comment: CPEMUS supports the modifications made to the regulations clarifying prohibitions on trading. However, CPEMUS submits that further modifications are necessary to clarify that commercial transactions undertaken in the secondary market for valid business purposes do not violate the prohibition on acquiring allowances and holding them for the account of another entity.

Section 95921(f)(1) of the proposed regulations, "General Prohibitions on Trading," has been modified to state:

"An entity cannot acquire allowances and hold them in its own holding account on behalf of another entity."

Despite this language, it appears clear that the Board anticipates that parties will be free to buy and sell their compliance instrument on the secondary market. For example, one section of the preamble (specifically, page 22 of the "Summary of Proposed Action" section) states that "Entities may enter into private transactions agreements, but the account system does not recognize the transaction until the account administrator receives valid transfer requests."

CPEMUS believes that the prohibition on trading is intended to work in tandem with the holding limit set out in Section 95920 to prevent an entity from holding compliance instruments for the purpose of enabling another entity to avoid the holding limits. CPEMUS believes that the prohibition is not intended to bar the types of arms' length commercial trading transactions routinely undertaken in market environments. However, the proposed regulations do not make any such distinction. CPEMUS therefore requests that the Board modify the regulations as proposed below, or specifically provide guidance as to what constitutes the prohibited conduct of "acquir[ing] allowances and hold[ing] them in its own account on behalf of others," as opposed to engaging in legitimate transactions such as long term contracts to buy and sell allowances. (CPEMUS)

Response: The regulation text, along with the staff report issued for the existing regulation, makes a distinction between beneficial holdings and the "arm's lengths transactions" referred to in the comment. The intent is not to impede normal market transactions. The intent is to ensure all transactions are apparent to ARB and the market monitor. This provision requires that allowances in one entity's holding account are not subject to control of another entity.

Transfer Process

G-11. Comment: Section 95921(b)(7) requires parties of the transfer request to, upon request of the Executive Officer, provide documentation on the transaction for which the transfer request was submitted. As currently proposed, ARB will already have access to transaction information regarding the parties involved, the date of the transaction and price. Access to the contract documents is unnecessary for market oversight. Such contracts are confidential business information that should not be subject to ARB oversight. (WSPA1)

> **Response:** Staff included section 95921(b)(7) so that staff investigating market disruptions or questionable transactions can access the documents on which the transactions are based. Access would also be needed for audits of the information submitted to ARB. ARB cannot rely on reported information alone for these functions.

G-12. Comment: Morgan Stanley finds the proposed rules governing transactions to be confusing at best and problematic at worst. Depending on ARB's actual intent, we believe that the wording needs to be changed, at a minimum, and that the substance of the proposals may also need to change.

At the core of the confusion is the following wording "…the day of settlement of the transaction agreement for which the transfer request is submitted". In general industry parlance, "transactions" are settled, not "transaction agreements". So, the confusion starts with what ARB might mean here. Is it simply a matter of meaning "transactions", and not using the customary industry terminology? Or does ARB have something else in mind? When combined with the "three day following" requirement, additional confusion results. Generally, settlement (that is, payment) would occur AFTER receiving confirmation of the completion of a transfer request (although a counterparty without good credit might be required to pay in advance). (MSCG)

> **Response:** Staff disagrees with the proposed change. The rule must address all types of contracts, including derivative contracts. As pointed out in comment G-19 a derivative contract may have other terms that must be settled after a transfer request is processed. Because the terminology in the regulation must address all the types of contracts that may result in a transfer request, basing the regulation on "general" practice would not work if the regulation cannot address all types of transactions.

G-13. Comment: Confirmation of trades: We agree that a time frame for confirmation of trades is necessary. Limits on time for confirmation should allow for reasonable internal review and occasional contingencies. A 24 hour period required to confirm a trade is not sufficient to assure that trades will proceed efficiently. We propose a period of 48 business hours to allow for unexpected absences and internal review. (CHEVRON)

> **Response:** Parties engaged in a transfer action within the tracking system have a maximum of 72 hours to complete the required push-push-pull process. There are no constraints to how those hours are partitioned between the originator of the trade and the recipient of the trade. Staff believes there is enough flexibility for entities to plan and review trades.

G-14. Comment: Clarify the role of the primary account representative in the transfer process.

Section 95921(a)(1) of the Regulation requires an allowance seller to undertake two steps in order to transfer allowances to a buyer: submit and confirm a transfer request. The transfer request may be submitted by the seller's primary account representative or an alternate account representative (section 95921(a)(1)(A)), and the confirmation must be made by the primary account representative or another alternate account representative (section 95921(a)(1)(B)).

If the primary account representative makes the initial submission, it is not clear whether the primary account representative—the same person—can also confirm the transfer request. (It is clear that the same alternate account representative cannot undertake both steps.)

SCPPA suggests, for greater flexibility, that the seller's primary account representative should be able to undertake both steps. If an entity wishes to have a second person involved, the entity is free to adopt that policy, but this should not be mandated by the ARB. If the ARB does not intend to allow the primary account representative to undertake both steps, section 95921(a)(1)(B) should be revised to clarify this. (SCPPA1)

> **Response:** Staff disagrees that clarification is needed. The regulation and accompanying ISOR make clear that each point of the push-push-pull be conducted by different account representatives except in the case where an individual account representative is allowed for voluntary participants. For covered entities, a minimum of two account representatives are required and therefore, a different representative must perform each of the push-push steps in a transaction.

G-15. Comment: Clarify that the buyer can confirm the transfer request at any time in the three-day period.

Section 95921(a)(1)(C) requires allowance buyers to confirm a transfer request "within the time remaining in the three days following the initial submission of the transfer request." This phrasing indicates, without specifying, that the buyer can only make this confirmation after the confirmation by the seller under section 95921(a)(1)(B), and that the buyer cannot make its confirmation directly after the initial submission of the transfer request under section 95921(a)(1)(A).

SCPPA sees no need for this restriction. For greater flexibility, the buyer should be allowed to submit its confirmation at any time in the three-day period, whether before or after the seller's confirmation. Providing this flexibility may allow for quicker transfers, if desired by the parties, and would not detract from the security provided by the three-step process, as the three steps would still be required. After the first step has taken place, kicking off the three-day period, the order of the other two steps is not important. (SCPPA1)

> **Response:** Parties engaged in a transfer action within the tracking system have a maximum of 72 hours to complete the required push-push-pull process. There are no constraints to how those hours are partitioned between the originator of the trade and the recipient of the transfer. Staff believes there is enough flexibility for entities to plan and review trades. The tracking system programming does not allow for the push-push-pull to occur out of sequence.

G-16. Comment: No penalties should be imposed if the transfer process is not completed within the required timeframes.

Section 95921(a)(3) imposes penalties if the seller and buyer do not complete the transfer process within three days of the initial transfer request and three days of the settlement day of the transfer agreement. SCPPA strongly opposes this section. The ARB should not impose penalties in these circumstances.

For the reasons discussed in section XII.D above, there should be no penalties for failing to complete the transfer process within a specified time of the settlement day.

It is also inappropriate, and unnecessary, to impose penalties for failing to complete the transfer process within three days after the initial transfer request. If the parties fail to comply with the timeframes set in sections 95921(a)(B) and (C), the only outcome the Regulation should specify is that the transfer will not be processed. If the parties wish to proceed with the transfer at a later date, they can restart the process of submitting the transfer request and two confirmations under section 95921(c)(1)(C). This is a sufficient incentive to ensure parties abide by these timeframes. (SCPPA1)

> **Response:** ARB rejects the suggested change. The language referred to in the comments does not call for automatic imposition of a penalty in all cases. ARB has statutory penalty authority that instructs ARB to set penalties based on specified criteria. The language proposed in the comment would prevent ARB from imposing a penalty regardless of the circumstances in which the transfer request was not completed.

G-17. Comment: Clarify that if the transfer process is not completed correctly, the transfer will not proceed.

Section 95921(c)(1)(C) provides that if an acceptable transfer request is not submitted within the time limit, the buyer and seller must either withdraw the transfer request or submit a new one, and penalties may still apply. SCPPA has three concerns with this provision.

Firstly, this provision requires the buyer and seller to undertake an unnecessary administrative task—withdrawing the transfer request (if they do not wish to submit a new one). If the transfer request was late or otherwise deficient, the consequence should be that the accounts administrator will not process the transfer. There is no need for a withdrawal process. The allowance transfer procedures should be made as clear and simple as possible to reduce the administrative burden on market participants, the accounts administrator and the ARB. The Regulation should only require notices to be submitted and other administrative procedures to be undertaken where necessary, and a withdrawal notice is not necessary.

> **Response:** The correction or replacement of a deficient transfer request will be a feature of the tracking system and will not be administratively burdensome. The exact administrative process implementing the regulation will be provided once the full tracking system is available.

Secondly, this provision does not clearly state that the accounts administrator will not process transfers if the transfer request is deficient and is not corrected. This consequence is important and should be made clear. (SCPPA1)

> **Response:** Section 95921(a)(1) states that the accounts administrator cannot register a transfer until the Executive Officer has determined that the transfer request meets the requirements of the regulation. A deficient transfer request would not meet the requirements of the regulation.

G-18. Comment: Section 95921(b)(2): Direct Transfers of Compliance Instruments to Another Entity's Compliance Account Should Be Permitted
Currently, compliance instruments cannot be transferred directly into another entity's compliance account but instead must go through that entity's holding account. SCE proposes allowing transfers directly into a compliance account, as this will provide compliance entities more flexibility in terms of account management and fits well with the push-push-pull mechanics described above. The ARB should revise the text in Section 95921(b)(2) of the Proposed Regulation Order as follows: "Holding account number or compliance account number of destination account and identification of primary account representative or alternate account representative for the destination account confirming the transfer request." (SCE1)

> **Response:** ARB did not provide the recommended option because the allowances cannot be removed from the compliance account once placed there. ARB anticipates that even with push-push-pull, errors could occur, and in those situations, ARB would be asked to change the transfer result.

Transaction Information Reporting

G-19. (multiple comments): Reporting the date of the transaction agreement and price of a particular transfer would provide limited value for ARB and should be deleted.

Sections 95921(b) (4)&(6) require reporting of the date of the transaction agreement for which the transfer request is submitted and the price of the compliance instrument. However, we can envision numerous situations where arrangements may be made during a particular year for delivery at a later time in the year (i.e., a contract between parties may be agreed upon in March for execution or delivery in December). The dates and prices of the transaction agreement would not be contemporaneous with the transfer request date. Therefore this information would not provide current relevant data that we believe ARB is seeking and would have limited value.

ARB should be able to more effectively gather current price and quantity data from exchanges and brokers and, if desired, publish them the next year in an aggregated and useful format. In addition, due to the netting of delivery obligations under different contracts with the same counterparty, it would not be possible to report an actual transaction date and price for that (net) transfer. This issue is particularly problematic for exchange-traded contracts. Therefore, Sections 95921(b) (4) & (6) provide little or no useful information.

Recommendation: Delete Section 95921(b) (4) & (6) (WSPA1)

Comment: Information requirements for transfer requests should be clarified. Section 95921(b)(1)-(6) sets out a list of information requirements for transfer requests. Two of the listed items of information should not be required for any transfer requests, and amendments to other items on the list should be made to accommodate internal transfers from an entity's holding account to its own compliance account.

Section 95921(b)(4) requires the parties to report the date of the transaction agreement for which the transfer request is submitted. It is unclear why the ARB needs this information. A single agreement may provide for a series of transfers to occur at intervals over a period of years, or for only one transfer to take place immediately. In either case, the date of the agreement does not appear to be relevant to the ARB. Parties should not be required to provide information under this section unless it is necessary for the transfer of compliance instruments. (SCPPA1)

Comment: WPTF has not previously objected to the requirement that entity's report price information as part of a transfer request. However, with the additional detail added in the proposed revisions and lack of clarity regarding how price should be determined, we now have concerns that it will be difficult for entities to comply and that reporting of price erroneous information could lead to financial penalties. For instance, because of the nature of various contract agreements and market practices, it may not be clear what value should be reported into the tracking system. In just one example, an entity may enter into three different contracts through the Intercontinental Exchange (ICE) at three different times for delivery on the same day: a contract buy 10,000 units at $15 on day one, another to buy 20,000 units at $17 on day, and another to sell 25,000 units on day three at $18. For purposes of as well as the tracking system, these three contracts will net out to a single transfer of 5000 units. But it is not clear what price the entity should report for the transaction, since the final delivery could have been sourced from either the day one or day two contracts. Swaps and various permutations of carbon in power sector contracts also pose questions.

Given these complexities, and the fact that better and more up-to-date information on market prices will be available from brokers and exchanges (where prices will reflect all transaction prices and volumes, rather than only netted transactions), WPTF questions the value of requiring price information for transactions and recommends its deletion. If CARB chooses to retain the requirement for price information, then the regulation should clarify how the entity should determine the price for a transaction.

WPTF is also concerned about the new requirement for Parties to a transfer request to provide documentation on underlying transaction to CARB upon request. WPTF believes that, in general, it is inappropriate for CARB to request bilateral market transaction information. We recognize that in cases where there is a discrepancy or dispute over a transaction in the tracking system, it may be necessary for CARB to verify records of the underlying contracts in order to sort out the discrepancy. We therefore recommend that CARB modify this provision to clarify that such documentation will requested only as necessary, and will not generally be required.

Finally, we appreciate CARB's efforts to improve the protection of confidential information related to the tracking system. Given sensitivities to the disclosure of information related to bilateral transfers, WPTF requests that CARB further modify this section to ensure that only *aggregate* information on price and quantity of instruments be published. (WPTF)

Comment: IETA believes that ARB's reporting requirements on compliance instrument transfers are unnecessary and problematic. Different types of transactions can create different problems. For example, it would be arbitrary to assign a specific transaction date and price to a net transfer of allowances that is the result of a number of bilateral transactions (i.e., transactions between two counterparties not cleared through an exchange) between the same counterparties that have netting arrangements contractually specified.

To further illustrate this point, consider the following scenario: *After having undertaken several buy and sell transactions of different amounts of allowances at different times for different prices, companies A & B look over their books and recognize that A sold B, in total, 100,000 allowances, and B sold A, in total, 75,000 allowances. Therefore, the "net" position, which A must deliver to B, is 25,000 allowances. Under the scenario, the two companies agree to "book out" the 75,000 allowances not needed to be delivered, and they agree to make one account transfer for the 25,000 net allowances owed.*

What is ARB's expectation for reporting on this type of situation? If only allowances delivered via account transfer are to be reported, how does ARB expect the reported price to be calculated?

Further, a transaction of allowances with another commodity (e.g., power or gas) may not distinguish a price for the two commodities separately. Ultimately, under the current reporting rules, ARB may not be aware of all the terms of a transaction; and, even if a price can be reported, it will not necessarily be reflective of a “plain vanilla” California Carbon Allowance (CCA). One major concern is that public reporting of prices that cannot be separated from other commodities, or have other factors included in the price, may create confusion in the marketplace as well as lead to erroneous assumptions about the market.

If ARB believes it integral to monitor CCA transfer prices and trends, California regulators could accrue this information just as—if not more—effectively from exchanges, where prices reflect all transaction prices and volumes, thereby reducing administrative burden for individual transacting parties. In addition, this data would be much more contemporaneous than data provided at the time of transfer. In light of these concerns and observations, **IETA recommends that ARB does not require transaction price reporting**. (IETA)

> **Response:** The date required in section 95921(b)(4) is needed to inform ARB that the transfer involves some type of a forward transaction. As the two comments correctly explain, there are many types of agreements that may result in the submission of a transfer request. Staff included 95921(b)(4) and other provisions as a less intrusive alternative gaining information about the transaction. Alternatively, ARB could have required the submission of the agreement itself, but determined such a requirement would be overly burdensome on stakeholders.
>
> Regarding the price data collected pursuant to section 95921(b)(6), staff agrees with the comment that interpretation of the price data will depend on the terms of the underlying transaction agreement. The reason staff has required the transfer request to list dates of the transaction agreement or expected settlement dates is to alert market monitoring staff to the fact that the transfer may represent the full or partial fulfillment of a derivative contract. Staff disagrees with the comment’s assertion that ARB can rely on price reports from individual exchanges, brokers, or others. These reports come from entities that represent fractional shares of the market, and they are difficult to aggregate. In addition, these reports have been vulnerable to misreporting or outright fraud designed to manipulate the market.
>
> Staff recognizes that the concerns raised in the comment apply to some transactions that are based on customized contracts. Staff expects that most transactions will be based on standardized contracts that do not have the

additional terms that are referred to in the comment. For these transactions, there will be an easily understood price to report.

G-20. Comment: As a matter of principle, MSCG objects to reporting transaction prices on transfer requests. We consider this to be proprietary business data and also would find it administratively burdensome. It simply is not needed to perform reasonable market monitoring. To the extent that ARB wants information on market prices, numerous trade publications are already reporting market prices for California Greenhouse Gas ("GHG") emissions allowances, and no allowances have even been issued yet. It is highly likely that Exchanges and brokers will also be issuing price survey data. Getting data on market prices should not be a problem even absent a transaction reporting requirement.

Philosophical differences on this issue aside, there are also practical problems with price reporting. While many, perhaps most transactions are straightforward "X allowances for $Y each", more complicated transactions are not uncommon, and an unambiguous price may not be available. For example, a "package deal" for a variety of goods and services, including allowances, would not be uncommon, and the price would be for the entire, bundled package. No separate, explicit price for allowances would exist.

Another type of transaction that could occur would be a non-cash trade. For example, party A might agree to deliver 20,000 California allowances for each vintage year 2013–2018 to party B, in return for 10,000 WTI crude futures for December 2013 at Cushing, Oklahoma. What price should be reported for a transaction of this type?

Given all the complications, concerns over proprietary data and bureaucratic administrative burdens, MSCG strongly recommends that ARB not require transaction price reporting. (MSCG)

> **Response:** The requirement to report a price in the transfer request is part of the existing regulation and not part of the proposed regulatory changes. The comment is outside the scope of the proposed regulation, and no response is required. Please also see the previous response regarding the requirement for direct price reporting in the transfer request.

G-21. Comment: Section 95921(b)(6): The ARB Should Adjust Its Price Reporting Requirements to Ensure that It Gathers Meaningful Data

SCE supports the ARB's efforts to monitor the GHG compliance instrument market to prevent market manipulation. Section 95921(b)(6) of the Proposed Regulation Order for Linkage would require parties to report the price of the compliance instrument to the accounts administrator as part of a transfer request. However, the proposed language would not require parties to indicate the contractual structure of the underlying transactions. Failing to distinguish between different categories of transactions may lead to inconclusive data, or data that is impossible to use for monitoring purposes.

Transactions such as physical settlements of tolling agreements, call and put options, and in-kind settlement agreements do not have a dollar figure for what is typically considered to be a "price." Physical settlements of tolling agreements would have a zero "price" because a utility is obligated to procure allowances, while in-kind settlement agreements would not settle in dollar terms and also cannot have a "price." These transaction types would skew analytical results if aggregated with price data from other types of transactions. Still, the current rules for price reporting could be effective in monitoring the prices of simple spot, forward, and futures contracts.

To remedy these potential inconsistencies in reported transaction prices, transferors should designate the structure of each reported transaction as a spot transaction, forward transaction, futures transaction, or a transaction without an accurate price to report. The first three categories would provide price data that is useful to the ARB. Allowing entities to provide a "not applicable" answer for the fourth category would prevent a skewed data set. For the "not applicable" transactions, ARB or the monitoring agency could periodically request additional documentation to prevent abuse. (SCE1)

> **Response:** The requirement to report a price in the transfer request is part of the existing regulation and not part of the proposed regulatory changes. The comment is outside the scope of the proposed regulation, and no response is required.
>
> Regarding the price data collected pursuant to section 95921(b)(6), staff agrees with the comment that interpretation of the price data will depend on the terms of the underlying transaction agreement. The reason staff has required the transfer request to list dates of the transaction agreement or expected settlement dates is to alert market monitoring staff to the fact the transfer may represent the full or partial fulfillment of a derivative contract. Staff appreciates the suggestion to collect additional information that would help staff classify the type of transaction involved as well as to help an entity submitting a transfer request to place a meaningful value in the price field.
>
> Staff recognizes that the concerns raised in the comment apply to some transactions that are based on customized contracts. Staff expects that most transactions will be based on standardized contracts that do not have the additional terms that are referred to in the comment. For these transactions, there will be an easily understood price to report.

Push-Push-Pull

G-22. (multiple comments): Changes in the Transfer Process

IETA would like to re-state its view that ARB's switch from the "two key" process to a "push-push-pull" method for transfer requests is unnecessary and unprecedented, and these regulations seem to bear no relation to traditional commercial markets. By regulation, a registered entity is bound by the actions of its representative; ARB therefore does not need to add further requirements.

While IETA understands ARB's intent behind requiring three (3) representatives to sign-off on a transfer request, we believe that companies will effectively prevent theft and fraud through their own, internal control systems; therefore, IETA recommends removing this requirement in the final amended regulation. Eliminating the requirement for multiple sign-offs would alleviate encumbrances and facilitate a more effective transfer process.

If provisions are retained, IETA urges ARB to consider changes to proposed language and deadlines, governing the transfer process. The deadlines associated with requesting, approving, and confirming a transfer to ARB are extremely short and will unnecessarily burden companies. Therefore, IETA recommends ARB consider either eliminating or, at the very least, lengthening these proposed deadlines. In addition, IETA recommends that ARB modify the language to read two or one business days, respectively, instead of calendar days. This would prevent inconvenient situations where account representatives would have to sign-off on transfers over a weekend or holiday. (IETA)

Comment: Push-push-pull: Chevron recommends the importance of market monitoring and fraud prevention, but finds that requiring three separate representatives to sign off on a transfer could prove onerous to companies and could create barriers to liquidity—particularly in conjunction with other restrictions on trades. (CHEVRON)

> **Response:** Staff believes that the three approvals needed to complete a transfer request will be sufficiently automated in the tracking system that the process will not be overly burdensome or time consuming. This mechanism is meant to prevent unauthorized transfers of compliance instruments within the tracking system. The requirement for three days is part of the existing regulation and staff is not proposing to change that requirement.

G-23. (multiple comments): ARB Should Consider Alternatives to the Proposed "Push-Push-Pull" Procedure for Transfers of Compliance Instruments

CERP appreciates that it is imperative for ARB to establish a secure and reliable procedure for conducting transfers of compliance instruments, especially in light of recent instances in the European Union Emissions Trading System (ETS) in which large numbers of compliance instruments were fraudulently transferred. A properly functioning transfer procedure should ensure that no transfer is undertaken unless authorized by bona fide representatives of both the source and destination accounts for the compliance instruments. Equally essential, however, is that the transfer procedure minimize the transaction costs for registered entities and avoid undue delays in the conduct of trading. Unnecessary friction in carrying out transfers will impair or discourage economically efficient trading and, ultimately, increase the costs of the cap-and-trade program to covered entities and California residents.

With these principles in mind, CERP questions whether ARB's proposed "push-push-pull" procedure—under which a transfer would require independent confirmation from two representatives of the source account as well as one representative of the destination account—is the best approach for ensuring the integrity of compliance instrument transfers. Many registered entities, including both covered entities and voluntarily associated entities, are likely to engage in large numbers of transfers of compliance instruments on a continuous basis. Entities that are highly active in trading will likely find it impractical to have two account representatives confirm every individual transaction. Such entities are likely to rely upon their own internal accounting and trading procedures to track the disposition of compliance instruments, rather than a cumbersome multiple confirmation procedure. CERP further notes that the regulations governing trading of sulfur dioxide allowances under Title IV of the Clean Air Act do not require a "push-push-pull" approach. To our knowledge, the Title IV procedure has not resulted in any notable erroneous or fraudulent transfers.

Accordingly, CERP encourages ARB to consider, and take comment on, other approaches that could achieve the goals of the "push-push-pull" procedure. As a preliminary matter, ARB's Know-Your-Customer (KYC) requirements provide ample confirmation of the identity of individuals with access to the tracking system—and are themselves a valuable safeguard against unauthorized transfers. An additional safeguard that ARB could propose in lieu of "push-push-pull" could include automatic notifications to all account representatives and viewing agents for a registered entity that initiates a transfer request. Such a measure would give owners of compliance instruments ample notice and opportunity to stop an unauthorized transfer.

In the event ARB proceeds to finalize the "push-push-pull" procedure, it should make the following changes to better accommodate the needs of market participants:

Allow three business days for confirmation of transfers. ARB proposes that an account representative for the source account confirm a transfer within two calendar days of initiating a transfer request, and that an account representative of the destination account confirm within three calendar days of initiating a transfer request. These deadlines could prove burdensome or even impossible to meet if the accounts administrator is not operational on weekends or holidays. Accordingly, CERP recommends that the deadlines be expressed in business days, not calendar days. (CERP)

Comment: Push, push, pull is unnecessarily burdensome

WSPA believes that the requirement for "push, push, pull" to register a transfer of compliance instruments between two entities is unnecessarily burdensome. Specifically, two authorizations from the same entity requesting the transfer are unnecessary. Internal corporate controls, in addition to ARB notifications to multiple entity representatives of the transfer requests, should provide sufficient oversight to prevent unintended or deceptive transfer requests. A "push, pull" process would provide sufficient safeguard while significantly reducing unnecessary burden.

Recommendation: WSPA recommends that the process for transferring compliance instruments be revised to a "push, pull" process. (WSPA1)

> **Response:** ARB is proposing the push-push-pull approach following discussions with stakeholders and WCI jurisdictions. These discussions reviewed experiences in the EU-ETS and concluded that additional security was needed for the system of transfer requests. The push-push-pull approach was part of the solution. As the comment points out, the Know-Your-Customer (KYC) requirements provide additional security on the identity of individuals accessing the tracking system. However, ARB views the KYC requirements as complementary to push-push-pull and not a substitute. The former addresses access to the system and the second addresses what an individual can do if someone succeeds in getting past the KYC requirements and improperly accessing the system. Further, as part of implementation, ARB will be building in automatic e-mail alerts into the tracking system when certain actions are taken. Again, these complement but are not sufficient to replace the other provisions. The requirement for three days is part of the existing regulation and staff is not proposing to change that requirement

G-24. Comment: Remove penalties for non-compliance with transfer procedure. ARB proposes to find both parties to a transfer in violation of the cap-and-trade regulations, and potentially apply penalties, if the deadlines for completing transfer requests are not met. CERP believes that applying penalties in such circumstances could unfairly punish one or both parties to a transaction for inadvertent lapses in completing a transfer request. By creating additional enforcement and compliance risks for registered entities, the threat of penalties could also "chill" legitimate trading activity. Further, ARB has not established that such penalties are necessary: at this early stage of implementation, it is not clear that large-scale initiations of delayed or uncompleted transfer requests are likely to occur. Nor has ARB explained how delayed or uncompleted transfer requests would harm the trading system. Absent such an explanation, CERP recommends that the regulations simply provide that a transfer request will automatically expire if the confirmation deadlines are not met. (CERP)

> **Response:** The regulation text referred to in the comment does not call for automatic imposition of a penalty. ARB has statutory penalty authority that instructs ARB to set penalties based on specified criteria. The language proposed in the comment would prevent ARB from imposing a penalty regardless of the circumstances in which the transfer request was not completed.

G-25. Comment: Section 95921 Conduct of trade—settlement dates
Section 94921(a)(1) requires that transfers of allowances between different entity accounts be completed within three days instead of three business days. During previous stakeholder technical sessions, CARB staff indicated that there may be issues

associated having the Compliance Instrument Tracking System Service (CITSS) available for 24 hour per day functionality and having a calendar day transaction process. LADWP believes that having both a 24-hour per day functionality and business day process can work together. Transactions submitted over the weekend can be processed starting at the next business day, for example. A calendar day transaction process could lead to fluctuations in the market in terms of pricing and a majority of allowance transactions could occur during the early part of the work week.

Section 95921(a)(3) states that the parties to a transfer will be in violation and penalties may apply if the transfer process is completed more than three days after the initial submission of the transfer request or more than three days after the settlement day of the transaction for which the transfer request is submitted.

LADWP believes that CARB should not impose penalties for entities that choose to withdraw from completing the transfer process and recommends that it include language to explicitly state this. There will likely be circumstances beyond the parties' control that warrant withdrawing from an allowance transaction within three days after the transfer request. LADWP recommends that CARB delete Section 95921(a)(3) and the last sentence of Section 95921(c)(1)(C). LADWP recommends the following be added to Section 95921(a)(3): "Within the three business day period of the initial transfer request, parties to a transfer may withdraw the transfer request and the Executive Officer will not process the transfer and impose penalties." (LADWP1)

> **Response:** ARB intends to have the tracking system available on a 24-hour per day, seven-days a week basis, except for maintenance downtimes. This should give account representatives the flexibility to submit or confirm transfers in a timely manner. In addition, while three days are allowed to complete the process, staff believes the push-push-pull process to an extent that transfers will take much less than the time allowed. Finally, the existing regulation allowed three calendar days for the transfer process, and staff has elected not to change it.
>
> The language referred to in the comments do not call for automatic imposition of a penalty in all cases. ARB has statutory penalty authority that instructs ARB to set penalties based on specified criteria.
>
> The language in the regulation refers to transfer requests that are completed after the deadlines have passed. Staff agrees with the comment that a transfer request may be submitted as part of the settlement process of a transaction, and the underlying transaction may itself be cancelled, necessitating the cancellation of the transfer request. Staff understands that in this case, the transfer is not completed.

G-26. Comment: Consequences of push, push, pull timing requirements should only be rejection of the transfer request; it should not be consider a violation

Section 95921(a)(1)(B) specifies that a second account representative of the entity submitting a request for transfer of compliance instruments must confirm the request within and the receiving entity must confirm the transfer request within the remaining three days following the initial submission of transfer request. We believe that the consequence of missing these time limits should be only the cancellation of the transfer request. Missing these time limits will not result in any harm to the market or cause environmental harm. Conversely, the limits will unnecessarily increase exposures to potential violations. We see no compelling reason to classify missing these specified time intervals as a violation of the regulations.

Recommendation: amend section 95921(a) (3):

Section 95921(a)(3) The parties to a transfer will be in violation and penalties may apply if the above process is completed:
(A) More than three days after the initial submission of the transfer request; or
(B) More than three days after the settlement day of the transaction for which the transfer request is submitted.

If the above transfer process is not completed within three days of the initial submission of the transfer request, the transfer request shall be considered as withdrawn. If the entity wishes the transfer to be executed, a new transfer request must be submitted. (WSPA1)

> **Response** The requirement to complete the transfer process within three days is in the existing regulation. The wording of the requirement was modified in the proposed changes to match the push-push-pull format. Staff included the requirement in both the existing and proposed language to prevent cases in which market participants draw out the settlement process in order to disguise who has ownership or control of allowances. Staff are concerned that this "fronting" could be used to hide strategic market behavior.
>
> The regulatory language referred to in the comment does not call for automatic imposition of a penalty. ARB has statutory penalty authority that instructs ARB to set penalties based on specified criteria.

G-27. Comment: Also, the compliance instrument transfer process outlined in 95921(a) could take up to three days, which allows very little time to find an appropriate counterparty. Given the possibility of an illiquid market where it may be difficult to sell large volumes of compliance instruments, additional time may be needed to find a buyer. (PGE1)

> **Response:** Staff disagrees with this comment. An entity would not start the trading process without already finding a counterparty. The push-push-pull process is simply the method for completing trade. It is not the case that every

time an entity wants to trade compliance instruments, it will have three days to find a counterparty.

Business Days Preferred Over Calendar Days

G-28. (multiple comments): Transfer Request Deadline

The deadline for submitting a transfer request in section 95921 needs to be changed in order to not require business to be conducted on weekends or holidays. In sections 95921(a)(1)(E) and 95921(a)(3), the three days requirement should be modified to "three business days." It is essential that mandated timelines for compliance instrument transfers refer to "business days" as opposed to "calendar days" to not limit secondary market trading to Monday through Thursday. Compliance instrument buyers may be reluctant to enter into spot transactions on Fridays because the transfers may require a confirmation during the weekend or risk ARB penalties. (SEMPRA1)

Comment: References to "days" in the Clean-Up Amendment (and Regulation) should be revised to "business days" to avoid administrative confusion and ensure that regulators and entities are operating under the same set of assumptions with respect to regulatory deadlines. (CALPINE1)

Comment: Business day time periods should be adopted for the allowance transfer process.

Sections 95921(a)(1)(B) and (C) of the Regulation set calendar day time periods for the allowance transfer process: two days for the seller to confirm the transfer request, and three days for the buyer to confirm the transfer request. Using business days for transfer time periods is preferable to calendar days given the short number of days in question, which may easily be exceeded over a weekend or holiday period such as Thanksgiving. If calendar days are used, this will tend to discourage transactions towards the end of the week where the time periods would end over the weekend. Trades would be concentrated in the first half of the week, which may be more difficult for the transfer system to handle as well as making the work flows of traders and the administrative personnel working on transfers more uneven. Business days are used elsewhere in the Regulation (e.g. section 95870(d)) as well as in Québec's cap and trade regulation, and should also be used in section 95921 of the Regulation. (SCPPA1)

Comment: Lastly, LADWP recommends allowing three business days rather than three calendar days for the transfer of allowances between different entity accounts. Without this change, if a transfer is initiated on a Friday, the push-push-pull would have to occur over the weekend in order to complete the transaction by the third calendar day, which is Monday.

To avoid this, account representatives would tend to initiate transfers during the first half of the week, which could skew market prices and transaction volume.

Our recommended change to three businesses days would allow transactions to be processed starting the next business day. (LADWP2)

> **Response:** The use of three calendar days follows the requirements in the existing regulation. Staff declines to make any changes to these existing provisions and believes that normal planning can ensure there are no problems related to the implementation of these requirements. Three days is the maximum time allowed for completion of the transfer request. Entities can complete the requirements in shorter time.

G-29. **Comment:** The references to "settlement" of transaction agreements should be removed.

Sections 95921(a)(1)(E), (a)(3)(B) and (b)(5) refer to the date of "settlement" of an agreement to transfer compliance instruments. Of particular note, section 95921(a)(1)(E) requires the parties to such an agreement to complete the allowance transfer process within three days of the day of settlement of the agreement. However, not all agreements may specify settlement dates as such—they may instead refer to delivery dates, transaction dates or transfer dates.

Furthermore, the parties may intend the settlement or delivery date to be the date on which the transaction is to be completed, i.e. the instruments transferred to the buyer, rather than the date starting the process of requesting a transfer, which may be up to three days before the actual transfer. Therefore it may be difficult to determine the "settlement" day of each transfer agreement, making it hard to comply with the requirement in section 95921(a)(1)(E) to complete the three steps for transfers within three days of the day of settlement. (SCPPA1)

> **Response:** The regulation makes a distinction between the date the transaction agreement was established, the dates a transfer is initiated, and the date of settlement of the agreement, if in the contract those dates are different. The settlement date is the date when all of the terms of the contract are fulfilled. If the transaction agreement specifies additional terms that may be executed after a transfer takes place, then the date of settlement of those terms is the expected settlement date. If completion of a transfer request is the final step in settling a transaction agreement, the expected date of completion of the transfer request process is the expected settlement date.

G-30. (multiple comments): If provisions are retained, IETA urges ARB to consider changes to proposed language and deadlines, governing the transfer process. The deadlines associated with requesting, approving, and confirming a transfer to ARB are extremely short and will unnecessarily burden companies. Therefore, IETA recommends ARB consider either eliminating or, at the very least, lengthening these proposed deadlines. In addition, IETA recommends that ARB modify the language to read two or one *business* days, respectively, instead of *calendar* days.

This would prevent inconvenient situations where account representatives would have to sign-off on transfers over a weekend or holiday. (IETA)

Comment: Additionally, it has been PG&E's understanding that transfer request deficiencies would result in ARB simply not approving the request and resultant transfer of compliance instruments. PG&E is concerned that Section 95921(a)(3) indicates that if either party fails to successfully approve the transaction within the limited time frame prescribed by the regulation, both parties would be in violation and that penalties may apply. PG&E recommends transfer request deficiencies resulting from both incomplete information or approvals occurring outside of the required time frame result in ARB declining the request and requiring that entities submit a new transfer request. (PGE1)

Comment: Modify Time Requirements Associated with Transfers Between Accounts (Section 95921(a)(1)) PG&E recommends that ARB consider translating the time requirements in the regulations from days to business days, to reflect any potential timing conflicts with holidays and weekends.

PG&E also recommends that ARB develop a master calendar for stakeholders that marks all holidays that ARB and linked jurisdictions plan to observe. (PGE1)

Comment: Section 95921(a)(1): The Timing for the "Push-Push-Pull" System Must Be Clarified to Refer to Business Days and Allow Two Business Days for the "Pull"

Section 95921(a)(1) would establish what the ARB has termed the "push-push-pull" system, where an account representative from the source account of the transfer submits a transfer request (push) that must be separately confirmed by a second account representative for that same entity (push), after which an account representative for the destination account must confirm the transfer request (pull). The current regulation language requires the transfer to be completed within three days, providing two days for the second push and one day for the pull. SCE suggests that the ARB require the second push to occur within one business day of the transfer request (by close of business local time, 5 p.m. PPT) and that the pull be completed within three business days of the transfer request (by close of business local time, 5 p.m. PPT).

SCE strongly urges the ARB to amend the mandated timelines for compliance instrument transfer requests to refer to "business days" to avoid confusion with calendar days. This modification would better reflect the practices in banking or commodity trading to publish market holidays and close on those market holidays or weekends. In addition, while payment and allowance transfer may not be linked, if payment is required for the allowance transfer, many compliance entities may be able to make payments only on business days. Without this clarification, the ARB could limit the flexibility of transactions and cause unusual transaction behavior. For example, buyers of compliance instruments may be reluctant to enter into spot transactions on Fridays if the transfer would require a confirmation during the weekend. To ensure clarity and certainty in the market, the ARB should provide a clear definition of "business day" and specify the holidays it (and any linked jurisdiction) plans to observe. (SCE1)

Response: The use of three calendar days follows the requirements in the existing regulation. Transfer requests are submitted once two parties have reached agreement to transfer compliance instruments. Both parties should therefore know the transfer request must be filed and be prepared to do so. Staff does not believe the requirements are so onerous that they cannot be completed within three days given the parties to the transfer set the date when the transfer is initiated. Staff understands that registered entities will have tracking system access on holidays and weekends. Three days are the maximum time allowed for completion of the transfer request. Entities can complete the requirements in shorter time.

H. PROCESS CHANGES TO THE AUCTION

Auction and Sales Procedures

H-1. Comment: Auction Frequency
IETA was pleased to hear that, at least in concept, ARB is not entirely foreclosing the option of increasing allowance auction frequency in the future. Increasing auction frequency would preclude the need for additional measures that attempt to prevent market manipulation—like holding or auction purchase limits. In addition, more frequent auctions could result in a faster learning curve for companies and more opportunities to become comfortable with the auction platform. That said, we recognize that administrative burden and cost to participate in auctions, as currently designed, could greatly increase with increased auction frequency; all administrative burdens and cost requirements should be kept in mind, and effectively assessed & addressed, when and if ARB considers an increase in auction frequency. (IETA)

Response: Staff appreciates the support. No further response is needed.

H-2. Comment: SPECIFIC PROVISIONS REQUIRE ADDITIONAL CLARIFICATION
Section 95892(c)(1).
Section 95892(c)(1) provides that electrical distribution utilities must offer one-third of the allowances placed in their limited use holding accounts into the auction. Because it could be read as limiting the number of allowances that may be consigned into the first auction to no more than one-third, NCPA recommends that this provision be revised to clearly state that electrical distributions utilities must place "at least" one-third of the allowances from their limited use holding accounts into the auction. This revision would allow those utilities that want to consign more than a third of their allowances into the first auction to do so. (NCPA)

Response: Staff specified that one-third of the allocated allowances contained in Limited use Holding Accounts be consigned to the first auction, due to the limited time between when the regulatory changes come into effect and when the first auction is scheduled to take place. To give staff and the auction administrator time to prepare for the auction and to issue a quarterly auction

> notice, section 95910(d)(4)(B) requires that, beginning in 2013, consignment transfers be completed 75 days before the auction. This timeline cannot be met for the November 2012 auction, and the only way the auction announcement can contain the number of allowances to be auctioned is to fix the number in advance.

H-3. Comment: The basis for setting the Auction Reserve Price at $10 should be explained and tested. Section 95911(c)(1) provides that the floor price or Auction Reserve Price ("ARP") for vintage 2013 and vintage 2015 allowances auctioned in 2012 will be $10. SCPPA requests the ARB to provide reasons for setting the ARP at this level. The FSOR states that:

> We chose the $10 reserve price for two reasons. First, we are concerned that through recessionary economic conditions or forecasting error the cap-setting procedure may accidently lead to the creation of excess allowances. Throughout the regulatory process, we heard concerns from environmental groups that the cap would be unintentionally set too lax—a condition sometimes referred to as "oversupply" or "over-allocation." The over allocation condition occurs if too many allowances are supplied to covered entities relative to expected business-as-usual emissions levels. If the cap is set too loose, prices will be lower than expected, and a weakened incentive to reduce emissions will be created. The reserve price mechanism would correct this condition by transferring excess allowances to future auctions. Second, staff is adapting the approach used in the federal Waxman-Markey proposal (HR 2454), which proposed a reserve price of $10 with an inflator mechanism of 5 percent per year plus inflation.
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> Finally, ARB does not consider the prices observed in markets, such as RGGI, as representative of the marginal cost of abatement or production of offsets. These prices are instead the result of the over allocation problem that ARB is determined to prevent in California.

The FSOR also states that:

> The auction reserve price starts at $10, which is high enough to support the initial expected offset credits price.

It appears that the $10 floor price in the Waxman-Markey cap and trade bill was adopted without further research and was assumed to be appropriate in the context of the California cap and trade program, even though the California program is quite different from a national cap and trade program of the kind that the Waxman-Markey bill would have established. Furthermore, we are not aware of the original basis for setting this floor price in the Waxman-Markey bill.

SCPPA would appreciate it if the ARB could provide any research indicating that an

ARP starting at $10 and increasing at five percent per year plus inflation is necessary in order to alleviate any over-allocation and to support the generation of offsets or covered-sector emissions reductions in California. Is it the case that a $10 floor price would achieve these objectives (listed in the above extracts from the FSOR) but that a lower floor price, or one increasing only with inflation, would not? This issue is significant because a floor price that is higher than necessary is likely to increase the overall cost of compliance with the cap and trade program. This issue should be tested in the market simulation exercises that will be undertaken this year. (SCPPA1)

Response: This comment is outside the scope of the notice. However, we will reiterate our rationale here for completeness. ARB is concerned about the possibility of oversupply of allowances and that a reserve price is intended to correct oversupply conditions and provides for allowances not sold at auction to be sold at a later date. This is still a concern for ARB, and thus the reserve price should be exactly that: a price that determines the auction settlement price when there are more allowances available than there are buyers. ARB anticipates that the reserve price will not routinely or regularly affect the determination of the auction settlement price.

The reserve price was set at $10 based on three factors: ARB's economic modeling of the allowance market suggests that market prices will exceed that level under most market conditions. In addition, there is already a secondary market for California allowances. Prices for these allowance delivery commitments have been above the $10 reserve price for all of 2012. Prices reported the week of July 12, 2012, were about $19. Market conditions will change, however, the initial reserve price of $10 does not appear to be too high relative to observed prices. Finally, ARB believes the $10 reserve price will encourage offset project developers to develop projects and seek approval for offsets. ARB's economic modeling shows that the availability of offsets is a critical element of compliance instrument supply. In particular, if offsets are few, overall compliance instrument supply is lower, and allowance market prices are higher.

H-4. Comment: Clarify the sale order of allowances consigned to auction by utilities that were unsold and then redesignated to auction. Sections 95911(f)(4)(A) and (B) state that unsold allowances that were consigned to auction from limited use holding accounts and from closed accounts will be held in the Auction Holding Account until the next auction. Section 95911(f)(1) sets out the order in which allowances will be sold at auction, including allowances that were previously consigned to auction by the ARB and remained unsold. However, section 95911(f)(1) does not specify the sale priority of allowances that are redesignated to auction from the Auction Holding Account under section 95911(f)(4). (SCPPA1)

Response: Staff believes the process is clear as written in Section 95911. Section 95911(f)(1) governs the priority of sale of all allowances at auction, including allowances redesignated for auction. If the pool of redesignated allowances include some allowances from suspended or closed accounts and some allowances from consignments, and it is necessary to prioritize the sale of redesignated allowances, the priority of redesignated allowances shall be as stated in Section 95911(f)(1). No change was made to the regulatory text.

H-5. Comment: Utilities consigning allowances to auction should be able to provide reduced bid guarantees. Section 95912(i) requires auction participants to provide bid guarantees covering the maximum potential value of the submitted bids. The value of the allowances that utilities consign to auction should be recognized when bid guarantees are calculated. The financial risk that the bid guarantee is designed to address—a winning bidder not being able to pay for its allowances—is reduced in the case of utilities that stand to receive payments for the allowances they consigned to auction. The bid guarantee for utilities that consign allowances and bid at the same auction should be reduced accordingly. (SCPPA1)

Response: Staff disagrees with this comment. Neither ARB nor utilities that consign allowances to the auction know the value of the consigned allowances until the auction settlement price has been determined. Reducing the bid guarantee for utility consignors is impractical, given that the value of consigned allowances is not known at the time that bid guarantees are due. Further, such a process could provide a competitive advantage for utility consignors relative to other market participants.

H-6. Comment: The period from the auction to notification of auction results and invoicing should be short. Section 95912(j) lists the steps that will be taken after each allowance auction. The only specified time period is the period of seven days for winning bidders to pay. (See SCPPA's comments on this period in section IX.D below.) No other time periods are specified.

ARB staff indicated at a meeting on May 14, 2012, that, at least for the first auction in November 2012, it will take a week after the auction to notify bidders of auction results, and a further five days will pass before invoices would be sent to successful bidders, with payments due two days later.

A period of one week from the auction to the notification of results is too long. Having such a long period before the results are available increases the risk of information leaks resulting in detrimental impacts on the secondary market for allowances (which will remain active throughout this period). It would be desirable, and should be possible, for results to be published electronically and invoices to be transmitted sooner after the auction. (SCPPA1)

Response: Staff agrees that the secondary markets and market participants are well-served by shortening the time period from the auction to notification of auction results and invoicing for the allowances won. Staff also agrees that a week from the date of the auction to releasing the auction results is generally too long. However, the regulations do not specify a time period from the auction to when the auction is certified to allow ARB and the market monitor sufficient time to investigate possible market manipulation or other instances of market misconduct. For implementation purposes, and based on further discussions with our contractors since mid-May, ARB intends to certify an auction with much less delay than the comment suggests. Once an auction is certified, the auction results will be released, including settlement price, allowances sold, and other auction-related data, and auction participants will be simultaneously notified of allowances won and total payment due. All auction participants will know the auction results at the same time, and in as short a period of time as ARB and the market monitor require to review the auction. Since the timing of the auction results is an implementation issue, no change has been made to the regulatory text.

H-7. Comment: Winning bidders should have seven business days to pay for allowances. Under section 95912(j)(2)(B) of the Regulation, winning bidders must pay for the allowances they purchased at auction seven calendar days after notification of auction results. This could be only three business days after notification, assuming an extended Thanksgiving holiday. Furthermore, as noted above, payments are due only two days after invoices are released, and most entities will need to receive a formal invoice before payment can be authorized.

Bidders should be given a longer period to pay for their allowances. Few bidders are likely to provide bid guarantees in the form of cash (as this would constitute an uncompensated loan to the FSA), so they will need to arrange for a separate payment after the auction. A period of two or three business days is not sufficient to prepare and authorize a payment which may be a significant amount, often millions of dollars. (SCPPA1)

Response: Staff disagrees with this comment. First, invoices will be provided at the time payment is due, i.e., when the seven-calendar-day period starts. Second, auction participants know at the time they submit their bid guarantee the maximum payment they may be obligated for and can plan accordingly, including making adjustments to established internal procedures for processing payments. Third, the number of business days available to process payment for the November 14, 2012, auction could be longer than the commenter suggests, depending on when the auction is certified.

H-8. Comment: The Regulation should specify that utilities will receive payment for allowances consigned to auction the day after payment by winning bidders. Section 95912(j)(2)(E) provides that auction proceeds will be distributed to entities that consigned allowances for auction. However, there is no indication as to when this distribution will take place. As this distribution will involve a significant amount of money, it is important for the relevant utilities to know when it will be received. This distribution should be made on the day following the deadline for winning bidders to pay for their allowances. If bidders have not paid on time, section 95912(j)(2)(C) allows for the use of their bid guarantees to cover their payments, so the FSA will have access to sufficient funds to make the distribution. (SCPPA1)

> **Response:** The regulation need not specify that utility consignors will be paid in a certain length of time after settlement is complete, since this is an implementation issue. However, based on discussions with ARB's contractors, ARB plans to process payment to utility consignors within a few days after all payments due from buyers have been received or bid guarantees have been used to effect payment. The financial services provider's processes are similar in terms of the time needed to process payments to utility consignors.

H-9. Comment: Modify Auction Administration to Return Unsold Allowances to Their Respective Source Accounts (Sections 95892(c)(1) and 95911(f))
The proposed language in this section provides that unsold allowances consigned to the auction from Limited Use Holding Accounts are kept in the Auction Holding Account until the next auction. After December 31, 2012, consigning entities have the flexibility to determine the quantity of allowances to be consigned in each particular auction, as long as all total annual allocated allowances are consigned within the applicable year. Adding the provision that unsold allowances remain in the Auction Holding Account restrains the flexibility of consigning entities to determine the quantity of allowances to be consigned in each auction. PG&E recommends, as was the case prior to the current draft amendments to the regulation, that any unsold consigned allowances be returned to their respective Limited Use Holding Accounts in order to support the management and timing of revenues returned to our customers.

In addition, the proposed language in section 95892(c)(1) requires that each IOU consign one-third of its 2013 allowances to the November auction. These allowances, combined with the 2015 allowances that will be auctioned in the Advance Auction, would create an outsized supply of allowances in the first auction. PG&E suggests instead that IOUs be required to consign one-fifth of their allocated 2013 allowances to auction, since there will now be five auctions for 2013 allowances. (PGE1)

> **Response:** Staff disagrees with the need to return the consigned allowances to the limited use holding accounts (LUHA). Staff made the change because of the additional tracking efforts that would have to be exerted to ensure that allowances would be sold after they had been returned to the LUHA. Staff also disagree that the utilities need the flexibility, since if they have unsold allowances carried over for the next auction they can always reduce the number of allowances they consign to that next auction.
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> Regarding section 95892(c)(1), when the decision was made to reduce the number of auctions in 2012 from two to one, ARB made the policy decision to maintain the number of allowances scheduled for auction in 2012. The decision follows the earlier design decision to have auctions and a secondary market functioning before the compliance obligations begin in 2013. ARB concluded that

reducing the number of allowances auctioned in 2012 may impede market development.

Consignment Requirement

H-10. Comment: The ARB Should Inform Market Participants When It Withdraws Allowances for Consignment to the Next Auction

Under Section 95910(d)(2) of the Proposed Regulation Order for Linkage, allowances withdrawn from closed accounts, accounts exceeding the holding limit, or accounts suspended or revoked would be consigned to the next auction. At any bidders' conference preceding an auction where the ARB intends to offer such allowances, the ARB should notify market participants of the volume of withdrawn allowances that will be made available for purchase. Such an announcement will allow for greater transparency for auction participants. (SCE1)

Response: The auction announcement will provide participants with the total number of allowances for sale at the auction. The announcement will not provide a breakdown by sources.

H-11. Comment: Utilities consigning allowances to auction should be allowed to net the payment to be received for allowances they sold against the payment to be made for allowances they purchased. Section 95912(j)(2) should allow netting in respect of payments for allowances purchased at auction. A utility that consigned allowances to auction will receive, after financial settlement, an amount equal to the number of its allowances that were purchased at the auction times the settlement price ("Sale Amount"). If that same utility also purchased allowances at the auction, it should be allowed to deduct the Sale Amount from the amount it must pay the FSA for the allowances it purchased ("Purchase Amount"). This should be reflected in the invoice from the FSA to the utility. If the Sale Amount is larger than the Purchase Amount, the utility should not be required to make any payment to the FSA, and the FSA should refund the difference to the utility after financial settlement. (SCPPA1)

Response: The financial services provider plans to pay utility consignors after all payments from buyers have been received or bid guarantees have been used to effect payment. It is more transparent to separate payments for allowances purchased from payment due to utility consignors. Therefore, no change was made to the regulatory text.

H-12. Comment: The Consignment Requirement for the November 2012 Auction Should Be Adjusted from One-Third to One-Fifth of the Allocated 2013 Allowances

SCE commends the ARB's decision to revise the auction schedule to allow ARB staff and other stakeholders to "perform a number of important activities before [the first real auction], including efforts to maximize stakeholder readiness." However, the new allowance consignment requirements for the sole 2012 auction (currently scheduled for November 14, 2012) could damage the market and consequently should be revised.

Section 95892(c)(1) of the Proposed Regulation Order for Linkage would require that each investor-owned utility ("IOU") consign one-third of its 2013 allowances to the November 2012 auction. Instead, a more reasonable approach would be to require utilities to consign *one-fifth* of their allocated 2013 allowances to auction since there will now be five auctions for 2013 allowances. (SCE1)

> **Response:** When the decision was made to reduce the number of auctions in 2012 from two to one, ARB made the policy decision to maintain the number of allowances scheduled for auction in 2012. The decision follows the earlier design decision to have auctions and a secondary market functioning before the compliance obligations begin in 2013. ARB concluded that reducing the number of allowances auctioned in 2012 may impede market development.

Auction Purchase Limit

H-13. Comment: Allowance Auction Provisions

Although, ideally, MSCG believes the program would be better served with less restrictive holding and purchase limits, we do not generally object to the structure of limits as currently proposed, and believe it will allow workable markets. However, we strongly object to different holding and purchase limits among customer classes, and in particular, object to the large 40% purchase limit on current vintage allowances granted solely to Electric Distribution Utilities. In particular, this doesn't make much sense for the Investor Owned Utilities, as their portfolios of owned generation, the facilities for which they will be responsible, are so heavily weighted towards hydro, nuclear and renewable resources. Other compliance entities such as MSCG, with, potentially, larger compliance obligations, will be placed at a significant and unfair disadvantage. Furthermore, the rule is likely to inappropriately skew commerce. If EDUs have preferential access to allowances, then it is likely that more electricity procurement transactions will take place outside the borders of California, so as to make the EDU the importing entity and therefore First Jurisdictional Deliverer, without regard to whether or not this is (otherwise) the most efficient mode of transaction. So, some potential exists for the preferential access rule to artificially raise costs to consumers.

Again, MSCG would prefer no discrimination among customer classes with regard to holding and purchase limit rules, but to the extent that any such distinction is made it should be with regard to compliance requirements, not entity type or function. For example, a larger holding or purchase limit for all compliance entities might be somewhat defensible. At least with a rule of this type, a need-based argument can be made. Furthermore, if such a need-based standard is devised, then the limit should be based in some manner on the anticipated compliance obligation, so that entities with similarly sized anticipated compliance obligations are assigned the same purchase limits. Finally, providing disproportionately large (relative to need) opportunities to purchase to one customer type is inconsistent with general ARB concerns about hoarding and other forms of market manipulation. Either the concerns are legitimate, and apply equally to all entities, or they are not and should not be in effect at all. (MSCG)

> **Response:** Staff disagrees with the comment. The proposed regulation imposes a purchase limit of 40 percent in place of the exemption contained in the existing regulation. If the difference between the purchase limit on utilities and the purchase limit on covered entities would create a market distortion, the proposed regulation would reduce said distortion.

H-14. Comment: The Auction Purchase Limit Discriminates Against Independent Generators.

The proposed amendments to the cap and trade program set an auction purchase limit for current vintage allowances at 15 percent of the allowances offered for auction for all Covered Entities, except electrical distribution utilities. For electrical distribution utilities, CARB is proposing an auction purchase limit equal to 40 percent of the allowances offered for auction. While IEP appreciates CARB's proposal to include a purchase limit for electrical distribution utilities, as opposed to imposing no limit at all as was considered in prior proposals; CARB is creating a discriminatory outcome between Independent Power Producers ("IPP") and Utility-Owned-Generation ("UOG") by establishing a purchase limit for electrical distribution utilities that is nearly three times the purchase limit for IPPs.

This proposal has a number of anti-competitive features. First, CARB is affording electrical distribution utilities significant flexibility in managing their compliance obligations through a significantly larger purchase limit, which is not available to other covered entities. Second, this policy could enable electrical distribution utilities, acting on behalf of their UOG, to obtain more allowances than they need for their own compliance obligation, only to sell those allowances back to their IPP competitors when prices are high. Furthermore, CARB is proposing this policy in spite of the fact that independent power producers generally have greater risk for cost recovery than electrical distribution utilities. Electric distribution utilities have a guaranteed rate of return and ensured cost recovery for GHG related costs from ratepayers. IPPs must recover these costs from the competitive market. (IEP)

> **Response:** Staff disagrees with the comment. The larger limit for the utilities reflects their larger emissions obligations and the requirement that they consign allocated allowances to auction rather than use them for their own use. The holding limits are large enough to allow both the IPP and the utilities the ability to cover their own emissions while purchasing extra allowances for sale on the market.

H-15. (multiple comments): The Auction Purchase Limit Should Be Scaled to Need.

The purchase limit must be established such that all covered entities face comparable opportunities/risks buying out of the auction those allowances necessary to meet their compliance obligations. Accordingly, CARB should set a purchase limit that recognizes different covered entities vary in the magnitude of their compliance obligations, and if purchase limits do not reflect this reality they will have disproportionate impacts on covered entities.

For example, while the 15% purchase limit may have little, if any, impact on relatively small emitters of GHG, such a proposal for relatively larger emitters or those with corporate associations may create constraints on their ability to choose which auctions to enter, when to purchase allowances from the auction, etc. In recognition of the dissimilar effect that the purchase limit will have on different covered entities, the Purchase Limit should generally remain at 15% of the allowances offered for auction; however, for large covered entities or a group of covered entities with a corporate association, CARB should set the Purchase Limit for these entities such that recognizes the different magnitudes of compliance obligations. IEP believes that this adjustment may only apply to a very small subset of covered entities or a group of covered entities with a corporate association. This amendment should be made to the regulation prior to the first auction in 2012.

IEP Recommendation: The auction purchase limit should be set at a level that makes the impact of the limit comparatively proportional for covered entities based on the size of their compliance obligation; and, it should make no distinction as between ownership type (e.g. UOG vs. IPP). (IEP)

Comment: WPTF remains concerned that the 15% auction purchase limit is overly restrictive on covered entities with large compliance obligations. As we noted in our February comments, the small increase in the quantity of allowances that may be purchased by any individual entity from combined Québec-California, relative to a California auction, is not sufficient to allay concerns about the constraining effect of the purchase limit on large California entities.

WPTF therefore continues to support elimination of the auction purchase limit for the first compliance period. If purchase limits are retained, we recommend raising them to 25% for all market participants in both jurisdictions. (WPTF)

> **Response:** This comment addresses issues that are outside the scope of the proposed regulatory changes, so no response is required. However, the purchase limit is meant to allow all covered entities the equitable access to the allowances at auction. Staff would also note that for the first compliance period most allowances will be freely allocated to covered entities.

H-16. Comment: The clean-up Amendments' proposed current vintage auction purchases limit of 40% for electrical distribution utilities (rather than the 15% auction purchase limit that applies to covered entities generally) should likewise be applied to all covered entities whose compliance obligations are greater than the allowance holding limit. Anything less would be anathema to fundamental fairness. The Board should also amend the advance purchase limit for future vintage allowances. (CALPINE1)

> **Response:** Under the existing regulation the electrical distribution utilities are exempt from the purchase limit. The addition of the 40 percent purchase limit on utilities reduces the difference between purchase limits on utilities versus other entity needs to purchase at auction to cover its emissions exposure. The difference in purchase limits is fair because of the difference in the number of allowances different types of entities may need to purchase at auction to meet their compliance needs.

H-17. Comment: We also have a 15 percent auction purchase limit. You heard earlier that the utilities used to have no auction purchase limit but they lowered it 40 percent. Well, just by example, PG&E, our biggest customer and sometimes our largest competitor in 2010, our emissions were nearly eight million metric tons. PG&E's was two million metric tons. Why do they get a 40 percent auction purchase limit when they're not going to be buying for our facilities because of the constraints on the holding limit? And yet, we get 15 percent, which we barely eek through. We ask that the Board make through 15-day changes to the auction purchase limit and the holding limit. (CALPINE2)

> **Response:** The original exemption from the purchase limit for the utilities was chosen because (1) the utilities had to consign all allocated allowances instead of using them for their own compliance needs, and (2) the utilities have contracts that require them to be able to procure allowances to cover the emissions from electricity generation that they purchase through contracts. Staff believes that the 40 percent purchase limit for utilities affords enough flexibility to meet these obligations while also ensuring access to allowances at auction for all covered entities.

Auction Advisor

H-19. Comment: The Board Should Clarify That Receipt By An Auction Advisor Of Confidential Information From More Than One Market Participant Does Not Create A Per Se Violation Of The Regulations.

The Board's proposed regulations clearly contemplate that some entities will use advisors in developing their bidding strategy. The regulations therefore demonstrate that the Board recognizes the importance of allowing entities subject to compliance obligations to reach out and acquire needed expertise through professional advisors that understand the market and the regulatory requirements. Transacting in carbon markets that span international boundaries can be complex and confusing. Although some market participants, such as the large utilities eligible for cost recovery, may be able to build the internal expertise to fully understand and track the market, other participants, such as the smaller industrial companies, will need to seek the assistance of advisors to understand and navigate the market. Such advisors will need to invest time and energy in understanding the market and developing market analytics, the cost of which must be spread over multiple clients.

Section 95914(c)(2) of the regulations states:
(2) If an entity participating in an auction has retained the services of an advisor regarding auction bidding strategy, then:
(A) The entity must ensure against the advisor transferring information to other auction participants or coordinating the bidding strategy among participants;
(B) The entity will inform the advisor of the prohibition of sharing information to other auction participants and ensure the advisor has read and acknowledged the prohibition under penalty of perjury; and
(C) Any entity that has retained the services of an advisor must inform ARB of the advisor's retention.

Although Section 95914(c)(2) does not prohibit an advisor from serving more than one market participant at a time, it does not, on the other hand, expressly permit such arrangements. CPEMUS requests that the Board revise the language of the regulations to clarify that an advisor can serve multiple market participants simultaneously.

CPEMUS believes the requirement that an entity disclose to the Board that it has retained an advisor, as set forth in Section 95914(c)(2)(C), is wholly appropriate, and should be retained. However, CPEMUS submits that the Section 95914(c)(2)(A), which requires an auction participant to ensure against certain actions by the advisor, should be revised to eliminate such responsibility on the part of market participant. The regulations already prohibit the advisor itself from transferring information improperly or coordinating bidding efforts. Adding to that prohibition the specter that an auction participant will be at risk of regulatory violations for the actions of a third party advisor will serve only to inhibit the willingness of market participants to obtain the services of advisors that understand the market and its requirements. As a result, it will detract from, rather than encourage, a well-functioning market in which knowledgeable parties transact on a level playing field. The Board should clarify the regulations to ensure that only the advisor itself, and not market participants, are accountable for any violations of the regulations by the advisor. Such a clarification will provide an incentive for advisors to understand and follow the regulations, while at the same time providing market participants with security that they will not have vicarious liability for the actions of third parties. In this way, advisors serving multiple participants will be responsible for ensuring protection of confidential trading information and compliance with the regulations. (CPEMUS)

> **Response:** Staff is not proposing any changes to section 95914(c)(2), so the comments are outside the scope of the proposed changes, and no response is required.

H-20. Comment: The Board Should Clarify That A Market Participant May Concurrently Serve As An Advisor

CPEMUS believes that the Board should clarify that—assuming no indication of misconduct of the kind generally prohibited with respect to trade, as set forth in Section 95921(f)(2)—an entity may function simultaneously both as an advisor and as a market participant. As an example, assume one small company with compliance obligations—perhaps a cement manufacturer—elects to invest the time and expense in training of an employee with respect to the carbon trading markets. That entity may be able to share some costs by making its employee available to advise a second company, defraying compliance costs for both. To the extent that neither entity exceeds its holding limit, that there is no attempt to corner the market, and that the advisory relationship is reported to the Board, as required by Section 95914(c)(2)(C), there is little risk of market manipulation or gamesmanship. Rather, the market benefits by having informed participants and California-based businesses benefit from reduced compliance costs.

As another example, CPEMUS anticipates that industrial entities with compliance obligations may desire to use third-party advisors to help meet their A.B. 32 compliance obligations in much the same manner as many already use third-party aggregators to help meet their electric power needs. As with California's successful Energy Service Supplier mechanism, such an approach can allow an industrial entity to offset its risk and avoid the need to add expertise in a field not otherwise part of its core business. However, such third-party advisors may be required to purchase compliance certificates to meet contractual obligations, and may therefore themselves be market participants. In order to provide market participants with certainty that they may rely on informed advisors that may also be market participants, the Board should clarify that, barring any violation of Section 95914 or Section 95921, persons may simultaneously act as advisors and be market participants. (CPEMUS)

> **Response:** Staff does not believe that an advisor that is a market participant (and presumably also an auction participant) can be an advisor to another auction participant and still meet the requirements of section 95914(c)(2)(A).

Sharing of Auction Information

H-21. (multiple comments): THE AMENDED AUCTION PROVISIONS SHOULD BE CLARIFIED TO ENSURE A SMOOTH AUCTION PROCESS

Regulated Entities Should Be Able to Share Confidential Bid Data with Their Regulators

Section 95914(c)(1) of the Proposed Regulation Order for Linkage would prohibit the disclosure of bidding information "among auction participants." Although the title of the subsection implies that this non-disclosure rule applies only "among" auction participants, the language itself could be construed as restricting the flow of information to regulators. Consequently, the regulation language must be clarified for highly-regulated entities. The proposed language prohibits the release of auction participation information, "unless it is to an auction advisor or other members of a direct corporate association" not subject to auction participation restrictions or cancellations. The ARB should plainly state that this language does not prohibit regulated entities such as SCE from sharing bidding information as required through regulatory or legal directives.

For example, as SCE seeks procurement authorization and demonstrates compliance with California Public Utilities Commission ("CPUC")-approved procurement plans, SCE will need to regularly share its bidding strategies, bid prices, and other confidential bid information with the CPUC staff. SCE is also required to periodically discuss its bid prices and bid strategies with its Procurement Review Group, a CPUC-formed advisory group of non-market participant parties that reviews the details of SCE's overall procurement strategy, including Requests for Offers, portfolio positions, procurement transactions, and other procurement processes. (SCE1)

Comment: Section 95833(c) – Disclosure of Information. Sections 95912(f) and 95914(c) both place limits on an entity's ability to disclose information on auction participation. PG&E is concerned that these provisions could conflict with a utility's obligations to provide information to the California Public Utilities Commission. PG&E appreciates the addition of section 95833(c), to address this concern, but suggests that it be modified as follows:
(c) Any registered entity subject to affiliate compliance rules promulgated by jurisdiction of state or federal agencies shall not be required to disclose information or take other action that violates the requirements of those agencies or any law, rule or regulation to which the registered entity is subject rules. (PGE1)

Comment: Auction Advisor

Section 95912 (f) states that an entity cannot share its bidding information with any other entity unless the other entity has a direct corporate association or is an advisor as described in section 95914 (c), Non-disclosure of Bidding Information Among Auction Participants. The regulation specifically states,
(1) Unless it is to an auction advisor or other members of a direct corporate association not subject to auction participation restriction or cancellation pursuant to section 95914(b), an entity approved for auction participation shall not release any confidential information related to its auction participation, including:
(A) Qualification status;
(B) Bidding strategy;
(C) Bid price or bid quantity information;
(D) Information on the bid guarantee it provided to the financial services administrator; and
(E) Other information identified as confidential information in the auction application by the auction administrator.
(2) If an entity participating in an auction has retained the services of an advisor regarding auction bidding strategy, then:
(A) The entity must ensure against the advisor transferring information to other auction participants or coordinating the bidding strategy among participants;

(B) The entity will inform the advisor of the prohibition of sharing information to other auction participants and ensure the advisor has read and acknowledged the prohibition under penalty of perjury; and
(C) Any entity that has retained the services of an advisor must inform ARB of the advisor's retention.
The regulation or guidance document should make it clear that an advisor "retained" includes the Procurement Review Group required by the California Public Utilities Commission (CPUC) for oversight of electricity procurement. This advisory group is not covered by the affiliate transaction rules described in 95833 (c), but serves as a procurement advisor to the investor-owned utilities, compensated indirectly by the utility per CPUC Decision 07-11-024.

The guidance document should also allow for release of bidding information, subject to confidentiality requirements of section 95914(c), to the CPUC if requested as part of its oversight role. Such a disclosure would not violate the intent of the rule and may be required by the CPUC to fulfill its regulatory obligations under AB 57. (SEMPRA1)

> **Response:** It is not the intent of section 95914 to limit compliance with state or federal regulations that apply an entity registered into the cap-and-trade program. Section 95833(c) is intended to ensure that this regulation does not require registered entities to disclose information or take any other action that would violate state or federal laws or regulations.

I. LINKAGE WITH QUÉBEC

Compliance Instruments

Permanence

I-1. Comment: PG&E appreciates that, as indicated in the Initial Statement of Reasons, ARB is committed to working closely with Québec staff to resolve any potential issues so as to ensure that delinking is not necessary. However, if such efforts fail, staff would have to propose regulatory action to the Board with no certainty that Québec compliance instruments would continue to be eligible for use in California. Given that compliant entities do not know the issuing jurisdiction of allowances in their holdings, this would create great uncertainty in the markets. PG&E recommends that ARB establish the continuing fungibility of Québec-issued instruments before the fact so as to avoid the possibility of such uncertainty. (PGE1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Harmonization

General

I-2. Comment: PG&E appreciates ARB's efforts to ensure that linkage occurs in a manner that does not adversely affect covered entities in California. On April 13, 2012, PG&E submitted comments on the draft amendments, which provided a number of other recommendations to refine the regulation in this regard. (See Attachment A, pp. 5–7.) PG&E recognizes that there is insufficient time to make all of these changes in time to allow the first auction to occur this year. However, PG&E urges ARB to carefully review these suggestions and make these changes in the next set of amendments. (PGE1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Allocations

I-3. Comment: Without ensuring equivalency between how allocations are administered there could be market impacts if California facilities are purchasing too few or too many offsets to meet compliance obligations. This uncertainty could affect the market value of allowances by either artificially inflating or deflating value based on demand. (VALERO)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Definitions

I-4. Comment: Prior to linking with any jurisdiction, including Québec province, California must ensure that all definitions in the corresponding cap and trade regulations and offset protocols are harmonized. For example, although several entities may be involved in the implementation of a carbon offset project for ozone depleting substances, it is the entity that has taken the legal responsibility for end-of-life management that must be given ownership of the carbon offset credits. The California regulation defines an "offset project operator" as the entity with legal authority to implement an offset project. However, it appears the Québec cap and trade regulation does not utilize the same definition. Therefore, further clarification of "legal authority" is needed in the regulation and AHAM requests the definition for "offset project operator" be changed as follows:

Offset Project Operator means the entity with the legal authority to implement an offset project. **For the purposes of this definition, legal authority is defined as the entity that has taken legal responsibility for end of life management regarding ozone depleting substances or GHG emissions.** (AHAM)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Linkage and Offsets

Harmonize Offset Protocols

I-5. Comment: In addition to allowing the use of offsets, a linked program should facilitate the availability of offsets to avoid increasing demand for the limited number of offsets that will be generated pursuant to the California program. This is particularly important given that the full cost containment potential of offsets will not be realized unless each covered entity is able to, and does, acquire offsets up to the eight percent limit, and that some studies (for example by Thompson Reuters Point Carbon) have indicated that there is likely to be a shortage of offsets in the California program compared to the demand from California covered entities only.

The California and Québec regulations approve the following divergent sets of offset protocols:

California	Québec
• Livestock methane destruction	• Livestock methane destruction
• Destruction of ozone depleting substances	• Destruction of ozone depleting substances
• Forestry and urban forestry	• Landfill methane destruction

It is unclear why California has not approved a landfill methane destruction protocol and why Québec has not approved forestry and urban forestry protocols. Nor is it clear whether the currently-approved California and Québec offset protocols will together produce sufficient offsets to meet the joint demand from the two jurisdictions. To increase the supply of offsets, SCPPA urges California to adopt an offset protocol similar to Québec's landfill methane destruction protocol, Québec to adopt protocols similar to California's two forestry protocols, and both jurisdictions to put a high priority on investigating and adopting additional protocols.

In addition, to avoid asymmetrical demand for Québec offsets and differential pricing due to differences in the risk profiles of Québec and California offsets, California should adopt Québec's rule regarding the replacement of invalid offsets: Invalid offsets should be replaced by the entity that generated them, not the entity that purchased or surrendered them as in the CA Regulation. Failing that, invalid offsets should be replaced from an offset buffer account maintained by the regulator. This approach will provide greater certainty in the offset market than the approach in the CA Regulation, and therefore will strengthen the offset program as a whole. (SCPPA1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-6. Comment: The California Air Resources Board has proposed amendments to its cap-and-trade regulation to allow for the use of compliance instruments issued by linked jurisdictions to facilitate a market based system. The Air Resources Board has evaluated the Québec cap-and trade regulation and proposes to allow for the interchange of compliance instruments between the California and Québec programs. However, recently Québec released its Climate Action Plan in June 2012, which could lead to the regulation of ozone depleting substances including refrigerants and foam blowing agents in a manner which would prevent any offset credits from being issued or traded in Québec province despite meeting the requirements in California as outlined in the “Compliance Offset Protocol Ozone Depleting Substances Projects” adopted by the Air Resources Board.

Offset projects located in the US, its territories, Canada, and Mexico that otherwise meet the requirements of the California regulation and the California ODS protocol could not be used in California and its linked jurisdictions to meet compliance obligations because of failure to meet the definition of additionality as defined in the California regulation:

> “Additionality means in the context of offset credits, greenhouse gas emission reductions or removals that exceed any greenhouse gas reduction or removals otherwise required by law, regulation or legally binding mandate, and that exceed any greenhouse gas reductions or removals that would otherwise occur in a conservative business-as-usual scenario.”

If Québec mandates refrigerator foam recovery or refrigerant recovery beyond present regulations then projects located in Québec and elsewhere would not have qualifying additionality.

Therefore, regarding linkage with Québec province or any trading partner, AHAM requests the regulation be modified with the following sentence in Subarticle 2: Purpose and Definitions:

The purpose of this article is to reduce emissions of greenhouse gases associated with entities identified in this article through the establishment, administration, and enforcement of the California Greenhouse Gas Cap-and-Trade Program by applying an aggregate greenhouse gas allowance budget on covered entities and providing a trading mechanism for compliance instruments. **In order to comply with the purpose of this article, any jurisdictions linked to the California Cap and Trade program must provide for the trading of compliance instruments, including offsets, as outlined in the protocols approved and adopted by the Air Resources Board accompanying this regulation.** (AHAM)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-7. Comment: In order to allow for the interchange of compliance instruments, including offset credits, between California and any linked jurisdiction; offset projects that meet the requirements of the offset protocols approved and adopted by the Air Resources Board must not be excluded if the offset project is within the boundaries of the United States or its territories, Canada or Mexico and implemented by an Offset Project Operator.

Compliance Offset Protocols from linked jurisdictions to the California cap and trade program can not prohibit Offset Project Operators meeting the requirements of the California regulation from being the entity with the legal authority to implement an offset project, being the sole owner, or owning GHG emission reduction credits from an offset project in the linked jurisdiction. It appears the Québec cap and trade regulation would require the carbon offset project to be domiciled in Québec and the project "promoter" to be the sole owner of the carbon offset credits without recognizing the legal authority of other parties.

AHAM requests the regulation change Section 95972(c) "Requirements for Compliance Offset Protocols" to the following:

Requirements for Compliance Offset Protocols **Including Linked Jurisdictions** Geographic Applicability: A Compliance Offset Protocol must specify where the protocol is applicable **and cannot exclude any linked jurisdictions**. The geographic boundary must be within the US or its territories, Canada or Mexico. **Entities meeting the requirements of the California Cap and Trade regulation and its approved and adopted Compliance Offset Protocols qualify as Offset Project Operators in linked jurisdictions.** (AHAM)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Offset Liability Issue

I-8. Comment: Québec's offset regulations were published in early June and ARB added them to the rulemaking docket on June 11. We appreciate that ARB has made such documents available for review. As ARB noted, it appears that most of Québec's offset regulations are the same or very similar to California's approach.

However, one area in which the offset regulations for the two jurisdictions differ is in their approach to liability for invalidated offset credits. California has adopted a "buyer liability" approach wherein the entity that surrenders an offset credit for compliance must replace it with another valid compliance instrument if the credit is invalidated. In contrast, Québec proposes that invalidated offset credits be remediated by canceling an equal quantity of offset credits held in an "environmental integrity account." Every offset project would contribute a small percentage, approximately 6% of its total issued offsets, into the environmental integrity account—thereby providing a form of advance insurance to protect the integrity of Québec's emission trading system. In addition, Québec proposes to grant the Minister of Sustainable Development, Environment, and Parks discretionary authority to require an offset project developer (or "offset promoter" in Québec's regulatory terminology) to replace invalidated credits with valid compliance instruments. These discretionary replacements and cancelations from the environmental integrity account will together cover any losses arising from offset project reversals or fraudulent credits. CERP and many other organizations recommended that ARB adopt such a buffer account as an alternative to the buyer liability approach.

To be sure, challenges and inefficiencies may arise if Québec and California adopt divergent approaches to assuring the integrity of offset credits across the WCI. Because Québec proposes to employ an approach to offsets invalidation that does not create buyer liability, covered entities throughout the WCI region will likely gravitate to offsets issued by Québec. Conversely, offset credits issued by California may be comparatively less attractive to buyers in light of their uncertain risk for invalidation liability. If different systems of invalidation liability persist, the emergence of a fragmented market with differential pricing of offset credits is very likely—distorting the efficiency and effectiveness of the broader WCI market.

Despite this potential for market discrepancies, CERP also believes the operation of two systems for insuring offset integrity could also provide a valuable “test run” of alternate models. Assuming Québec proceeds to adopt an environmental integrity account, we recommend that ARB use this opportunity to monitor and assess the performance of this approach. Ultimately, CERP believes that over time it will be important to harmonize the offset invalidity approaches. Thus, CERP urges ARB to use the first few years of market operation to assess the buffer account employed by Québec, and after gaining assurances of its performance, to consider adopting a similar approach in California. (CERP)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Evaluation of New Protocols

I-9. (Multiple comments): On behalf of its 90,000 California members, The Wilderness Society (TWS) is writing to provide input on the proposed amendments to the cap-and-trade regulation to allow for the use of compliance instruments from linked jurisdictions. TWS commends ARB and California for continued leadership in developing sustainable policies for reducing greenhouse gas emissions. Climate change presents serious threats to the economic wellbeing, public health, natural resources and environment in California. The cap-and-trade program is an important part of achieving California’s greenhouse gas emissions reductions, and coordinating and integrating California’s efforts with other greenhouse gas reduction programs is another critical step in fully addressing climate change.

TWS appreciates the work and public consultation that has already occurred with respect to developing the proposed amendments to allow for the use of compliance instruments from linked jurisdictions and supports California’s effort to link with Québec. Pursuant to the May 9, 2012 ARB Staff Report: Initial Statement of Reasons, TWS understands that Québec’s cap-and-trade regulation does not yet include provisions for generating compliance offsets; that any future compliance offset program in Québec is expected to be consistent with the criteria included in the WCI Offset System Essential Elements Final Recommendations Paper for ensuring that offsets are real, quantifiable, permanent, enforceable, additional and verifiable; Québec's offset program may include projects that occur in Mexico; and Québec is not currently developing a forest offset protocol.

TWS seeks further clarification regarding the process for evaluating: any protocols which may be adopted by jurisdictions after linking has occurred; any modifications to protocols which are adopted after linking has occurred; and any changes to a linked cap-and-trade program that substantially alters compliance instruments traded within such program (e.g. subsequent unilateral linking to a third jurisdiction which includes the acceptance of offsets generated pursuant to different protocols, different offset types, and/or offsets from new geographic locations that may have different policies and programs, such as UNFCCC Nationally Appropriate Mitigation Strategies, that are relevant to the evaluation of whether offsets are real, quantifiable, permanent, enforceable, additional and verifiable). As noted above, TWS supports continued integration of the California program with greenhouse gas reduction programs in other jurisdictions and supports cap-and-trade programs with the flexibility to amend features like offset protocols, to reflect evolving scientific standards and methodologies. (TWS1)

Comment: The Wilderness Society appreciates your continued leadership on climate change that supports linkage to other jurisdictions and underscores the timeliness of this effort at the end of the week that has seen over 1,000 heat records broken across the United States in catastrophic wildfires across the west that have impacted many lives and the public lands that the Wilderness Society seeks to protect.

The staff presentation noted the existence of three draft offset protocols and a geographic restriction on these potential offsets to Canada and California. TWS has submitted written comments seeking additional clarifications that echo the comments of Breathe California and the Pacific Forest Trust about additional clarification that's needed regarding a process for evaluating any protocols after linking or any modifications to protocols or modifications to link jurisdictions' programs that could significantly change the types of compliance instruments available, for instance, by expanding the geographic scope of available offsets. (TWS2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-10. Comment: Thank you again for the opportunity to submit comments on regulation for linking California's and Québec's cap-and-trade programs. We focus these comments on CARB's process for ensuring that Québec's offsets protocols, and the offsets protocols of any jurisdiction with which California shall link in the future, meet the requirements of AB 32 that offsets credits be real, permanent, quantifiable, verifiable, and enforceable, additional to what would have otherwise occurred, and represent a no lesser reduction in greenhouse gas emissions than a California compliance instrument. Ensuring the quality of offsets programs across linked jurisdictions is a challenging aspect of linking cap-and-trade programs. Since credits are fungible across linked programs, ensuring the quality of the offsets program of all linked jurisdictions is essential to the integrity of the entire set of linked programs.

We urge CARB to make clear the criteria it will use to assess whether the offsets protocols of a linked jurisdiction meet AB 32 requirements. We also urge CARB to make its assessments publicly available. (UCS)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-11. Comment: Second, we urge CARB to establish procedures that would discourage a linked jurisdiction from making substantial changes to its own cap-and-trade program that weakens the program so it no longer meets California's requirements. CARB should clarify that if a jurisdiction makes substantial changes to its program, such as adopting a new protocol or substantially modifying an existing protocol, CARB will evaluate that change. If CARB finds that the program no longer meets CARB requirements, CARB will disallow the additional use of compliance instruments from that jurisdiction until its program is found once again to meet CARB's standards. (UCS)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Against Linking

Delay Linkage

I-12. (Multiple comments): California's cap-and-trade program should not be linked to cap-and-trade programs in other jurisdictions, such as Québec, until issues associated with linkage have been fully vetted, some practical experience with the respective cap-and-trade programs has been gained, and there is evidence that linkage can help to contain the costs of the linked programs.

In theory, a larger market for allowances would be a more liquid market and having a larger market would make available more lower-cost opportunities to reduce greenhouse gas ("GHG") emissions. The call to link with Québec would be more persuasive if these theories were supported by empirical evidence, relating to the particular circumstances of the California and Québec programs, that linkage will indeed produce the intended benefits. SCPPA encourages the ARB to seek such evidence and disseminate it to stakeholders. (SCPPA1)

Comment: A California-Québec linked system does not achieve the basic goal of linkage—to develop a broader more cost-effective cap and trade market. The ARB's Initial Statement of Reasons (ISOR) states that this linkage is a first step, however, it is also the only step that California can make in the foreseeable future. Other WCI partners (U.S. states and Canadian provinces equally) have backed away from implementing cap-and-trade programs. (CHEVRON)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-13. (Multiple comments): The ARB wishes to link California's cap-and-trade program with Québec's in 2012, before either program has become operational. Linking will unavoidably result in making California's program—which is already complex and rife with uncertainties as to how it will operate in practice—even more complicated and less predictable, particularly given that the linked jurisdiction is outside the United States. Linking at this early stage increases the number of issues that may arise with the new programs, raising the risk that significant problems will occur that would necessitate delinking or major revisions to the programs.

For these reasons, the ARB should consider delaying linking until the California program and the Québec program have started operating, initial problems have been resolved, and the programs have demonstrated that they are stable and effective.

SCPPA is not alone in holding this view. The California Senate Budget Subcommittee No. 2 recently recommended that a provision be included in the 2012 California budget trailer bills prohibiting the ARB from linking until November 30, 2013, unless linking is approved by the California Legislature in a future statute. (SCPPA1)

Comment: SCE has consistently supported a national cap-and-trade program, or in the alternative, a broad cap-and-trade program with linkage to other jurisdictions. A broader program will create more efficient markets that will benefit all Californians that bear the impact of a carbon price on their consumer products. The Western Climate Initiative ("WCI") recently released an economic analysis assessing a linked program between California and Québec. While SCE continues to support a wide-ranging, robustly-designed cap-and-trade market, this report raises concerns that linkage with Québec may fail to create such a market. Indeed, the relative size of Québec to California is a red flag that leads SCE to question whether this partnership could truly achieve the primary goal of linkage—a wide-ranging market that will result in lower compliance costs due to more efficient distribution of emissions reductions.

Because Québec alone does not offer California the opportunity to develop a comprehensive and robust cap-and-trade market, the ARB must consider including other jurisdictions in a linked trading environment. Other WCI jurisdictions no longer have public support for linked cap-and-trade programs. Unfortunately, a California-Québec system is insufficient to provide the necessary benefits for efficient emissions reductions. The ARB should not enter into a linking agreement with Québec until linkage with other jurisdictions is a realistic option. SCE recommends that ARB develop of a set of criteria to assess this and future linkages to ensure that the overall policy, economic, and environmental impacts of such partnerships are in line with California's cap-and-trade goals. (SCE1)

Comment: ARB's original concept of linking California's CTR in a combined, multi-state market would have furthered the goals identified through WCI. At the time, a number of US states were actively contemplating adopting cap-and-trade regulations and, if they had continued on that path, the potential regional market would have been much larger. However, as of today, that opportunity is limited to Québec as the only remaining member of WCI with a C/T regulation.

ARB's proposal to link with the Canadian Province of Québec would create a combined carbon market relying only on a highly specialized market infrastructure reflecting the two jurisdictions. This specialized market structure may well adversely impact linkage to other markets in the future if they also require specialized requirements.

<u>Recommendation</u>: Linkage is premature until ARB defines a broader, simpler and more cost effective program. WSPA has always supported linkage to a broad market with consistent and flexible requirements for all participants. (WSPA1)

Comment: Neither California's nor Québec's cap-and-trade programs have been implemented. With California's "adaptive management" approach, it is highly likely that the California program itself may undergo modifications as the program develops and matures. Rather than linking the programs when it's not clear whether, or how, either one of them will work in practice, and when it's highly likely that each program will be a moving target, it seems prudent to allow each program to develop on a standalone basis and have an opportunity to demonstrate success before attempting to link them. ARB should consider the possibility that the Québec program may prove to be the best option when considering the long-term viability of a cap-and-trade program. In which case, the ARB program may require modification prior to linkage.

It is also worth noting that the relative size of the Québec cap-and-trade market may not significantly impact the California market. ARB should consider whether linkage should also be deferred to incorporate other cap-and-trade programs to provide a more robust trading market. (VALERO)

Comment: In our comments on linkage, we urge the Board to consider delaying linkage with Québec until the California and Québec program start operating, until the inevitable start-up problems are resolved, and the program show they are stable and effective. (SCPPA2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Finalize California Regulation Before Linking

I-14. (Multiple comments): Prior to linking with another cap-and-trade program, outstanding issues with the California program should be addressed. Specifically, priority should be given to resolving electricity issues, including resource shuffling, the position of publicly-owned utilities that are interconnected with the California Independent System Operator, and the treatment of electricity imports. Electricity issues were specifically noted in ARB Resolution 11-32 approving the cap-and-trade regulation in October 2011. These issues affect emissions reports due this year as well as important decisions which must be made by September 1, 2012, regarding the allocation of allowances between a utility's accounts. These are not issues that can be delayed until next year. (SCPPA1)

Comment: The ARB must lay the foundation for the success of California's program *before* linking to Québec or any other jurisdiction. Linking California's yet-untested cap-and-trade program to Québec's program is diverting limited ARB resources from the critical task of successfully launching the California cap-and-trade market. SCE commends the ARB for its plan to conduct a practice auction in advance of the first live auction scheduled for November 2012, as a mock auction is a crucial step in discovering flaws in the compliance instrument tracking and auction systems. Still, SCE is concerned that a single test auction will adequately test neither the baseline functionality and reliability of these systems and processes, nor the ARB's ability to impose its regulatory control on these systems. Moreover, the limited scope of the one planned practice auction excludes allowances consignment and bid guarantee submissions and is not fully integrated with the ARB's compliance instrument tracking system.

SCE urges the ARB to dedicate additional resources or hire contractors to run a minimum of *three* fully integrated practice auctions over the next three months in order to fully develop and test its systems and processes, and to repair any weaknesses that are discovered. Potentially billions of dollars are at stake in the first auction; it is essential that ARB increase cap-and-trade implementation staffing to ensure that all systems and processes are fully tested and functional.

Inadequate testing of these new processes and systems could be disastrous and the possible consequences far outweigh any potential short-term savings. Additionally, SCE respectfully requests a more detailed schedule outlining the necessary implementation and testing activities to ensure that compliance entities have enough detail to properly plan key readiness activities heading into November.

SCE has been closely involved in a cap-and-trade implementation working group with other market participants and has previously offered assistance (in conjunction with other electric utilities) to the ARB in developing milestones and a roadmap for implementing the cap-and-trade program. These activities include, but are not limited to:

- Designing, deploying, and testing a compliance instrument tracking system;

- Allocating time for program participants—compliance entities and regulators alike—to familiarize themselves with the ARB's systems, operations and processes, as well as to build their own systems and interfaces to the ARB's system;
- Designing, deploying, and testing an auction platform with market participants;
- Undertaking market simulation efforts to expose, and address market flaws that open the program to manipulation or gaming; and
- Opening an organized, ongoing forum to field stakeholder questions and concerns about ARB's implementation efforts, and incorporating stakeholder feedback.

SCE strongly encourages ARB to focus additional resources on these critical market readiness tasks. In a few short months, billions of dollars will flow through the auction and tracking systems, making it far too risky to rely on a less than comprehensive implementation process. It will do no good to attempt linkage to Québec, or to any other jurisdiction, if California's program is not successful. Multiple practice auctions with full integration of the ARB systems, processes, and controls are necessary for a successful initial auction on November 14, 2012. (SCE1)

Comment: California (both the ARB and possible market participants) needs to "learn to walk before they run". There are great benefits in gaining experience with California Cap and Trade Program prior to taking on tasks associated with linkage with other programs. We should take the time to understand what is going well and not going well before expanding the universe of trading further. (WSPA1)

Comment:

- The California program has not begun, is untested, and systems are still being put in place for an auction in November and compliance obligations in 2013. California should not link with Québec until California's own cap-and-trade system has had opportunity to function independently. Given the magnitude and complexity of California's own program, adding an unnecessary additional layer of complexity by coordinating with a foreign jurisdiction at the outset would be imprudent.

- Other cap-and-trade systems, such as the European Union's ETS, have encountered implementation problems in their initial period. California also is likely to experience unforeseen difficulties in implementing its program, and thus should proceed incrementally. Linking with foreign jurisdictions only will make the system more complicated for the State and for stakeholders.

- Stakeholders and regulated parties are expressing serious concerns about holding and purchase limits, allowance allocation and the availability of offsets to minimize the costs of allowances. CARB may wish to amend the regulation in the future to adjust to market problems, yet not have freedom to act unilaterally if the program is linked with Québec.

- Current and future litigation about important elements of the program could also upset timing and execution, and resolution will be complicated if California must include foreign governments in negotiations. Involving another jurisdiction in our program could seriously limit flexibility to make needed adjustments in the program.

  Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-15. Comment: Finally, the linking process has imposed a considerable administrative burden on ARB staff. We are concerned that this burden has resulted in a diversion of limited resources away from key priorities such as auction preparation and modeling, offset protocol development, accreditation of third-party offset registries and fixing program flaws identified by industry and other groups such as Legislative Analyst's Office. Indeed, we understand that, contrary to prior statements made to us by staff, ARB will not have an opportunity to run another rulemaking before the start of the program.

On balance, while Chevron remains steadfastly supportive of true linkage to broaden markets for cost-effective market efficiencies, it is premature to embark on a costly linkage until California's program design is completed and fully tested and additional partners or a cost-effective and efficient broader cap-and-trade market can be established. (CHEVRON)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-16. Comment: Valero has previously requested in prior comments that ARB fully develop the cap-and-trade program elements before modifying or changing the regulation. With respect to linkage with Québec, ARB posted their revised regulation for comment on May 9, 2012, while Québec was still developing revisions to their regulation. This makes it very difficult to fully assess impacts when one regulation is unavailable for review. In fact, the English translation of the revised Québec regulatory changes was not issued for review until June 11, 2012. Complicating matters was the fact that a full English translation of the entire regulation was not provided making a comprehensive review within the timeframe allowed difficult. (VALERO)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Linkage Raises Costs for California

I-17. Comment: SCPPA understands the ARB's view that not all of the provisions of the linked programs need to be identical in order for linking to be successful. However, certain features of the two programs, discussed in sections V.A to V.C below, should be reviewed and harmonized to ensure that linking Québec's program to California's will mitigate rather than exacerbate allowance prices.

The ARB should be careful to ensure that Québec's cap-and-trade program will not contain features that would counter productively result in an increase in the cost of allowances, thereby negating the principal benefit—cost containment—that can be obtained through linkage. A key part of this is ensuring that Québec's program is not so short of opportunities to reduce GHG emissions that covered entities in Québec would rely on California disproportionately to generate emissions reductions, potentially causing allowance prices to be higher than they would be if California were not linked to Québec's program.

As a related issue, California should be careful to ensure that the cap set by Québec is not more stringent than California's cap. Linking to jurisdictions with more stringent caps would tighten the market for allowances in the linked jurisdictions, driving up allowance prices. Some studies (for example the Barclays study in February 2012) have indicated that allowance prices may increase due to linking because Québec is expected to be a net buyer of allowances. SCPPA requests the release of data and analyses to support statements made by ARB staff that the California and Québec caps are equally stringent and that linking will have no discernible effect on prices. (SCPPA1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-18. Comment: The ARB staff has indicated that it was not considered crucial to harmonize the prices of allowances in California's and Québec's cost containment reserves, as each jurisdiction is independently establishing a reserve and entities will only be able to access the reserve in their own jurisdiction. However, reserve prices function as a soft cap on the price of allowances. Thus, differences between the reserve prices in each jurisdiction are likely to affect the unified allowance market. If the administratively established prices for allowances in Québec's cost containment reserve escalate more rapidly than the administratively established prices for allowances in California's allowance price containment reserve, Québec could put pressure on prices in the unified allowance market, forcing more reliance by California covered entities on the California allowance price containment reserve than would occur otherwise. This could occur despite the fact that entities registered in Québec will be unable to access California's reserve directly. Thus, the rate of escalation of the prices for reserve allowances should be harmonized.

Section 95913(e)(3) of the CA Regulation and section 58 of Québec's regulation set the same initial prices for allowances in the allowance reserves (although in different currencies): $40 per allowance for allowances from the first tier, $45 per allowance for allowances from the second tier, and $50 per allowance for allowances from the third tier. The rate of escalation of allowance prices is set at five percent annually plus the rate of inflation. However, the currencies will fluctuate, and the rates of inflation will differ in California and Québec. If currency and inflation fluctuations cause Québec reserve allowances to become more expensive than California's, there may be less demand for allowances from Québec's reserve and greater demand for California allowances which are likely to remain capped at the California reserve prices (at least until the California reserve becomes depleted).

SCPPA suggests that the prices of allowances from the California and Québec reserves be harmonized by providing that the prices be the lower of the prices that would otherwise apply under the California and Québec regulations. (SCPPA1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-19. (Multiple comments): As noted above, one of the key purposes of linking to other cap-and-trade programs is to reduce the cost of compliance. However, one of the changes in the CA Regulation that was included to facilitate linking may instead increase the floor price of allowances at auction ("auction reserve price").

Section 95911(c)(1) of the CA Regulation sets the auction reserve price at $10 per metric ton for allowances auctioned in 2012. In subsequent years, the auction reserve price will be the higher of the prices established under the Québec and California programs. The Québec and California prices may differ due to differences in inflation rates and currency fluctuations.

Rather than choosing the higher of the two prices, which may result in increasing the floor price above what it would be in the absence of linking, the auction reserve price should be the lower of the two prices. Section 95911(c)(3)(E) of the CA Regulation should be revised as follows:

> (E) The auction administrator will use the announced exchange rate to convert to a common currency the Auction Reserve Prices previously calculated separately in U.S. and Canadian dollars. The auction administrator will set the Auction Reserve Price equal to the lower~~higher~~ of the two values.

See also the comments on the level of the auction reserve price in SCPPA's submission on the non-linking changes to the CA Regulation proposed on May 11, 2012. (SCPPA1)

Comment: As noted by CARB at a July 27, 2009 workshop, a purpose to link is to reduce overall greenhouse gas emission abatement costs by allowing emitters to choose lower cost reductions in one program instead of higher cost reductions in the other program. But a recent study by the WCI suggests that Québec's greenhouse gas reductions are much more expensive than California's partly due to the large amount of hydroelectric power in the Province. Assuming that three-fourths of allowable offsets are available for the market, the study finds that in 2013 a Québec-only program will see prices of $37/mt and that a California-only program would yield $17/mt. The analysis projected prices of $19/metric tonne (mt) in 2013 in a joint Québec/California program scenario. It appears that overall lower abatement costs for the linked California/Québec program would be achieved by the decision to link with Québec. However it also means a higher cost for California facilities when compared to a California-only program. In CARB's initial statement of reasons (ISOR) for the linking regulation, CARB even goes as far as saying that increasing the price of allowances is good for California business, because it allows them to invest in more expensive (but now "cost-effective") emission reductions that they can sell to Québec. This logic has two huge flaws:

1) In California, it takes years to get emission reduction projects from concept to permit to construction to operation. Facilities in California would have to have projects well underway right now in order to have excess emissions to sell to Québec within the 2020 timeframe. Does CARB know of such a scheduled project?
2) California's cap-and-trade program is 6 times as large as Québec (ISOR – page 85) making California's need for reductions and offsets much greater than Québec's. However, according to the WCI study, since Québec's price of carbon is over twice as large as California, linking with Québec will only make the cost of offsets higher as Québec industry will have twice the incentive to go after the limited number of offsets, thereby increasing the cost of offsets. Thus from a California facility standpoint, linking with Québec with a small cap-and-trade program and a higher carbon price is a lose/lose proposition—higher cost for offsets and higher cost for emission reductions. (AB32IG)

Comment: We also expressed concern about the potentially adverse impact Linkage could have on California allowance prices. A WCI study projected a potentially negative impact. The Board, as we just heard, will now defer the linkage issue in light of the passage of SB 118. SCPPA urges the Board to take its comments on linkage into account when it gets to the point on whether to link or not. (SCPPA2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-20. Comment: At this stage, when realistically there are no other viable WCI partners to enable a broader, more liquid, efficient market, it is unreasonable to take on a partner that will increase the costs of the market to California. The economics study done by the Western Climate Initiative (WCI) shows that the linkage and administrative design rules proposed in the regulation will have significant negative impacts on the California economy. The estimated impact will be an increase in allowance prices of $2.00 in 2013 rising to $4.00 in 2020. This is a significant increase which will increase the competitive disadvantages faced by California's business sector, electrical generators, and ultimately residents. (CHEVRON)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Linkage is Too Complicated

I-21. (multiple comments): In addition to being premature, the proposed method of linking is needlessly complicated. A joint auction between jurisdictions is not a requirement for linkage and in this case will only serve to complicate and increase the potential costs of the California program. California could take a simpler approach by accepting the allowances from a larger and already mature climate change program - the European Union Emissions Trading System (EU ETS), which would represent a truly broad and efficient market. California could recognize the allowances of the EU without the lengthy, restrictive process required by a joint auction. (CHEVRON)

Comment: Simpler approaches to linkage and market administration would better serve the state and the goals of AB 32. It is preferable to develop this program in a way that helps create a well functioning market with reasonable administrative rules that is able to continually expand through additional linkages. This can be done without complex matching rules and without a coordinated auction by meeting only two criteria: 1. each system has a robust mechanism to ensure that a ton is a ton; 2. Accepting allowances and offsets from the other program (even with the inclusion of limitation on such use by individual emitters). We believe this best fulfills the promise of AB 32. (CHEVRON)

Comment: WSPA has supported market-based approaches in the past and we continue to do so.

We understood that linkage was intended to reinforce the Cap and Trade Program as the market-based approach chosen by the ARB. So it's somewhat disappointing that many of our comments that we submitted in March and again in April appeared not to have been included in the recent staff proposals.

For example, the proposed linkage provisions are neither simple nor supportive of the cap and trade effort. Instead, it makes things harder. It's simply not linkage to a broader market and not a way to make compliance easier and less costly. So it's good that additional work on linkage is contemplated. (WSPA2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Québec and California Programs Are not Sufficiently Similar

I-22. (multiple comments): In ARB staffs Initial Statement of Reasons ("ISOR") dated May 9, 2012, ARB comments that "(l)inking the two programs would result in equitable treatment for covered entities in both jurisdictions". However, ARB goes on to comment that "the regulations in Québec are not as detailed as those in California in some respects, however staff's evaluation is that the end result of each regulation will be substantially similar. Staff believes that the minor differences identified between the two programs will not adversely impact the environmental integrity of a linked cap-and-trade program".

Valero believes the differences between the two programs are more than minor. The California program is significantly more onerous than the Québec program and opens the door for inconsistencies in how the regulation is administered. This could ultimately affect California program participants by requiring compliance with more prescriptive requirements and allow Québec more flexibility in how regulated parties are treated. There are also substantive differences between the two programs that clearly show the programs are not "substantially similar". For example, there are inconsistencies in the refining units that are regulated under the two programs and it is not clear what the limitations are regarding emission credit trading from specific sources.

The California cap-and-trade regulation places significantly more constraints on regulated parties through the inclusion of hundreds of more defined terms which ultimately establishes the basis and intent of what and how California intends to regulate entities. For example, the California regulation has 288 defined terms while the Québec regulation has 15. The Québec program does not include a definition for "offset verification" where the California regulation does, which highlights the differences in the Québec program and the ability to demonstrate that the two programs will ensure equitable treatment of regulated entities. It seems improbable that consistency between the two programs is possible when the fundamental element to define regulatory scope, i.e. definitions, is so blatantly different. (VALERO)

Comment: The additional liquidity and market power mitigation that could come from partnering with western states is a strong rationale for the Western Climate Initiative. But only Québec is ready to join and is very small compared to California. The small size of Québec would not significantly enhance liquidity or reduce concerns about market power.

In the proposed linkage regulation, [II Summary of Proposed Action] CARB states that, "California will only consider linking our cap-and-trade program with other programs of similar scope and stringency—that is programs of equal rigor in their environmental integrity." It is clear that this test has not been met. California will be regulating more than 300 industries while Québec only has 80 regulated industries. Québec does not compete with, nor does Québec engage in a significant amount of trading with California. As of 2011, the population of Québec is 7,903,001 and the major industries of Québec are farming, lumbering, mining, and fur trapping. California has a population of 37,691,912 and, prior to the recession, used to be the nation's leading industrial state, claiming the number one position in almost every general manufacturing category: number of establishments, number of employees, total payroll, value added by manufacture, value of shipments, and new capital spending.

Imposing a cap-and-trade compliance obligation on Québec does not protect any California industry from competitive pressures. The leakage prevention value of linking with Québec is nil. (AB32IG)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Insufficient Time to Review Québec Program

I-23. (Multiple Comments):

- CARB's regulations preclude California from linking with Québec until CARB—and the public—have had the opportunity to review proposed linkage regulations from Québec. Québec only just issued draft linkage amendments within the last two-and-a-half weeks, and the 60-day comment period on those proposed amendments has only just begun. A preliminary review of these proposed amendments, moreover, suggests that they are even less developed than CARB's proposed amendments.

- Approving linkage under these circumstances would not only be imprudent, it would violate CARB's own regulations, see C/T Reg. § 95941, requiring opportunity for full public notice of and comment on linkage with an external jurisdiction. CARB cannot fulfill this obligation if the full picture of the linkage relationship is not available to the public. Linkage would also violate the WCI's Program Design, which requires that each partner jurisdiction have full opportunity to review a linking jurisdiction's program prior to linkage. See WCI Program Design at 22. Recognizing these crucial transparency problems, the California Legislature has proposed legislation requiring independent review of any linkage regulations by the Attorney General and Governor (AB 1478). This underscores the need for CARB to proceed cautiously before any finalization takes place.

- In addition, California's proposed linkage regulations have key gaps—enforcement mechanisms, specification of which precise Québec compliance instruments California will accept, whether allowance reserves will be pooled or separate—which can only be assessed with full documentation of the proposed linkage from both California and Québec.

- CARB should not deny the public the notice and comment provided for in the regulation and otherwise should make sure that CARB and the public are fully aware and understanding of the full nature of the linkage relationship before committing to link with Québec. (AB32IG)

Comment: I'm a policy advocate for the Chamber. However, today, I'm also speaking on behalf of the AB 32 Implementation Group. IG is a business and taxpayer coalition working for AB 32 policies that will achieve the goals of AB 32, while protecting the economy and jobs.

We are pleased to hear that the Board will be taking action pursuant to the budget trailer bill language directive of 1478 as it relates to linkage. The IG submitted extensive comments which we hope you will take into consideration. Several of these comments have been expressed by several of the other speakers already.

However, briefly, we are opposed to the linkage today because of the following reasons:

There has not been sufficient opportunity to review and comment on the Québec regulation. There are no sufficient benefits, rather, to linkage and there remain a myriad of unanswered questions and potential problems with California's yet to be started market. Québec's auditor in general has found serious flaws with the integrity of the systems to measure carbon emissions to the point of calling the measurements arbitrary. And finally, linkage with Québec without first assuring the market functions properly and market manipulation protections actually work poses new and unnecessary risk and complications.

We hope that CARB will move toward making reasonable rational changes to the leakage regulation to make it more cost effective, beneficial, and administratively workable. We look forward to working with CARB going forward. And thank you so much for the opportunity today. (CALCHAMBER)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Linking Propagates Flawed Market Policies

I-24. (Multiple comments): Québec has followed the WCI design and California regulations closely in preparing its own program. As a result, the Québec program contains a number of market design flaws that are identical to those of California. A prime example is the holding limit which will remove from the California market a quantity of allowances in excess of the entire amount of GHG allowances contained in the Québec program.

<u>Recommendation:</u> WSPA recommends simpler linkage approaches that would not require detailed market harmonization and that would facilitate linkage with Québec and other programs as well. (WSPA1)

Comment: Chevron is concerned that linking will be used by ARB or otherwise requires ARB to keep or even introduce market design flaws in California. Indeed, in this rulemaking, staff has explained that its amendment to the holding limits applicable to future vintage years results from “WCI discussions”. This amounts to the prioritization of a future hypothetical market’s interests over the current need to promote efficiency and liquidity in the California market. Chevron has already communicated its serious concerns that the current market design does not adequately mitigate the risk of market power and market abuse. Specifically, Chevron has introduced documents in the record describing how experiences in other markets demonstrate that frequent auctions are the best policy tool to address market power and that the current holding limit (without an exception for large compliance entities) will result in a liquidity crunch. Chevron is disappointed with the lack of attention to these materials and best interests of the California market. As the current leader in Cap-and-Trade development in the WCI, California should set the standard for sound market practices rather than accommodate the flawed market policies of other members.

Not only are flawed market policies such as the holding limit problematic for the participants in both jurisdictions, these overly restrictive policies will lead to higher costs. Holding limits decrease liquidity by creating a barrier to entry for the voluntary market participants (e.g., market makers, investors) and restricting the availability of allowances on the market. Illiquid markets do not benefit the overall environmental goals of the program. High costs will chill other markets' interest in linking with California. Chevron also objects to the change to the holding limit in the new program amendments, which would effectively create separate holding limits for each vintage year, creating additional structural obstacles to the satisfaction of Chevron's compliance obligation.

Because changes to the joint market will require changes to both Québec and California policies, linkage to Québec will result in unreasonable new hurdles to modify flawed market policies. We propose that simpler approaches using minimum criteria rather than a combined market are better for all. Linkage can be pursued using the minimum harmonization criteria necessary for all parties to have confidence that the reductions represent real reductions and that reductions will be made to the same level in each partner's market (i.e., the caps are equivalent). (CHEVRON)

Comment: Québec may not be ready to link with California. Recently, in an annual report, Michael Samson, the Canadian province's acting Auditor General, said Québec's greenhouse gas reporting data has been erratic to the point where it won't be clear whether it has achieved the reduction target set out in its 2006–2012 Climate Action Plan. Samson said the Province too often relies on reporting that is "anecdotal" and cannot be verified, and said new policies are needed." While California's program has gone to extremes and at a high cost to the state and industry to get a very accurate verified emissions inventory, yet Canada's own Auditor General is placing doubt on the program in Québec. Wouldn't it be more prudent and in the best interests of California employers and consumers for California's regulatory agency (CARB) and elected officials to delay linking to a program that has not yet been verified? How can a ton of carbon in California be equal to a ton in Québec, when Québec does not even know how many tons are really there? Further, how can the price for that ton be legitimate, when the market will not know how many emissions there are and how many emission reductions are needed? Again, beyond the question of prudence, finalizing linkage with Québec under these circumstances would violate CARB's own public notice requirements and the WCI's pre-linkage review protocols. See C/T Reg. § 95941; WCI Program Design at 22. (AB32IG)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Support for Linkage

I-25. Comment:
When the California Legislature passed and Governor Arnold Schwarzenegger signed the Global Warming Solutions Act of 2006 (AB 32), it tasked the Air Resources Board with developing a suite of actions that were and still are urgently needed to protect the health and welfare of California citizens in the face of impending global climate change. Since 2006, the science on climate change has only become clearer—GHG emissions threaten our way of life and increasing atmospheric concentrations of anthropogenic CO_2 and other GHGs are already showing signs of having adverse impacts, including here in California.

Since EDF and NRDC originally co-sponsored AB 32 in 2006, we have worked diligently to assist with implementation of the bill and have provided detailed comments throughout the development of the cap-and-trade regulation. EDF and NRDC's comments and participation in this process are rooted in the belief that reducing GHG emissions is of paramount importance to public health and welfare and can be achieved in a manner that will help our economy prosper.

Linking California's program has the potential to be just one of many elements of the overall AB 32 program that allows California to achieve its GHG emissions reduction targets cost-effectively. We applaud CARB on its tremendous efforts to-date in developing a state-of-the-art blueprint to reduce GHG emissions under the AB 32 Scoping Plan that will benefit Californians for generations to come. In this same vein, if CARB determines that Québec's program meets California's stringent standards, and if authorities in Québec make the corresponding determination about California's program, linking via mutual recognition could provide additional flexibility and cost-saving opportunities for regulated entities in both California and Québec, thus improving the overall effectiveness of each jurisdiction's cap-and-trade program.

EDF and NRDC recognize that if after making such a determination, California is going to effectively offer the benefits of linking to its stakeholders, certain (though not all) elements of the California and Québec programs will need to be harmonized. EDF and NRDC agree with CARB that joint auctions, a shared compliance instrument tracking system, and equivalent holding limits are among the programmatic elements that should be harmonized to allow California entities better access to the market of fungible compliance instruments and will enhance the integrity of both programs. WCI, Inc.—which was created as a not-for-profit organization in November, 2011—will also allow WCI participants to avoid duplicative efforts and achieve cost-savings by carrying out logistical, administrative tasks for all participants that would have been completed by an independent contractor if WCI, Inc. did not exist. Of course, California will retain its full suite of enforcement tools, ensuring that it can exert full authority over regulated entities doing business in California. (EDF1)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-26. (Multiple comments): EDF and NRDC also want to commend CARB for its participation in the WCI. By joining WCI, California recognized that climate change is a global challenge and that emissions must be reduced quickly and effectively worldwide in order to avoid the most devastating impacts of climate change. As a state, California can best work towards this goal by designing and implementing a strong program that demonstrates to other global actors that reductions are achievable. The WCI coalesced as a group of likeminded states and provinces, brought together by their shared sense of the urgent need to reduce GHG emissions. The WCI provided a platform for these states and provinces to share information and discuss best practices for reducing emissions. Because of WCI's role as an information portal, California and Québec ended up on parallel tracks with cap-and-trade programs that are similar enough that linking the programs is possible and could result in many benefits to each jurisdiction.

CARB has provided a key resource to California stakeholders by publishing relevant information about regulated entities under the California program such as name, location, historical emissions and economic sector; we recommend that the same is provided for sources within Québec's program. Overall, EDF and NRDC see tremendous benefits and potential in assessing the possibility of linking with Québec and future jurisdictions that meet the stringency of California's program. (EDF1)

Comment: Finally, we appreciate CARB's commitment to transparency by publishing relevant information about regulated entities under the California program such as name, location, historical emissions and economic sector. We recommend that the same information be provided for entities within Québec in an easy to access location.

We look forward to working with CARB as it moves forward with linking to Québec and as implementation of the cap-and-trade program continues. (EDF2)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-27. Comment: Showing that two different governments with two different economies can work together and put a price on carbon and reduce greenhouse gas emissions would be a transformative step for North America and a step that could really launch a regional effort to join the international movement that's desperately needed to address the threat of climate change and to create a prosperous and green economy.

And California has been vigilant in designing the most rigorous Cap-and-Trade Program so far, as we heard today in the staff report, and this is going to work with other measures targeted in the AB 32 2020 goal to make sure that's possible.

And because Québec and California have been working together through the WCI process and sharing information and best practices, they've really been on parallel tracks to create Cap-and-Trade Programs that include the central components of good design, which are mandatory reporting rules and the stringent cap and scientifically rigorous offsets and effective enforcement measures. And this makes Québec an excellent partner for California to link with at this time.

And the main thing with other jurisdictions that meet California's rigorous environmental standards can provide both economic and environmental benefits, including increasing market liquidity and broaden the emission reductions that are possible and also expanding the demand for emission reduction technology, many of which are made here in California.

And linking with Québec in particular can bring capital flows into California to increase investments in on-site emissions which can create local jobs and local emissions reductions.

For all of these reasons, Environmental Defense Fund supports the current proposal to accept compliance from linked jurisdictions and to link Québec as well, and also the other proposals to strengthen the Cap-and-Trade Program through "Know Your Customer" provisions and others. We've submitted comments on that. (EDF4)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

I-28. Comment: And we just wanted to say for the record that we support ARB's linkage with Québec. And we support this to provide a successful market model. (SEMPRA2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed.

Monitoring and Evaluation

Market Performance Monitoring

I-29. Comment: As noted above, linking increases the complexity of the cap-and-trade program. Issues with one or both programs may arise. If so, prompt action will be required to identify and address the issues to avoid negative impacts on the markets, including related markets such as the electricity market. For this reason, the CA Regulation must contain procedures for tracking the performance of each program and for monitoring and reporting on California's and Québec's markets. The flows of compliance instruments between the two jurisdictions and the trading activities of covered entities and (separately) non-covered entities should be monitored. (SCPPA1)

> **Response:** ARB takes market monitoring seriously, and staff will track allowance flows and the trading activities of covered and non-covered entities.

The same is true of market performance, which will be continually assessed. The data in the market program will be subject to close review by ARB and the market monitor. At least annually, staff will provide a Board update on the market program.

I-30. Comment: Market Simulation And Monitoring Must Include Both Jurisdictions

Market Simulation Should be Expedited and Should Include Analysis of Québec's Market and Ancillary Markets.

NCPA supports the creation of the Market Simulation Group (MSG) and encourages the simulation efforts of that group to be undertaken expeditiously, as it would be helpful to identify potential market problems in advance of CARB's first auction. The MSG should include a detailed analysis of ancillary markets that directly impact the cost of allowances in its review and analysis. Such an analysis should include the electricity market, for example, especially during the first compliance period when the electricity sector includes such a large percentage of the compliance entities participating in the market. Furthermore, the Proposed Revisions—or at a minimum guidance and direction from the Executive Officer—should include direction regarding the scope of market simulation that will include the Québec markets. As recently as the June 7, 2012 MSG Stakeholder meeting, it was not clear to what extent inputs from Québec's program would be included in the market simulations to be conducted by the MSG. While California's allowances comprise a far greater percentage of the allowance market, a realistic simulation of the entire auction cannot be conducted absent an analysis of the entire market. Direction and clarification regarding the receipt and use of information regarding the Québec market must be provided as soon as possible.

Market Monitoring Should Include Québec's Market and Related Ancillary Markets

Ongoing market monitoring is a key element in the overall program design of California's Cap-and-Trade Program. Linking with Québec—or any other partner—should not diminish the integrity of that monitoring. As California modifies its own program and makes accommodations to allow for linking with the Québec program, the role of the market monitor becomes even more important. Since linking will still essentially entail two separate jurisdictional programs, it is imperative that the market monitor also track the direct impacts of the Québec markets, and the implications of such transactions on California's market and market participants (particularly covered entities). This is especially important when one considers the fact that although the two programs adhere to a common set of principles, they are still unique in several material respects. For example, California entities are required to make an annual surrender of compliance, where the Québec regulation does not include a similar requirement. Nuances such as these that create slightly different obligations for compliance entities between the two jurisdictions must be closely monitored and tracked. (NCPA)

Response: Staff agrees in general with this comment. ARB staff, the market monitor, and the Market Surveillance Committee will carefully monitor the market.

The Market Surveillance Group's analysis will potentially inform on future regulatory amendments. The Board did not act on linkage, so no further response is necessary.

I-31. Comment: Section 95921(e): The ARB's Regulations Should Signal the Intent and Principles for Market Performance and Market Data Publication to Design Data Publication Rules Outside of the Regulation

Section 95921(e) addresses the protection and release of confidential information. Given the potential consequences to the allowance market and electricity markets if confidential information is mishandled, SCE strongly supports the protection of confidential information by the Executive Officer and accounts administrator. Still, publishing some public data is necessary to augment external monitoring efforts and to discourage market participants from manipulative positions. The ARB should revise its regulation to indicate its intent to publicly release appropriate transaction data and outline the intent, goals, and principles for data publication.

Along with the ARB's market monitor and stakeholders, the ARB can create business process documents outside of the regulation to establish the exact processes for data publication.

SCE recommends that the ARB hold a workshop to solicit input on data publication structures and consult its Independent Market Monitor and Market Surveillance Committee on the issue. SCE cautions the ARB, however, that releasing all transaction data would expose parties' cap-and-trade procurement or strategies and positions, for which confidentiality can be crucial. To this end, SCE suggests that the ARB delete Section 95921(e)(4), which would expose compliance entities' compliance account holdings. SCE also recommends that the ARB exercise sensitivity with respect to releasing transfer price and quantity data under Section 95921(e)(1). Ensuring an appropriate level of transparency is of the utmost importance and should be discussed thoroughly with stakeholders as the ARB and its market monitor develop data publication protocols outside of the regulation. (SCE1)

Response: The suggestion to change the reporting of information on compliance accounts (section 95921(e)(4) is outside the scope of the proposed changes, so no response is required.

Staff appreciates the commenter's concerns with the implications of releasing market information. ARB intends to discuss the issue with both the market monitor and the Market Surveillance Committee. ARB has existing policies on confidentiality and incompatible activities that are based on the Government Code and will govern staff handling of confidential material.

Linkage Review Criteria

I-31. (multiple comments): In the coming months, we also urge CARB to clearly identify the criteria it will use to evaluate the stringency of other programs whose compliance instruments it will consider recognizing. These criteria should include, at a minimum, core programmatic elements such as: the stringency of the cap, the reliability of mandatory reporting requirements, the stringency of offset protocols, limits on borrowing, and the adequacy of penalty and enforcement mechanisms. By developing these criteria through a public process, CARB can ensure that California stakeholders have confidence that linking, or mutual recognition of compliance instruments, will be in the best interests of California and further the goals of AB 32. (EDF1)

Comment: Develop criteria and/or a methodology for evaluating other jurisdictions' programs to assess whether or not they are of similar enough structure and rigor to warrant linking with California's program. (PFT1)

Comment: We're generally supportive of linking with Québec and linking with other jurisdictions as those opportunities arise. But we think that it would serve the Board well to establish a process and criteria for evaluating these other jurisdictions as they want to link with California. So it's not a new free-standing evaluation each time, but there are some guide posts to measure against. Staff has done that in the case. But as additional opportunities arise in the future, I think having some consistency to how different opportunities are evaluated would be very beneficial.

Additionally, as these other jurisdictions are adopting offset protocols, I think it would be very useful for ARB to again have a guidance document, a process for independently evaluating those offset protocols that are adopted in other jurisdictions to make absolutely sure that they meet the criteria of AB 32 and any other applicable California standards, rather than just letting them come into the system because another jurisdiction has approved them. I think it behooves to the Board to retain a little more oversight over the compliance instruments that we use in our system.

So those are areas that I think—I'm not sure what the best mechanism is at this point in terms of 15-day changes or additional language in the resolution or guidance documents from the staff. But those are two areas that I think would be very beneficial to further clarify with additional linkages in the future. (PFT2)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

Delinking Provisions

I-32. (Multiple comments): Also, the CA Regulation should contain provision for delinking in specified circumstances. However, to provide certainty to the market, the delinking provisions must explicitly allow California entities to continue using Québec allowances (which will not be identifiable as such by market participants) that have already been issued for compliance after delinking. (SCPPA1)

Comment: SCE previously identified “de-linking” as an issue for consideration when developing the linkage rules and recommended that the ARB clearly outline the process for addressing changes to either cap-and-trade program that could potentially affect linkage. For example, SCE asked how a covered entity would manage its allowance holdings from a linked jurisdiction in the case of delinking. For example, in order to incorporate the risk of linkage failure (and consequently losing allowance value), market participants in California might trade allowances from Québec at a discount to California allowances. In that case, the two systems would never truly be linked and the allowances would not be truly fungible. In the ISOR, the ARB staff briefly addressed this issue and noted that regulatory action would be needed for de-linking. ARB staff also correctly noted that although staff “cannot pre-suppose Board action,” they “expect that previously-issued Québec compliance instruments would continue to be eligible for use in the California program.” While this statement is encouraging, it will not provide sufficient certainty to market participants. Further, in such a situation, the California GHG compliance market would be oversupplied and the State would not achieve the reductions envisioned under the cap-and-trade program. Instead, well-developed rulemaking language must be included in the regulation in order to reduce the likelihood of market participants discounting the price of allowances to account for the risk of delinking.

Similarly, Section 95920(d) adjusts holding limits to account for linkage with Québec. If linkage does occur, SCE supports this modification to allow covered entities necessary flexibility. It is unclear, however, what would happen to entities whose holdings reach the new holding limit if California and Québec were to de-link. Would these entities be forced to divest the allowances that exceed the previous California-only holding limits? (SCE1)

Comment: Issues and uncertainties relating to the proposed C/T program continue to cloud the near-term (and perhaps longer-term) future. Until such time as policies, procedures, and requirements etc., become finalized, uncertainties about how the C/T program will function will continue to grow. For example, questions such as what happens to allowance values if either program is delayed/changed/stopped due to legal issues continue to remain unresolved.

Additionally, Québec’s proposed linkage regulation is still uncertain and is not anticipated to be adopted until fall of 2012. The Initial Statement of Reasons (ISOR) identifies several differences between the California and Québec programs, such as the offset programs, GHG measurement accuracy and missing data substitution procedures.

In light of these regulatory uncertainties, it is vital for ARB to provide assurance and certainty for businesses to encourage the establishment of a working market.

Recommendation: WSPA recommends that ARB's linkage program should clearly define contingency plans to address stranded costs if linkage with the C/T program in other regions is unsuccessful. (WSPA1)

Comment: The Regulation Should Include a Fail-Safe Provision for Delinking Finally, NCPA continues to urge CARB to review the potential inclusion of a provision that would allow for an expedited end to linking with any currently active partner jurisdiction in the event that certain triggers occur. The entities responsible for market surveillance and monitoring could outline a list of factors that, in a "perfect storm" situation, would result in irreparable harm to the California program. The factors would be well defined and clearly articulated at the onset of linking, so that all affected stakeholders—covered entities, third party marketers, government agencies, and interested parties—would be apprised in advance of what circumstances may lead to delinking. In the event of such an occurrence, the Executive Director would have the ability to immediately temporarily suspend the linked portion of the program to avoid harm to California markets and compliance entities, until such time as the full Board could review the situation and take any necessary actions. (NCPA)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

Greater Transparency Needed

I-33. Comment: Linking with other jurisdictions appears to lead the ARB to rely on private entities, in particular WCI, Inc., and indeed to delegate some authority regarding the operation of the cap-and- trade program to that entity. This causes concern because WCI, Inc., unlike the ARB itself, does not operate in a publicly-accountable manner. SCPPA recognizes that as a private Delaware corporation WCI, Inc., is not subject to the "sunshine laws" that apply to public entities in California. However, SCPPA requests the ARB to ask WCI, Inc., to consider operating as if those laws did apply to it—for example, by providing notice of its meetings at which cap-and-trade operational issues will be decided and by allowing public attendance and input at those meetings. Information on the method by which WCI, Inc., will resolve disputes regarding the operation of the cap-and-trade program should also be provided.

Furthermore, the voting power of each participating jurisdiction on the WCI board should be commensurate with that jurisdiction's share of the total emissions covered by the linked cap-and-trade programs. Others share these concerns regarding WCI, Inc. The California Senate Budget Subcommittee No. 2 recommended on May 23, 2012, that provisions be included in the 2012 budget trailer bills to restrict California funding and staffing of WCI, Inc. (SCPPA1)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

I-34. Comment: In the ISOR, ARB states that "(t)he decision to propose linkage of the California and Québec cap-and-trade programs followed extensive discussions between California staff and Québec staff on the harmonization of regulatory provisions. In these discussions, staff considered which items must be identical, which need to be consistent, and which could be different in a linked program. Staff of the jurisdictions each concluded that the remaining differences would not adversely affect the efficiency or equity in a regional program". ARB should have fully engaged regulated parties in better reviewing and defining what regulatory program elements should be equivalent between the two programs. In addition, the involvement of the Western Climate Initiative ("WCI"), which Valero has previously commented on the lack of transparency in the WCI process, makes the linking process between jurisdictions a "below the radar" activity in which stakeholders have neither knowledge in, nor input to, the process. (VALERO)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

Effect of Linkage on ARB's Authority

I-35. Comment: The ARB must consider how international linkage may affect the appropriate regulator for the allowance trading market. Because the ARB is conducting an auction with international and interstate participants, it may need to consider the intrusion upon, and potential dilution of, its regulatory authority over the primary market auction. If allowances and offsets are eventually considered commodities by federal regulators, then many (or in some cases, all) GHG transactions could fall within the reach of the federal Commodities Exchange Act's ("CEA's") statutory provisions, the Commodities Futures Trading Commission ("CFTC") (the jurisdiction of the agency charged with enforcing the CEA), or the California Commodities laws embodied in California Corporations Code Sections 29500, et seq. If some compliance instrument-related products are deemed securities, the ARB could be exempt from the issuer requirements of federal and state securities laws. However, because it will be offering allowances issued by Québec in its auction, it could be considered a broker-dealer with respect to those allowances and could be subject to federal, state, and international trade laws, such as the North American Free Trade Agreement ("NAFTA"), governing broker-dealers, as well as antifraud and price manipulation laws for commodities and securities. (SCE1)

Response: As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

J. CHANGES TO AUCTIONS AND RESERVE SALES RELATED TO LINKAGE

J-1. Comment: The ARB Should Carefully Consider the Effect on the Developing Allowance Market of the Revised Auction Format Provisions in Sections 95911 and 95912

In Sections 95911 and 95912 of the new Proposed Regulation Order for Linkage, the ARB has substantially revised the format for the auction of California allowances. Below, SCE provides its comments on the amended language.

1. **Section 95911(c)(3): To Avoid Penalizing Compliance Entities in Jurisdictions with Weaker Currencies, the ARB Should Set the Auction Reserve Price in One Currency Only**

Section 95911(c) of the Proposed Regulation Order for Linkage contains new language setting the Auction Reserve Price and accounting for linked jurisdictions. Section 95911(c)(3), which links the price floors of the two jurisdictions, could dramatically affect floor prices and consequently the allowance market. The revised Section 95911(c)(3) provides:

(A) The Auction Reserve Price in U.S. dollars shall be the U.S. dollar Auction Reserve Price for the **previous calendar year** increased annually by 5 percent plus the rate of inflation as measured by the most recently available twelve months of the Consumer Price Index for All Urban Consumers.
(B) […]
(C) The auction administrator shall set the exchange rate as the most recently available noon daily buying rate for U.S. and Canadian Dollars as published by the Bank of Canada, and shall announce the exchange rate prior to the opening of the auction window.
(D) The Auction Reserve Price in Canadian dollars shall be the Canadian Dollar Auction Reserve Price for the **previous calendar year** increased annually by 5 percent [. . .]
(E) The auction administrator will use the announced exchange rate to convert to a common currency the Auction Reserve Price previously calculated separately in U.S. and Canadian dollars. The auction administrator will set the Auction Reserve Price **equal to the higher of the two values**.

This method could penalize unnecessarily the jurisdiction with the weaker currency. For example, if one of the two currencies were to continually weaken, the weaker currency's price floor in the native denomination will be much higher than it would have been. Such weakening is not theoretical; the U.S. dollar has systematically weakened compared to the Canadian dollar over the past ten years. If such a trend continues, the compliance entities in the jurisdiction with the weaker currency would face much higher compliance costs simply because they would be subjected to a much higher floor price.

Moreover, the price floor could increase significantly with linked price floors than in a

California-only market. The ARB is relying on the concept of purchasing power parity, a theoretical relationship between inflation rates and currency exchange rates, with no guarantee that such a relationship would hold in practice. Even a 10% variance in allowance prices away from the price floor (without adjustments for the currency exchange) could result in a sizeable increase in compliance costs. If a theoretical relationship between inflation and exchange rates were to hold, there would be no need to mandate currency update in the regulation.

SCE suggests that the ARB modify Section 95911(c)(3)(E) to set the Auction Reserve Price in one currency only, and adjust the floor price by 5% plus inflation when applying it to the joint auction. When one currency appreciates more than a second, the first currency will have more purchasing power, with or without price floors. As with other commodities, the ARB should allow each buyer and seller to assume foreign currency risk. SCE opposes linking price floors, which would create, rather than prevent, market distortions. (SCE1)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

J-2. Comment: Section 95911(e): Settling Tie Bids in a Proportional Manner is Efficient and Fair

Section 95911(e)(5) contains updates to the bid settlement language that would allow tie bids to be settled in a proportional manner. Previously, the regulation resolved tie bids by assigning random numbers to bundles of allowances at each bid price. SCE supports the proposed approach as efficient and fair. (SCE1)

> **Response:** Thank you for the support.

J-3. Comment: 3. Section 95912(i)(2): The ARB Should Clarify the Language Describing the Amount of the Bid Guarantee

Section 95912(i)(2) of the Proposed Regulation Order for Linkage describes the minimum amount for each auction participant's bid guarantee. While the language in this section was fairly straightforward in the Final Regulation Order, the revised language in the Proposed Regulation Order for Linkage is overly complex and confusing. SCE recommends rejecting these proposed modifications and preserving the language of the Final Regulation Order stating that "the amount of the bid guarantee must be greater than or equal to the sum of the value of the bids submitted by the auction participant." (SCE1)

> **Response:** Staff disagrees with the comment. The change was made from the original regulation because the maximum value of a set of bids in a single-price auction is not equal to the simple sum of the value of the bids submitted. The process used is the same as in the RGGI.

J-4. Comment: California Participants Should Not Be Subject To Devaluation Of The U.S. Dollar

Some of the most extensive revisions to the California regulation must address auction protocols and the need to reconcile the use of two different currencies in a single auction. One such amendment is section 95911(c)(3) regarding calculation of the Auction Reserve Price. NCPA remains concerned that the provisions of section 95911(c)(3)(D) that provide for the Auction Reserve Price to be based on the higher of the two values could result in the potential devaluation of the U.S. dollar vis-à-vis the Canadian dollar. Before finalizing the proposed amendments, CARB Staff should look closely at the potential impacts and unintended market consequences that could result and explore options and alternatives that may address such consequences in a fair and non-discriminatory manner. (NCPA)

> **Response:** As noted in the introduction, the Board did not take any action on the linkage amendments. No further response is needed, as the linkage regulations are outside the scope of these regulatory changes.

K. COMMENTS UNRELATED TO THE AMENDED REGULATION

Typographical Errors

K-1. **Comment:** Section 95920(f)(3) refers to entities that are part of a direct corporate association that choose to opt out of account consolidation pursuant to section 95833(e)(3). The provision on opting out of account consolidation is section 95833(f)(3), not (e)(3). This cross-reference should be corrected. (Note however SCPPA's comments on section 95833(f) of the Regulation, in section VI.B above, which if adopted would result in a change to the numbering of section 95833.) (SCPPA1)

> **Response:** Staff agrees that there is a typographical error in the reference and staff has corrected the error.

System Readiness

K-2. Comment: SCPPA is concerned that there remains much work to be done before the cap and trade allowance transfer system and auction platform will be ready for a successful auction in November 2012. In particular, concerns have arisen regarding software development, the ability to undertake thorough testing of the systems and user training, and ensuring the market is secure. ARB staff have been unable to state whether the software will be able to support certain desirable features such as 24/7 access to the tracking system and instant updating of holding limits. Dates for stakeholder testing of, and training on, elements of the tracking and transfer system have been delayed repeatedly, and it is unclear whether the practice auction scheduled for August 2012 will provide a thorough test of all elements of the auction, including the consignment of allowances.

SCPPA welcomes the establishment of the Market Simulation Group with the University of California Energy Institute. However, statements made at the first meeting of that group on June 7, 2012, indicate that results from its modeling and simulation work will not be available until just prior to the first auction in November 2012. This may be too late to correct any issues that are identified through this process.

Unless rigorous testing is undertaken, and time is allowed to correct the system if any weaknesses are identified and to properly train users of the system, there is a risk that market participants will find a way to manipulate the transfer system or the auctions to their advantage. To ensure a successful start to this ambitious program, the ARB should allocate all necessary resources to ensure that these tasks are completed before the first auction later this year. (SCPPA1)

> **Response:** No response is needed because the comment does not address any proposed changes to the regulation. However, staff is committed to ensuring a successful launch of the cap-and-trade program and is working with stakeholders through training, help desk assistance, and individually to address questions and concerns.

Practice Auction

K-3. Comment: CARB should clarify the parameters of the August 2012 practice auction in order for it to serve as a model for the first real auction of allowances in November 2012. (CALPINE1)

> **Response:** No response is needed because the comment does not address a change to the regulation. There is no mention in the existing or proposed regulation of a practice auction. However, staff intends to provide stakeholders with instructions on how to participate and which auction, financial transactions, tracking, and other systems will be activated for the practice auction.

K-4. (Multiple comments): California is taking a leadership role to address global climate change. It's critical that the State's Cap-and-Trade Program work effectively to demonstrate the value of a market-based approach. The date to go live with cap-and-trade, as Chair Nichols mentioned, is fast approaching. And while much of the policy discussions have been wrapped up, where we are focused right now is on the many details of implementation and the requirements of making this program actually work as designed.

To date, many of the important details of program implementation are yet to be formalized. SCE continues to have some serious concerns that the auction and the interactions with the various systems needed to make the program work have not been sufficiently evaluated and tested.

As of today, SCE is not confident that the auction will operate as intended without further Board direction to staff to implement some specific steps. These steps include allocating the needed resources to implement activities to engage stakeholders that ensure that the market design and the systems are fully tested prior to go live. This includes establishing a robust set of readiness criteria which, at a minimum, should include multiple test auctions. Currently, there is a test auction expected I think August 27th. Today's presentation said late August.

However, it's insufficient to have simply one. If the results of that auction don't necessarily yield any problems, it's not clear that it was broadly representative. We would like to have a second practice or test auction to make sure that those results are robust as you would like. If there is a problem that's demonstrated in that test auction, of course, you would want to implement some sort of a repair or fix and then run another practice auction.

In addition to those repeated auction design, we would like to see a more end-to-end design for this test auction which would include all elements, including the CITSS system feeding the allowances into the auction and then transferring them back into the individual regulated entity's accounts after the auction. And so right now we don't see that that's part of the design.

It's very crucial the parties are going to make million dollar investment and procurement decisions have full confidence that this mechanism is going to work as designed. We simply encourage the Board to direct staff to implement further tests and evaluations to make sure this system operates as expected. (SCE2)

Comment: The last item is somewhat echoing what SCE was commenting about with respect to practice auction. We fully support the practice auction. But we do believe that in order for the practice auction to fully prepare both ARB and the stakeholders for the first auction, we recommend that ARB proceed with the practice auction with a few key considerations in mind.

The first is completeness. We also think that the practice auction needs to be a full end to end. The current practice auction being envisioned today is close, but it's missing this kind of integration with the market tracking system. So we would like to see if that could somehow be captured in a practice.

The second is robustness under duress in that it would be really helpful to have certain scripted stress scenarios tested in a practice auction so that you can see that the infrastructure in place is able to stand strong in light of a variety of scenarios that could occur.

And then the final consideration is evaluation; to be able to have staff look at the results from this practice and make changes as needed.

So if ARB is unable to incorporate the above considerations in the practice auction, we request that ARB consider other ways to involve stakeholders in testing, et cetera. Thank you very much. (PGE2)

> **Response:** The comment is outside of the scope of the regulation and no further response is necessary. However, staff agrees that the practice auction is an important step for market readiness.

Allocations

K-5. Comment: California is currently revising cap and trade regulations to harmonize its system with the cap and trade system that is being assembled by the Province of Québec. Québec has adopted a production-based metric for the GPM industry. In keeping with the goal to harmonize these two cap and trade systems, CARB should adopt industry benchmarks that are comparable wherever possible.

We propose that CARB work with the GPM industry through the Gypsum Association to solicit and establish a new production-based emissions benchmark for gypsum board production. The units of this benchmark should not be in terms of metric tons of stucco, but should reflect a production-based metric, such as CO_2e produced per a normalized unit or volume of board footage. The GPM industry is conducting an internal data review and intends to have a proposed metric available for presentation to CARB for review and discussion in the very near future. As with the Industry Assistance Factor, the Gypsum Association would appreciate being included in the stakeholder process to evaluate industry benchmarks in 2012. (GA)

> **Response:** The comment is outside the scope of the changes to the regulation and no response is needed. However, staff can assure the commenter that staff will include stakeholders in the review of regulatory provisions related to allocation.

K-6. Comment: CHP is Critical to Meeting the GHG Emissions Reduction Goals Under AB 32

CARB should provide free allowances to CHP, which is among the most cost effective and technologically feasible sources of clean and efficient energy. As previously expressed, CHP is the concurrent production of electricity or mechanical power and useful thermal energy (heat) from a single source of energy. By capturing and utilizing heat that would otherwise be wasted, CHP is more efficient than traditional separate electricity generation and heat production, thereby using less fuel and emitting lower levels of GHG and criteria pollutants. Given these environmentally beneficial attributes, CHP lowers demand on the electricity delivery system and frequently reduces reliance on less efficient traditional energy supplies.

As described in PEB's prior comments, CHP is widely recognized as one of the most promising options in California's and the country's energy efficiency portfolio. According to the U.S. Department of Energy, "energy efficiency and renewable energy are key components of a portfolio of promising supply- and demand-side resources that can provide the Nation with clean, affordable energy and support continued economic prosperity. *CHP is first and foremost an energy efficiency resource*." Indeed, "CHP reduces the carbon footprint of separately generated heat and power, [and] *is one of the most cost-effective methods of reducing CO_2 emissions*." Likewise, the U.S. Environmental Protection Agency ("EPA") recognizes that "because CHP uses less fuel than conventional generation, it reduces GHG emissions and air pollutants," and has established the Combined Heat and Power Partnership program, which seeks to reduce the environmental impact of power generation by promoting the use of CHP nationwide. U.S. EPA describes CHP as "an efficient, clean, and reliable approach to generating power and thermal energy" that "can increase operational efficiency and decrease energy costs, *while reducing the emissions of greenhouse gases that contribute to global climate change*."

The California Public Utilities Commission ("CPUC"), the California Energy Commission, and CARB itself "*have all recognized that efficient and clean CHP can reduce GHG emissions*." Governor Brown's "Jobs for California's Future" platform also recognizes the increased efficiency of CHP, as compared to traditional industrial and power plants, and seeks to increase deployment of CHP by 6,500 MW over the next 20 years. Indeed, it is "*the policy of the state to encourage and support the development of cogeneration* as an efficient, environmentally beneficial, competitive energy resource that will enhance the reliability of local generation supply, and promote local business growth." To this end, the CPUC created the State CHP Program in 2010 to encourage the continued operation of the state's existing CHP facilities, as well as the development of new CHP Facilities, "in order to increase the diversity, reliability, and environmental benefits of the energy resources available to the State's electricity consumers."

Throughout the Cap-and-Trade Rulemaking, CARB Staff has expressed its goal of promoting "widespread development" of CHP facilities in furtherance of the state's goals of reducing GHG emissions to 1990 levels by 2020. Clearly, there is consensus among federal and California agencies, as well as the Governor's Office, that CHP offers significant environmental benefits compared to separately purchased electricity and thermal energy, and are important to reducing GHG emissions from power generation. Given these attributes and to ensure proper integration of these programs, CARB Staff should provide free allowances to those existing legacy CHP facilities, such as PEB, that are at risk of shutting down because they are unable to recover the cost of allowances under existing fixed price contracts for steam.

Further, CARB is required under AB 32 to *prevent any increase* in the emissions of toxic air contaminants or criteria air pollutants as part of the Cap-and-Trade Regulation. If CARB does not provide such relief to PEB, the facility may be forced to shut down, which would require the end user (i.e., UC-Berkeley) to operate, in the interim, older, less efficient boilers—that emit higher levels of GHG and criteria pollutants—in order to provide steam to its campus. Meanwhile, it would take several years, with no assurance of success, to site and build a new facility in the Berkeley area to replace

PEB. Thus, potentially forcing the end user to switch to higher emitting boilers is contrary to this express statutory directive and clearly at odds with the GHG emission reduction goals under AB 32. (PEB)

> **Response:** The comments are outside the scope of the proposed changes as the proposed regulation changes do not alter the allocation benchmarks. No response is needed. However, ARB understands the impacts noted in the comment and is interested in working with stakeholders to find solutions to address such concerns.

Effect on Electricity Markets

K-7. Comment: V. SCE CONTINUES TO HAVE SIGNIFICANT CONCERNS REGARDING THE TREATMENT OF ELECTRICITY IMPORTS

A. Failing to Address Out-of-State Electricity Imports Could Have a Large Distortionary Impact on the California Independent Systems Operator ("CAISO") Electricity Markets

In the cap-and-trade regulation, "imported electricity" includes "electricity delivered across balancing authority areas from a first point of receipt located outside the state of California, to the first point of delivery located inside the state of California, having a final point of delivery in California." SCE and several other parties have raised the issue of the compliance responsibility of out-of-state sellers bidding into CAISO markets at nodes that are physically located outside of California. The ARB has indicated that it believes that such sales at out-of-state interties constitute deliveries of this electricity into California, and thus these sellers will be considered "First Deliverers" and required to comply with the California cap-and-trade regulations.

The ARB must be aware that it may not be able to fully enforce this definition and the corresponding compliance framework, which in turn could have a large distortionary impact on the GHG allowance market and the electricity markets. Out-of-state electricity sellers may choose not to inform the ARB of their electricity sales into the CAISO markets at out-of-state interties. Such sellers may argue that such sales took place outside of California and therefore are not under the ARB's jurisdiction, or that the electricity was simply sold into a large pool without any predetermined California sink. They could claim that it is CAISO that brings the power into the state, and that therefore CAISO is the true importer of their electricity. Below, SCE discusses two major problems that will result and suggests immediate action that the ARB must take to address these issues.

1. The CAISO Market Will Experience Significant Distortionary Effects

If out-of-state sellers believe that they will not eventually have to bear the compliance burden for their sales and deliveries at out-of-state CAISO delivery points, they will not include GHG costs in their bids and can place much more competitive bids than in-state generation. Such actions will thwart the cap-and-trade program's goal of including an accurate GHG price signal in wholesale electricity prices. Moreover, the California electricity markets will suffer immediate and harmful effects as *seemingly* lower-cost imports (possibly from higher GHG-emitting sources) outcompete California-based generation. The resulting electricity dispatches, based on false economics, will likely cause numerous problems including the increased use of CAISO reliability backstop measures, the costs of which entities such as SCE or other stakeholders must unfairly bear. Additionally, this may reduce the dispatch of California's highly flexible generation resources, exacerbating the State's challenge to integrate renewable resources into the electricity grid.

2. The ARB May Have Difficulty Assigning an Emissions Obligation for a Large Portion of California's Imported Electricity

SCE does not suggest that potential claims by out-of-state sellers that they are not "first deliverers" are correct. But lengthy regulatory or legal action may be needed to settle these disputes, which will create tremendous uncertainty and volatility in the allowance and electricity markets. Furthermore, should these arguments prevail, the ARB will be left with a large number of import-related emissions for which no entity will take responsibility. SCE maintains that any attempt to require downstream California electrical load customers to backstop this obligation will violate the nature of a source-based cap-and-trade program and be unjust and unreasonable. Such a structure would force downstream electricity users to pay for GHG compliance twice: once in the form of higher wholesale electricity clearing prices, and again through an after-the-fact downstream cascade of compliance obligation. Meanwhile, out-of-state sellers would reap a windfall and cause lasting damage to the efficient functioning of the electricity markets in California.

3. The ARB Must Develop a Data Collection Process with Specific Provisions for Enforcement Against Out-of-State Sellers

It is imperative that these import concerns be addressed before the cap-and-trade market officially begins. SCE emphasizes that the CAISO market impacts will likely occur simply with the *speculation* that there is a loophole in the ARB's regulation, even if any official challenge is eventually defeated. This speculation already exists. To address this potential issue and to reduce speculation, SCE proposes that ARB undertake the following actions:

- <u>Initiate a process to collect the data needed to identify all imported electricity transactions within a compliance year:</u> The data should include (1) all North American Electricity Reliability Council ("NERC") E-tags created when electricity is scheduled to flow into any of the California balancing authorities, and (2) all information about all dynamically scheduled electricity and electricity scheduled over pseudo-ties connected to the California grid. The ARB should compare the collected data with the compliance entities reports and verify that all electricity reflected on the NERC E-tags is accounted for. SCE strongly recommends that the ARB immediately adopt this process and perform this exercise for 2011 data to demonstrate good faith and to proactively identify existing reporting issues. The results should be discussed at a later public meeting dedicated to this topic.

- Develop specific provisions for enforcement procedures against out-of-state sellers: SCE urges the ARB to outline its regulatory and statutory authority to enforce compliance within the mandatory reporting requirements and the cap-and-trade regulations, as well as the steps it will take to initiate enforcement actions and the potential consequences of such enforcement action. SCE suggests partnering with the CAISO in developing these regulations, in consultation with the State Attorney General.

Response: The comments are outside the scope of the regulatory amendments, so no further response is necessary.

K-8. Comment: Additional Electricity Import Issues Must Be Resolved

A number of important issues relating to electricity imports must still be addressed before the system and the market "go live." These include the definition of resource shuffling, the calculation of the QE Adjustment, and language relating to the RPS. The current regulation (and in the Proposed Regulation Order for Linkage) continues to be vague and open to interpretation. Below, SCE briefly describes its suggestions for the record.

SCE recommends that the ARB:

- Modify the definition of resource shuffling and also provide specific examples of resource shuffling in order to guide the behavior of electricity market participants. The definition of "resource shuffling" is so vague that it could chill typical market behavior. The ARB should identify specific situations or provide specific exemptions for typical electricity market behaviors. SCE also proposes that the ARB redefine resource shuffling as "any intentional plan, scheme, or artifice to avoid importing higher emissions resources by engaging in an improper substitution of such higher emissions resources with lower emissions resources. Such substitution would not be considered resource shuffling if the lower-emitting resources are eligible to be counted towards RPS compliance in California or if the lower-emitting resources are surplus resources at the time of import in the area from which the imported electricity is sourced, even if these resources are typically committed to serve load outside of California."
- Improve the QE Adjustment to remove perverse incentives that could discourage imports of low-carbon electricity. SCE continues to advocate for some minor modifications to address some of the perverse incentives created in the current regulation language that could discourage low-carbon energy imports. SCE recommends that the ARB consider adopting its "lowest first" QE Adjustment Calculation or its "lowest non-zero" redline change to improve the cap-and-trade regulation language and remove this disincentive to bring low-carbon energy into California.
- Modify the language relating to Renewable Energy Credits ("RECs") in the cap-and-trade regulation and the Mandatory Reporting Regulation ("MRR") to ensure

consistency with California's RPS. SCE supports the ARB's efforts to sure that out-of-state renewable electricity from an eligible renewable energy resource (that compliance entities can count towards California's RPS program) should receive proper GHG treatment under the ARB's cap-and-trade program. SCE suggests that the regulations be modified to prevent double counting of renewable energy attributes while recognizing the requirements and functioning of California's RPS program, and looks forward to working closely with the ARB to develop this language. (SCE1)

Response: This comment falls outside of the scope of the amendments to the cap-and-trade regulation. . We held a workshop in May 2012 to provide further clarity on the regulatory approach to electricity imports. No further response is necessary.

Cost Recovery on Long-Term Contracts

K-9. (multiple comments): CARB should adopt the Linkage Amendments and in doing so, include appropriate revisions to provide electricity generators subject to long-term contracts that provide no mechanism for recovery of allowance costs with a direct allocation of allowances. (CALPINE1)

Comment: Though the Board is not required to consider comments not directly relating to the additional documents, La Paloma hopes that the Board will see fit to address this important issue. La Paloma wants to take this opportunity to add to the public record a plea for assistance from the California Air Resources Board. The proposed solution of contract renegotiation has been attempted both with and without the help of the ARB and has failed in all cases. The long-term contract counterparty is Morgan Stanley Capital Group Inc. (Morgan Stanley). Morgan Stanley has indicated that it has entered into wholesale resale contracts of its own relying upon its portfolio of long-term purchase contracts, including the La Paloma contract. We would note, and appreciate, that ARB representatives have participated in certain of these discussions with Morgan Stanley in an effort to further the mandate to provide assistance to entities such as La Paloma. Nonetheless, Morgan Stanley has refused to renegotiate, stating that it would be unfair for it to absorb the costs of these emission allowances, which it cannot economically or feasibly pass through to its counterparties. Accordingly, resolution through bilateral negotiations has been attempted and, despite best efforts, has failed for La Paloma. We are aware, however, that this proposed solution has been effective for generators that hold long-term contracts with the state's independent owned utilities (IOUs). The IOUs are the beneficiary of the carbon allowances via the auction process, and no doubt have been encouraged by the regulating authorities to negotiate the amendments intended by the Final Regulation Order.

The California cap and trade program as currently structured does not provide the same relief to sellers maintaining long-term contracts as was provided in other proposed federal and regional legislation, presumably to avoid discriminatory and burdensome outcomes. For example, two of the federal Cap-and-Trade proposals, Waxman-Markey

(H.R. 2454) and Kerry-Boxer (S. 1733) and the memorandum of understanding between several States in the Northeast known as the Regional Greenhouse Gas Initiative ("RGGI"), all provided allowances to certain facilities subject to long-term contracts that did not allow the recovery of the costs of purchasing allowances at auction. The CARB cap-and-trade program does not provide similar allowances. As such, the solution proposed by CARB for generators to negotiate with their counterparties is flawed since the counterparties cannot be caused to negotiate, as is the case with La Paloma.

La Paloma does not believe this unduly discriminatory outcome resulting from the difference in the nature of the counterparty (IOUs vs. wholesale marketing companies) was either intended or would survive legal challenge. Nor is it desirable to impose such a burden on an efficient and clean natural gas-fired generator such as La Paloma. Indeed, the CARB Board directed that solutions should be proposed for entities in the situation now faced by La Paloma when needed. Only with an effective solution does the program avoid discriminatory, inefficient, undesirable and legally suspect outcomes. (LP)

Comment: Pre-Existing Contracts Without a Reasonable Means of Cost Recovery Should be Treated Comparably Across Linked Jurisdictions.

IEP remains concerned that neither the proposed amendments to the cap and trade program nor the proposed amendments on linkage address the treatment of existing contracts that do not have a reasonable means of recovering the cost of GHG allowances required for their continued operation. For a small subset of IPPs operating under existing contracts, currently no viable mechanisms exist within their existing contract structures to recover the cost of the GHG allowances they must obtain to comply with the Cap and Trade (C&T) program.

The Québec Regulation, on the other hand, provides a free allocation to electric power generation sold under a fixed-price contract executed before January 1, 2008, that has not been renewed or extended after that date. Unlike the Québec Regulations, the amendments to the California cap and trade program and the amendments to facilitate linkage provide no consideration of this issue whatsoever. This lack of specific consideration in the cap and trade regulation regarding generators caught in these specific circumstances raises serious equity and consistency concerns not only in the context of the California cap and trade program, but also in the context of linking in form and function to the Québec program.

CARB Staff has indicated its preference for resolution of this issue through contract renegotiation between contract counterparties; however, the counterparties to the IPPs have no incentive to renegotiate these contracts. In fact, the buyer in the context of these pre-existing energy contracts may have a clear incentive to not renegotiate these energy transactions as the counterparty/buyer will garner windfall profits from the sale of the electricity in a market where the Market Clearing Price (“MCP”) contains a GHG value. Québec has addressed the competitive concerns related to assigning GHG costs to generators that have no means of passing those costs through in a satisfactory manner by allocating free allowances to these entities. In the effort of making the Québec and California programs as compatible as possible, CARB should actively engage in a solution for generators that do not have a means to pass through the GHG costs associated with their fixed price contracts.

IEP Recommendation: CARB should commit now, in a Resolution, to resolve the treatment of existing contracts without a reasonable means of GHG cost recovery by the end of 2012. (IEP)

Comment: The pre-AB 32 Contract Issue is not resolved

The Pre-AB 32 Contract Issue remains an important concern that has not yet been resolved. A generator with a Pre-AB 32 Contract will bear the costs of the cap-and-trade program, and will be the only generation in the utility's portfolio with carbon costs that the utility and its customers do not see even though the utility receives free allowances assuming a GHG cost is incurred. That condition is clearly contrary to the Statement of Reasons that was adopted by the Board in October 2011. In the case of tolling arrangements where the utility controls dispatch, the utility will also have an incentive to run this limited group of generators more often than would be appropriate with proper consideration of GHG costs, which is also contrary to the intent of the cap-and-trade program. While CARB and the California Public Utilities Commission ("CPUC") have encouraged a negotiated solution, the issue has yet to be resolved at the CPUC. The Commission considered the issue in 0.12-04-046, directing the utilities to renegotiate Pre-AB 32 Contracts with no available mechanism for cost recovery. The Commission, provided the utilities 60 days before it would begin considering the issue in R.11-03-012, the CPUC's rulemaking on the Investor Owned Utilities' ("IOUs") use of cap-and-trade allowance revenue. The 60 day period lapsed on Monday, June 18 and to date, there has been no resolution Wellhead is aware of. (WEC)

Comment: In addition, CARB should provide the Executive director with flexibility to adjust allowance allocations when an electrical distribution utility does not actually bear the costs that an allowance allocation was based on.

Wellhead also believes that CARB should also be prepared to directly resolve the Pre-AB 32 Contract Issue. CARB should include additional amendments to the cap-and-trade regulation to provide the Executive Director with the flexibility to address this issue through administrative adjustments to allowance allocations if the Pre-AB 32 Contract Issue is not resolved prior to the initial allowance auction or free allowance allocation. In summary, Wellhead 's proposed revisions would position the Executive Director to adjust a utility's allowance allocation if it determines that a generator with a Pre-AB 32 Contract is bearing costs for which the utility would otherwise receive free allowances attributable to that generation.

Wellhead's proposed regulatory Amendments (noted in bold and underlined) are:

Section 95892 Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.

(f) In the event that the Executive Director determines that an electrical distribution utility receives allowances attributable to a contract for the sale of electricity at wholesale, which:

i. does not provide for payment of, or refer to, GHG costs for energy dispatched and purchased by the electrical distribution utility, either directly in the contract or through a CPUC authorized pricing basis that includes GHG costs;

ii. was full executed before the final approval of AB 32 (September 27, 2006); and

iii. has not been amended to address GHG costs with such changes approved by the appropriate regulatory authority on or before September, 2012,

then the Executive Director will reduce the allocation of free allowances to that electrical distribution utility to reflect the GHG emissions associated with the utility's purchases under such contract and the Executive Director shall freely allocate those allowances to the generator for the limited purpose of addressing the generator's costs of cap-and-trade compliance; provided, that such allowances may not be sold or traded, they may only be used for compliance with these regulations by the recipient. The Executive Director shall have the discretion to adjust future allocations under this provision based on the generator's actual verified emissions for a particular compliance period. (WEC)

The CPUC should have greater flexibility in addressing the pre-AB 32 contract issue.

While Wellhead still hopes that there will be a negotiated solution, and will continue to engage PG&E towards that end, there is an unmistakable and significant probability that negotiations will not be successful prior to the initial allowance auction later this year, and in that case, CARB and the CPUC should be prepared to act expeditiously on their own if necessary. The CPUC is currently evaluating how it will expand the scope of the R.11-03-012 proceeding to address the pre-AB32 contract issue. While the use of utility revenue from the sale of free allowances to compensate generators with Pre-AB 32 contracts may be a possible solution, the timing for implementing this type of solution is unclear. For these reasons, Wellhead believes that it would be prudent for CARB to provide the CPUC with greater flexibility to address the issue. In particular, the CPUC should have the discretion to control the disposition of a small pool of allowances needed to meet the requirements of a Pre-AB 32 contract for which the utility does not incur any costs. As proposed in the regulatory language below, if a utility has failed to comply with the direction the CPUC and CARB have provided regarding renegotiation of a Pre-AB 32 contract with no means of GHG cost recovery, then the CPUC should have the ability to require the utility to transfer allowances to the generator.

Wellhead's proposed regulatory Amendments (noted in bold and underlined) are:

Section 95892 Allocation to Electrical Distribution Utilities for Protection of Electricity Ratepayers.

(a) Allocation to Individual Electrical Distribution Utilities. The allowances allocated to each electrical distribution utility from each budget year shall be the electrical distribution utility sector allocation calculated pursuant to section 95870(d) for the budget year multiplied by the percentage allocation factors specified in Table 9-3. **Without limiting the effect of Section 95892(c)(3),** any allowance allocated to electrical distribution utilities must be used exclusively for the benefit of retail ratepayers of each such electrical distribution utility, consistent with the goals of AB 32, and may not be used for the benefit of entities or persons other than such ratepayers.

(c) Monetization Requirement.
(1) In 2012 an electrical distribution utility must offer one sixth of the allowances placed in its limited use holding account in 2012 for sale at each of the two auctions scheduled for 2012.
(2) Within each calendar year after 2012, an electrical distribution utility must offer for sale at auction all allowances in a limited use holding account that were issued: (A) From budget years that correspond to the current calendar year; and (B) From budget years prior to the current calendar year.
(3) The CPUC may direct a utility to withhold allowances from consignment to the auctions if the CPUC determines that the utility has not or will not incur the costs of GHG compliance for which the allowances are attributable. The CPUC shall have discretion to control the disposition of these allowances and direct the utility to transfer the allowances to another entity as deemed necessary by the CPUC to comport with the CARB policy that free allowances to be aligned with actual costs of GHG compliance incurred. (WEC)

Comment: CHP facilities are a reliable and highly efficient energy source that is critical to California meeting its goals under AB 32, and are an important part of the state's efforts to improve public health and develop a clean energy economy. As an energy efficient technology, CHP lowers demand on the electricity delivery system, frequently reduces reliance on traditional energy supplies, and reduces emissions of GHG and criteria pollutants. Consistent with Québec's cap-and- trade program, PEB strongly encourages CARB Staff to modify the California Cap-and-Trade Regulation to provide allowances to legacy CHP facilities, such as PEB, that have no ability to recover the cost of allowances due to fixed-price long-term contracts for steam that were entered into decades ago before this type of regulatory program was remotely foreseeable. We believe a harmonized approach to this issue is necessary to appropriately integrate these cap-and-trade regulatory programs.

The intellectual integrity of the California Cap-and-Trade Regulation dictates a consistent approach to similarly situated projects, in particular, with respect to the equitable treatment of stranded assets. Absent the necessary relief, PEB will bear a disproportionately higher cost of compliance as compared to certain Québec entities. Further, by adopting programs that cause substantial economic harm to legacy CHP facilities, CARB could effectively shut down the very legacy projects built in response to California's progressive energy policies developed during Governor Brown's first administration to implement the Public Utility Regulatory Policies Act of 1978 ("PURPA"), the landmark legislation designed to reduce the barriers to and promote development of CHP nationwide. (PEB)

Comment: I. Québec's Cap-and-Trade Regulation Provides Appropriate Relief to CHP Facilities

As discussed throughout the rulemaking for the Cap-and-Trade Regulation, a limited number of legacy CHP facilities in California are parties to long-term contracts with no available passthrough mechanism for allowance costs related to steam supply. In the case of PEB, it entered into a contract to supply steam in 1987 (well before carbon emissions regulations were even contemplated). CARB Staff has recognized the need to address the issue of long-term fixed price contracts and committed early on to work with stakeholders to address this issue. To date, however, CARB Staff has not proposed any solution and, thus, this important issue remains unresolved.

Québec, on the other hand, has squarely addressed this issue by providing free allowances to all electricity generators and steam suppliers who entered such contacts prior to January 2008. The Québec program clearly recognizes that stranding allowance costs on such generators does not advance the goals of the program, but will cause inequitable financial harm to CHP, which is a reliable and highly efficient energy source that is critical to reducing GHG emissions as part of any cap-and-trade program. The Cap-and-Trade Regulation, however, creates unrecoverable costs and economic hardship to certain legacy CHP facilities, including PEB. Significantly, with no corresponding burden to Québec entities, California CHP facilities will have greater cost of compliance compared to Québec entities. As described in the attached letter from Gowlings, PEB would not bear these unrecoverable costs under the Québec program. Such a result appears contrary to the LAO's report, which determined that "in order to effectively link California's cap-and-trade program with another jurisdiction's program, California's cap-and-trade rules should be harmonized with the rules of the other jurisdiction, ensuring that covered entities in both jurisdictions are subject to equally stringent rules for compliance."

As CARB Staff is aware, climate change programs are designed to change the behavior of end users by increasing the cost of energy, which, in turn, induces end users to choose different technologies, or encourage conservation or energy efficiency improvements. In the Initial Statement of Reasons (ISOR), CARB Staff provided an overview of the possible economic impacts to California of linking the Cap-and-Trade Regulation with Québec's cap-and-trade program. CARB Staff noted that expanding the number of sources that are able to trade will reduce the overall cost of reducing

GHG emission reductions and will improve the efficiency of the emissions trading market. As part of its discussion, CARB Staff noted that the California Cap-and-Trade Regulation does not specify how or where emission reductions will be made, but emission reductions will be made when the cost of making efficiency improvements is less than the cost of acquiring allowances. Specifically, GHG emission reductions will be made "*as a result of changes in the prices of energy which will induce marginally greater investment in energy efficiency and/or energy conservation* and by small changes in the purchase of all other goods and services, particularly energy-intensive goods and services." As part of its analysis, CARB Staff recognized that a critical factor influencing the allowance price is "the extent to which consumers shift to low-GHG products *in response to changes in prices*." Indeed, "[w]henever the allowance price rises above the cost of making additional emissions reductions on-site, businesses will choose to make those reductions."

Under its current steam supply contract with PEB, UC-Berkeley will incur ***no*** cost increase for its use of steam, and thus, it has no incentive to modify its energy usage or behavior. This consequence erodes the effectiveness of the Cap-and-Trade Regulation, because, unlike other consumers of steam subject to the program, these costs will not be realized by UC-Berkeley, the end user. Stranding PEB with these unrecoverable costs clearly frustrates the purpose of the Cap-and-Trade Regulation because there will be no corresponding reduction of GHG emissions without a pass-through or cost recovery mechanism. (PEB)

Comment: CARB Staff Should Provide Allowances to Legacy CHP Facilities With Long-Term Contracts Without a Pass-Through Mechanism

As discussed throughout the rulemaking for the Cap-and-Trade Regulation, PEB believes that the appropriate solution is for CARB Staff to amend the Cap-and-Trade Regulation to provide direct allocation of allowances to PEB until its existing contract expires in 2017 or is substantively renegotiated. At a minimum, in circumstances where entities receive free allowances but have no corresponding increase in energy cost (due to a fixed price energy supply contract), CARB should not provide such entities with free allowances. Instead, CARB should provide free allowances to the counterparty who incurs such costs.

Absent allocation of allowances to legacy CHP facilities, CARB is effectively *disincentivizing* investment in new California CHP, contrary to these well established and uniform public policy objectives, by sending a clear signal that California energy investments represent a material risk of economic harm and regulatory uncertainty, which should be priced into any new investment in California, if one decides to invest at all. Further, to the extent that new CHP facilities are built in California, rate payers will likely realize higher project costs to account for this increased risk to investors and developers as a result of CARB's inequitable application of the Cap-and-Trade Regulation to CHP facilities that lack any pass-through or cost recovery mechanisms.

These burdensome costs to PEB are expected to consume all of the profits for its facility in advance of the first compliance period and will force the facility to operate at increasing losses over time. Further, given the physical constraints in the Berkeley area, it is unlikely that a new facility could be constructed in the area to replace the corresponding loss in steam or electricity generation capacity. Because Berkeley is located within a constrained "load pocket" area in this regard, any replacement generation would be located further away from existing load centers (i.e., Berkeley). Also, it should be noted that PEB today has "black start" capability and, therefore, can help restart the local electricity grid and can operate independently from the grid to supply power and steam to UC-Berkeley during a blackout. Thus, in addition to resulting in higher emissions of GHG and criteria pollutants, a shutdown of PEB—as a consequence of the Cap-and-Trade Regulation—would threaten local stability and reliability, and eliminate the facility's ability to provide critical services to the community in the event of a natural disaster or other emergency. (PEB)

Comment. And also, we ask that the Board direct staff to take action today on the legacy contracts and direct staff to withhold allowances to those entities who are receiving a free allocation for emissions associated with steam and electricity for which they do not have an obligation under long-term contracts. We have the obligation. They do not. They are essentially getting unjustly enriched. We ask that the Board direct staff to withhold those allowances from those entities as we move forward and work on the other long-term contract issues. (CALPINE2)

> **Response:** The comments do not address proposed changes to the regulation so no response is needed. However, ARB will be holding stakeholder workshops to better understand their industry specific leakage situation, and may propose future regulation amendments in response to ongoing analyses.

Leakage Risks

K-18. (Multiple comments): Our previous submissions and those we sent to you yesterday also discuss several technical issues, such as holding limits. I'll not get into the details of those issues at this time. However, the unresolved policy and technical issues remain troubling to those parties who are entrusted with implementing the emission reductions that you all claim in your program. We note, for example, that the refining industry is highly trade and should be classified that way. The BCG report that was recently released clearly documents that fact. ARB should make program changes to recognize that the refining industry is highly traded as a first step to improve the efficiency of the Cap and Trade Program. (WSPA2)

Comment: The ISOR states that "the analysis indicates that the impact of linking with Québec could cause the allowance price in California to remain unchanged or increase slightly". It further states that the "economic dynamics that will arise if linking with Québec results in an increase to the California allowance price", is that it could "result in California facilities making more on-site emissions reductions. These reductions would be financed by sales of allowances to Québec." It assumes that "whenever the allowance price rises above the cost of making additional emissions reductions on-site, businesses will choose to make those reductions. WSPA believes that such assumptions may not be valid where the cap and trade program has not ensured that its features minimize leakage.

<u>Recommendation</u>: WSPA recommends that ARB re-evaluate the 90% "of average" benchmarking policy and the trade exposure analysis for the refining sector to ensure that leakage is minimized. As demonstrated by the analysis in the BCG Study, we believe that the refining industry should be designated as highly trade-exposed. (WSPA1)

Comment: Our turbine engine research and test facility in San Diego has been reporting and verifying greenhouse gas emissions through the climate registry and now with ARB since 2006 and will be one of the initial businesses in the Cap and Trade Program.

First, Solar very much appreciates the time and effort ARB staff has spent over the last two years understanding our very unique business. Thank you, Mr. Cliff, in particular. And we also very much appreciate the personal visits by Member Roberts and Chair Nichols to our facility.

Our concern today is that the linkage with Québec will do very little to reduce the leakage risk which is critical to our facility under the Cap-and-Trade Program. Solar has to make long-term decisions, business decisions to continue and create jobs in California. We are actively planning and taking actions to meet our business commitments for 2015 and 2020, including the construction of new test facilities. Solar is a very unique business. It's the only one in our entire source category. Under the current leakage designations, our facility will either need to procure tens of thousands of allowances or reduce our engine testing by more than 50 percent. Because the testing is required by our customers to meet safety criteria, it is doubtful that we will be able to reduce anywhere close to that amount.

We are being asked to perform business planning, assuming that we will be able to support more than half of our production activity by participating in a market that is yet to be tested at a cost that is yet to be determined. This scenario presents real risk to our business. Therefore, while we recognize the need for ARB to work through the pros and cons of linkage with Québec, we request the Board prioritize the leakage risk categories and the methodologies for developing them for immediate review so that unique businesses like Solar can plan accordingly right now. Thank you. (SOLARTURBINES)

> **Response:** The comments do not address proposed changes to the regulation so no response is needed. However, ARB will be holding stakeholder workshops to better understand their industry specific leakage situation.

L. RESOURCE SHUFFLING

L-1. (Multiple comments): The Clean-Up Amendments fail to clarify the meaning of "resource shuffling" and CARB Staff recently indicated that it will provide only "limited guidance regarding what is not resource shuffling." The Board should amend the resource shuffling definition and provide detailed guidance to covered entities regarding the scope of the resource shuffling provision. (CALPINE1)

Comment: Resource Shuffling

IETA is aware that specific opportunities to further comment on electricity issues, including resource shuffling, will soon arise, and we look forward to engaging with ARB during these future consultations. In the meantime, however, IETA would like to express ongoing concern about the lack of clarity, currently governing what will—or will not—be considered resource shuffling under California's program. IETA is aware of ARB's initial attempt to define resource shuffling as an intentional "plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred". However, more clarity from ARB will go a long way to ensure the certainty and confidence necessary for markets to function effectively. As the current guidelines stand, willing market participants cannot accomplish consistent compliance without clarity about what the rules allow, and what the rules prohibit. Absent further clarity on "resource shuffling", some participants may elect to simply withdraw from the market entirely, or simply reduce their level of participation, out of fear of potential regulatory liability.

One possible solution for ARB's consideration might exist through a "no-action" letter process, under which an entity may obtain formal, written, and confidential guidance as to whether a proposed transaction would constitute resource shuffling. Today, "no-action" letters are frequently issued by other regulatory agencies, including the Federal Energy Regulatory Commission (FERC), the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission (SEC). Going forward, IETA welcomes the opportunity to discuss various options with ARB staff, with a view to providing enhanced clarity on resource shuffling to help drive the development of a fully-functional, broad, and liquid California market. (IETA)

Comment: Outstanding Issues Impacting The Electricity Sector Should Be Addressed As Soon As Possible

During the October 2011 CARB Board meeting, several issues that impact the electricity sector and utilities with a compliance obligation under the regulation were identified and flagged for further review and resolution. According to recent statements by CARB, resolution of those issues is scheduled to be presented to the CARB Board as proposed revisions to the Cap-and-Trade Program Regulation in the first part of 2013. NCPA urges CARB to move forward expeditiously with resolution of these matters, as they significantly impact compliance with the Cap-and-Trade Program for electrical distribution utilities and other electricity sector covered entities.

In particular, details regarding the program restrictions and definitions for contract shuffling must be addressed, as well as restrictions and discriminatory treatment of POUs located within the California ISO balancing authority vis-à-vis the use of the value from allocated allowances must be resolved. As it currently stands, there are both equity and market liquidity issues that have the potential to adversely impact the market and a large group of California electricity ratepayers. Notwithstanding the need to ensure that amendments specific to linking the California and Québec programs are developed and approved in a timely manner, details regarding the impact of California's Cap-and-Trade Program on covered entities subject to a compliance obligation in the first compliance period must also be resolved expeditiously. (NCPA)

Comment: WPTF is also extremely concerned that CARB staff has moved forward with changes to enhance the security of the tracking system, and to enable the linkage of California's cap and trade program to that of Québec, but has not yet addressed other issues that are critical to the effective implementation of the program. Specifically, CARB has not adequately addressed the issue of 'resource-shuffling', as directed by Resolution 11-32 adopted by the Board in October, 2011.

WPTF and many other electric power entities have repeatedly raised concerns that the current definition of 'resource-shuffling' in the cap and trade regulation is so broad as to provide no clarity or regulatory certainty regarding which transactions would be considered legitimate specified or non-specified imports and which would be considered resource-shuffling. The resultant lack of clarity will increase the risks associated with electricity market transactions, impede the efficiency and effectiveness of the electricity market and raise the cap and trade program's compliance costs.

To address these concerns, WPTF has recommended that CARB provide the needed clarity for the electricity sector by 1) modifying the definition of resource shuffling in the regulation, 2) developing guidance documentation for use by electric entities and verifiers around 'bright-line' scenarios that clearly would or would not be considered resource-shuffling and 3) establish a formal process by which an individual entity can get an upfront determination of the appropriate emission factor to be used for specific import situations.

We urge the Board to direct staff to continue to work with stakeholders to develop additional regulatory clarity around the issue of resource-shuffling in advance of 2013 implementation. (WPTF)

> **Response:** This comment falls outside of the scope of the amendments to the cap-and-trade regulation. Staff also held a workshop in May 2012 to provide further clarity on the regulatory approach to electricity imports. Staff will continue to monitor the effect that regulatory provisions will have on the electricity market and will work with stakeholders to address concerns.

M. OFFSETS

This section includes responses for comments concerning the offsets provisions of the regulation, including sections 95970–95988 and sections 95990–95997. Major topics include limits on the geographic location of offset projects; limits on the use of offset credits; quality of offset credits; linkage with other offset and carbon trading programs; offset project registries; monitoring, reporting, and record-retention requirements; verification; recognition of early action; and sector-based crediting.

Offset Supply and Additional Offset Protocols

M-1. Comment: SECTION 95973: THE ARB SHOULD APPROVE ADDITIONAL OFFSET PROJECT TYPES IN 2012.
Section 95973(a)(2)(C) of the Regulation lists the four offset project types that are currently approved by the ARB as Compliance Offset Protocols. This limited range of offset project types will limit the number of offsets that are available to covered entities for compliance, particularly in the first compliance period. If less than the maximum allowed quantity of offsets is available, the offsets program will not fulfill its cost containment potential and the costs of the cap and trade program as a whole will increase.

On May 17, 2012, the Western Climate Initiative ("WCI") announced that it will review and evaluate additional offset protocols, including protocols relating to coal mine methane and small landfills. The WCI may also consider reviewing additional protocols relating to municipal and industrial waste water treatment, fertilizer application N2O emission reductions, rice cultivation, and enteric fermentation.

SCPPA recommends that the ARB works with the WCI to ensure the review and evaluation process is completed promptly, and that the ARB then proceed to a new rulemaking in 2012 to approve the additional offset protocols for compliance use. This prompt action will help ensure that sufficient offsets are available from the first compliance period onwards, maximizing the cost containment potential of the offsets program. (SCPPA1)

> **Response:** These comments are outside the scope of the regulatory amendments. No further response is necessary.

M-2. Comment: In addition to addressing changes to the regulations, CERP again urges ARB to make public the timing of additional offset protocols. As we have noted before, this information will assist the market in planning and assure covered entities that sufficient offset supply will exist as the market gets underway. New protocols will be crucial for ensuring sufficient supply of offsets in the cap-and-trade system, especially in the second and third compliance periods. CERP therefore requests that

ARB make public additional information on the schedule for consideration of new offset protocols. It would be helpful if ARB announces a date for the offset workshop on new protocols, and signals when those engaged in the market can look forward to seeing such new protocols introduced.

Offset projects take significant time to complete and therefore new offset protocols must be introduced as early as possible so that project development may begin in a timely manner and offset credits may be generated. The disclosure of further information regarding ARB's process and timing is especially important to project developers who are trying to determine whether to invest significant capital in new project types and who need signals concerning what protocols will likely be accepted and able to earn ARB credits. As we have stated previously, even if ARB can only provide a tentative indication of protocols under consideration, such a message can be helpful. The market is comfortable making advance investments around such conditional information. Any new information that ARB can provide the public with regard to their process for offset system development will be helpful in preparing the cap-and-trade market to begin operation. (CERP)

> **Response:** These comments are outside the scope of the regulatory amendments. No further response is necessary.

M-3. Comment: American Carbon Registry really appreciates all the hard work you and your staff are doing to get the Cap and Trade Program launched, and we support all the work that you have done.

We are really looking forward to the opportunity of serving as an project registry for the program. And we particularly appreciate your efforts to bring more protocols into the program and encourage you to consider additional protocols as we feel there will be a need for additional offset tons early on and throughout the program.

We are particularly excited that you are working on the rice protocol. We feel that's really important to have agriculture as part of the offsets program.

Lastly, we would be very interested in following up with staff on the possibility of the new rice protocol being considered because we do believe there is a potential that the protocol can generate valuable tons in the program in the first compliance period when we feel it could be a shortage of tons for the program. (ACR)

> **Response:** These comments are outside the scope of the regulatory amendments. No further response is necessary.

M-4. Comment: D2. Approve Additional Offset Protocols and Adjust Quantitative Usage Limit
PG&E believes that the use of high-quality offsets is an effective cost containment tool and an essential part of a successful cap-and-trade program. In fact, ARB's May 2012 economic analysis forecasts an increase of 14 percent in allowance prices if offset

volume falls below 80 percent of that allowed in the regulation. PG&E's economic analysis forecasts allowance prices to more than double without the use offsets. As stated in PG&E's February 17, 2012, comments, without the approval of additional protocols and adjustment to the implementation of the quantitative usage limit, the cost containment objectives with respect to the use of offsets in the cap-and-trade program will not be realized.

PG&E is encouraged that Western Climate Initiative Partner Jurisdictions "will begin the review and evaluation" of four new protocols, two of which are new for the ARB—Coal Mine Methane and Small Landfills. Unfortunately, these protocols will not produce sufficient volume of offsets for cost containment. PG&E recommends that the ARB and Québec adopt the Climate Action Reserve's Nitric Acid Production and Coal Mine Methane protocols, as well as the American Carbon Registry's Protocol for Conversion of High-Bleed Pneumatic Controllers in Oil & Natural Gas Systems. These two protocols show the greatest potential of quickly delivering high quality reductions.

Given the time required to approve additional protocols, the current limited supply of offsets, and the uncertainty surrounding the outcome of the Citizens Climate Lobby lawsuit, PG&E also requests that the quantitative usage limit apply to a complying entity's total compliance obligation from January 1, 2013, through the current compliance period. This will allow time for the offset market to develop projects while maintaining the current cap on the use of offset credits. (PGE1)

> **Response:** These comments are outside the scope of the regulatory amendments. No further response is necessary.

M-5. Comment: And we also appreciate the staff's commitment today to develop a public process around offsets protocols for rice. (EDF3)

> **Response:** These comments are outside the scope of the regulatory amendments. No further response is necessary.

N. SUPPORT FOR CAP-AND-TRADE

N-1. Comment: Global climate change is one of the most serious issues of our time. Unabated, climate change poses dire risks to both human and natural systems in California and beyond. Climate-induced sea level rise threatens low-lying coastal areas, and saltwater intrusion in the Sacramento Delta could substantially disrupt California's freshwater supply. A 2008 study by UC Berkeley projected that the failure to act on climate change will result in tens of billions of dollars per year in direct costs, and expose trillions of dollars of assets to collateral risk from extreme weather events, sea level rise, and catastrophic wildfire.

Given the seriousness of this issue, we are very supportive of California's continued leadership on this issue, and appreciate the opportunity to comment on the proposed changes to the cap & trade regulation necessary to facilitate linking California's system with Québec's similar cap & trade system. PFT is generally supportive of broadening the cap & trade system to include other jurisdictions, in order to facilitate greater GHG emission reductions and improve the efficiency of the system. (PFT1)

Response: Staff appreciates the support. No further response is required.

N-2. Comment:
Similarly, the proposed changes regarding holding limits for future vintage allowances [moving from entire pool to each year; see §95920] and procedures on auction registration and revocation reflect CARB's continued willingness to proactively take steps to ensure the market functions as designed.

EDF and NRDC support these changes in the regulation and take the position that these provisions will protect the integrity of the program and any incidental burdens they impose are justified. EDF and NRDC also appreciate that CARB is collecting information from the market monitor and is taking specific action based on this information to strengthen the program overall. The decision to hold a simulated auction in August and to hold the first allowance auction in November is a responsible decision by CARB that will help ensure that all elements of the auction program are in place, fully coordinated, and tested without resulting in any delay of the full launch of the program. (EDF3)

Response: Staff appreciates the support. No further response is required.

O. OPPOSITION TO CAP-AND-TRADE

O-1. (multiple comments): I oppose cap & trade. Please reconsider this law. The countries that are the biggest offenders do not have to follow this law. California has done a wonderful job cleaning up our air! We just need to continue doing what we are doing, not add anymore regulations to our businesses and the people of California. (SAVNIK)

Comment: I was very disappointed to read about your decision to terminate the recent meeting when so many people took the time out of there busy lives. I am one of many who is not in favor of cap and trade. (WHELTON)

Comment: I do not support CARB (cap + trade). It kills jobs and hurts California. I am so disappointed (but not surprised) that you would not listen to comments from the public. (LEHR)

Comment: As written and yet to be tried in the real world, the economic disaster called Cap +(or) Trade will kill or severely cripple most businesses in the late State of Calif (or Nation). Our small family business has 5 Diesel powered machines—Cap + Trade what? Where? With whom?

The latest buzz and the above is that we may have to relocate in Nevada or Texas!! What in the name of the of “Jehovah” is a small business man to do in the face of our own inscrutable law?? (FREEMANW)

Comment: As the head of the Air Resources Board, you are in charge of an agency which has no obligation to California voters.

Improved engines will reduce carbon. This department takes money from a state than can better spend budgeted money. (FREEMANH)

> **Response:** The comments are outside the scope of the regulatory amendments. However, climate change is one of the most serious environmental threats facing the world today. The California Global Warming Solutions Act of 2006, Assembly Bill 32 (AB 32), required us to adopt regulations which would implement measures to achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas (GHG) emissions. This law was challenged in 2010 by Proposition 23, which would have effectively repealed AB 32. The proposition was overwhelmingly defeated by state voters, demonstrating the electorate’s desire for action on climate change.

P. DEFINITIONS

P-1. Comment: A “DAY” MUST BE CONSISTENTLY DEFINED.

Throughout the Cap-and-Trade Program Regulation and in the Proposed Revisions, there are repeated references to the term “day”. However, since a “day” for purposes of the Cap-and-Trade Program Regulation is not consistently defined, the Regulation should be revised to provide a uniform use of the term.

For example, in section 95830 there are references to both “calendar days” and “working days.” In the proposed revisions, section 95830 refers to “working days” and “days.” There are also references to “business days” (see § 95870(d)) in both the existing regulation and the Proposed Revisions. Different organizations and industries may have different interpretations of working and business days, which makes the multiple references problematic. Unfortunately, even the reference to the “business day in California” used in section 95911 is not without alternative interpretations. The different use of the term “day” leads to confusion and ambiguity, especially when California’s program is linked with a program from a different country. Due to the nature of allowance trading and the various underlying markets, as well as the diverse business and cultural climates that are at play here, it is imperative that the Cap-and-Trade Regulation employ a single definition of all references to a 24-hour period, and use that definition throughout the document.

Likewise, the reference to “Pacific Standard” and “Pacific Daylight” times should be specifically linked to one jurisdiction, in the event that any partner jurisdictions do not observe pacific daylight time. (See § 95911(c)(4)) (NCPA)

Response: These comments are outside the scope of regulatory amendments. No further response is necessary.

P-2. Comment: C3. Clarify Definition of Serial Number Section 95802(258) – Definition of Serial Number. PG&E requests that ARB clarify in its Guidance Document that the definition for "Serial Number" should be broadly interpreted and that entities registered in the tracking system will only be able to view attributes of the serial numbers and not unique numbers associated with the compliance instruments. (PGE1)

Response: The commenter is correct. Individuals in the tracking system will see general attributes of the allowances and offsets in their accounts, but not unique identifiers.

ATTACHMENT A: FINAL STATEMENT OF REASONS

Response to Comments on the Environmental Analysis Prepared for the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions

July 2012

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Commenters

The list below identifies the commenters that submitted comments related to the Environmental Analysis, and includes commenter information.

Commenter ID	Commenter Information
BREATHECALIFORNIA	Andy Katz Affiliation: Breathe California Oral Testimony: 06/28/2012 Hearing Witness #: 10
CBD	Brian Nowicki Affiliation: Center for Biological Diversity Written Testimony: 06/27/2012 45-Day Linkage Comment # 17
EDF2	Erica Morehouse, Environmental Defense Fund; Michelle Passero, The Nature Conservancy; Alex Jackson, Natural Resources Defense Council; Jennifer Martin, Center for Resources Solutions Written Testimony: 06/27/2012 45-Day Linkage Comment #: 16
EDF4	Erica Morehouse Affiliation: Environmental Defense Fund Oral Testimony: 06/28/2012 Hearing Witness #: 3
PFT1	Paul Mason Affiliation: Pacific Forest Trust Written Testimony: 06/27/2012 45-Day Cap-and-Trade Amendment Comment #: 18
TWS1	Ann Chan Affiliation: The Wilderness Society Written Testimony: 06/27/2012 45-Day Linkage Comment #: 2093
TWS2	Ann Chan Affiliation: The Wilderness Society Oral Testimony: 06/27/2012 Hearing Witness #: 14

Commenter ID	Commenter Information
WSPA1	Catherine Reheis Boyd Affiliation: Western States Petroleum Association Written Testimony: 06/27/2012 45-Day Linkage Comment #: 8

Location of Comment Letters on the ARB Website

All comment letters and attachments received on the proposed Cap-and-Trade Regulation are posted on the ARB website at the following link: http://www.arb.ca.gov/lispub/comm/bccommlog.php?listname=capandtradelinkage12

To manually locate the comments on the ARB website:

- Go to www.arb.ca.gov.
- Select “Climate Change Program” in the left column.
- Under “Assembly Bill 32 Implementation and Other Activities,” Select “Cap-and-Trade Program” on the Activities tab.
- Select “View All Public Comments” in the right column.

On the website, the comments are ordered by date received, grouped by review period.

ENVIRONMENTAL ANALYSIS COMMENTS AND RESPONSES

This section summarizes comments on the Environmental Analysis and presents ARB's responses to those comments. Comments that do not pertain to the adequacy of the environmental analysis are addressed in other chapters of this Final Statement of Reasons (FSOR).

This chapter provides written responses to a subset of all comments received on the proposed Cap-and-Trade Regulatory Amendments and Linkage Regulation that raise environmental issues. These comments are responded to in this chapter as part of the FSOR for the Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms for purposes of the Administrative Procedure Act (Government Code section 11340 et seq.). Any of these comments raising significant environmental issues will be answered in writing thoroughly in a separate response document in accordance with ARB's certified regulatory program under the California Environmental Quality Act (CEQA) at the time that the Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions are considered for approval.

In this Response to Comments document, individual comments are presented under the correspondence within which they were received, ordered alphabetically by COMMENT ID and identified as follows:

COMMENT ID: *This is the abbreviation used to identify the comment correspondence in which the individual comments are contained.*

Name:	*Person(s) submitting the comment*
Affiliation:	*Affiliation of the commenter(s)*
Written Testimony: M/D/Y	*Type of comment and date received*
45-Day Comment #: 123	*Comment period and unique comment number. The unique ID number corresponds to numbering in the FSOR.*

Comment: *Comments received under the COMMENT ID are presented individually as shown in this example, beginning with **Comment** on the first line.*

> **Response:** *Responses are presented following each comment. Responses are indented from the left margin.*

Comment: *All of the individual comments received under the COMMENT ID are presented as demonstrated in this example. This comment would be followed by subsequent comments from this commenter.*

> **Response:** *Responses are presented following each comment. Responses are indented from the left margin.*

BREATHECALIFORNIA

Name: Veronica Hicks
Affiliation: Breathe California
Oral Testimony: 06/28/2012
Hearing Witness #: 10

Comment: To clarify a process for ensuring that linked jurisdiction's programs continue in the future to meet the requirements of AB 32, I'm thinking specifically of environmental integrity criteria that are specified in AB 32. When you think about offsets, it's that they're real, permanent, quantifiable, verifiable, enforceable. They're additional to what would have otherwise occurred. And the overall program and compliance instrument from another jurisdiction is equivalent to California's jurisdiction. (BREATHECALIFORNIA)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

CBD

Name: Brian Nowicki
Affiliation: Center for Biological Diversity
Written Testimony: 06/27/2012
45-Day Linkage Comment # 17

Comment: Our primary concern is that the regulation linking California's greenhouse gas cap-and-trade program with partner jurisdictions will force California to accept carbon offset credits from projects with low or no environmental standards, thereby leading to substantial negative environmental impacts. This is of particular concern with respect to forest offset projects, which, if not developed pursuant to environmentally rigorous standards, can impair forest ecosystems, wildlife habitat, and water quality, even in cases when those forest projects may provide climate benefits. California's cap-and-trade program should not contribute financial incentives that would drive forest ecosystem degradation in other states and provinces. California must ensure that our greenhouse gas reduction efforts do not rely on projects that result in ecosystem degradation to our forests or outside the state in order to reduce the costs of compliance for industrial polluters in California.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: The regulation commits California to accept offsets generated under future regulations not yet written in other jurisdictions.

The regulation requires California to accept any offset credit accepted by any linking partner. "*Once a linkage is approved, a compliance instrument issued by the linked jurisdiction may be used to meet a compliance obligation in California."* § 95942 (e) at page 75.

This regulation would commit California now to accepting in the future offset credits from protocols that have not yet been developed yet by partner jurisdictions, as well as any offset credits issued by any other jurisdictions to which we link our cap-and-trade program in the future. California cannot rationally agree to offsets when we do not yet know the content of the protocols for those offsets. It is impossible for ARB to ensure that these as-yet-undeveloped protocols will meet AB 32 standards and other applicable laws, particularly AB 32's requirement that ARB maximize environmental co-benefits in developing market-based greenhouse gas reduction programs. It is not possible even to know the environmental costs of these protocols, much less maximize their environmental benefits, when they do not yet exist. ARB must first determine what the protocols are for any offset it wishes to potentially accept, and then must conduct environmental review of those protocols and receive public comment. ARB cannot and should not commit California to buying offset credits out of this "black box" of potential future protocols.

Furthermore, because we do not yet know the content of the protocols of other jurisdictions, ARB is creating a situation that could lead to contradicting protocols. In the future, when other jurisdictions establish their own protocols, those protocols may or may not be consistent with the protocols California has established. Also, it is not possible for the public to meaningfully comment on protocols that do not yet exist. Only after other jurisdictions establish their protocols can the public meaningfully examine and analyze those protocols.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: The regulation would force California to accept offset credits with low or no environmental standards.

While the regulation requires California to accept any offset credit accepted by any linking partner, there is no mention in the regulation or the ISOR of any review of offset protocols adopted by other jurisdictions, any consideration of the environmental impacts of offset projects, or any mechanism for reducing California's reliance on offset credits generated by projects with negative environmental impacts. Furthermore, Québec's cap-and-trade regulation contains no environmental criteria for offsets or the adoption of offset protocols.

Under this provision, California would be forced to accept offset credits generated under offset protocols with lesser environmental standards than the offset protocols adopted by California for the same project types (e.g. forest projects), even when the offset projects in other jurisdictions result in significant negative environmental impacts. And while the regulation requires ARB to ensure that all offsets accepted as compliance instruments in California's cap-and-trade are real, permanent, quantifiable, verifiable, and enforceable, it does not provide for any determination of the environmental impacts.

These agreements similarly exclude any determination of environmental impacts. The WCI agreements, to which ARB is a party but which have not been adopted under any California regulatory process, contain no environmental criteria for offset projects or the approval of offset protocols except for the practically meaningless requirement that "projects must meet all applicable local environmental regulations and be in compliance with all applicable laws." The WCI agreements acknowledge that offset projects have "the potential to impact the environment or social environment in which the project is located," but sets neither standards for ensuring that offset projects do not result in negative environmental impacts nor thresholds for allowable levels of environmental impacts. Furthermore, the WCI agreements explicitly reject the notion of setting standards to achieve environmental or social benefits: "WCI Partners recognize the environmental, social, economic and health benefits that may arise from an offset project and the offset system will focus on those benefits directly related to mitigating climate change. <u>A WCI offset project is required only to result in a greenhouse gas emission reduction or removal</u>."

In December 2011, WCI adopted a process for the approval of offset protocols by WCI partner jurisdictions. Under that process, if a protocol is found to be consistent with WCI principles (which do not include environmental criteria or standards), the protocol would be available for use by any of the WCI partners. The WCI process thus appears to require California to accept any offset credits accepted by a WCI partner, and it does not appear to allow California to object to a protocol used by a WCI partner based on negative environmental impacts. (CBD)

> **Response** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: The regulation would undermine California's authority to achieve AB 32's mandate to maximize environmental co-benefits.

AB 32 mandates that market-based compliance mechanisms, such as this one, must maximize environmental co-benefits. However, by explicitly committing to accept offsets from any future protocols yet to be written and providing no conditions on their acceptance, the regulation not only makes it impossible to maximize environmental co-benefits, it forfeits any opportunity to analyze, assess, or reduce negative environmental impacts of future protocols. The regulation should explicitly require ARB to analyze the environmental impacts of any offset protocol that generates offset credits that can be used as compliance instruments in California. In addition, the regulation should include provisions that explicitly require that all offsets used for compliance in California must maximize environmental benefits, and that all offset projects in linked jurisdictions meet or exceed the standards of protocols adopted by ARB for similar offset types.

> **Response:** In California, the environmental analysis for future protocols will be addressed as part of ARB's regulatory process and certified regulatory program under CEQA, which provides that stakeholders will be provided ample opportunity to provide public comment.
>
> WCI Partner jurisdictions will coordinate on the development of any new protocols. Upon completion of the development effort and the development of a WCI-recommended offset protocol, each jurisdiction will take that recommended protocol through its own regulatory and stakeholder review process before it is formally adopted by the jurisdiction.
>
> ARB rejects the recommendation that the regulation should explicitly require ARB to analyze the environmental impacts of any offset protocol that generates offset credits that can be used as compliance instruments in California, because the implication is that if any offset protocols in a linked jurisdiction did not meet acceptable environmental standards, the resulting offsets could not be used in California. As described in Alternative 4 in the ISOR, this suggestion would not work, as Québec could still allow for the use of the resulting offsets, but California entities would not be able to use them and maximize the benefits of cost containment from a linked program. Such a situation could result in increased

compliance costs to California entities. That being said, it is staff's intention to coordinate closely with any linked jurisdiction as it develops a protocol, and staff will report to the Board prior to any changes in a linked jurisdiction's program. This will provide an open and public process through which stakeholders can comment on those changes for Board consideration.

Comment: The Center for Biological Diversity has repeatedly expressed concerns over the potential for offset projects to result in negative environmental impacts. This is of particular concern with forest offset projects, which can result in substantial impacts to forest ecosystems, wildlife habitat, and water quality. In order to ensure that California's cap-and-trade program does not rely on or result in the degradation of forests and ecosystems elsewhere, the regulation should not allow credits from forest protocols adopted by any linked jurisdictions to be sold into California's cap-and-trade system absent meaningful minimum protections (e.g. provisions to ensure maintenance of native species, diverse age classes, structural diversity, wildlife habitat, water quality, and other natural resources).

Response: The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Accepting lower quality offsets would allow project developers to choose among different protocols to select one with the lowest standards.

The regulation does not expressly prevent offset developers and projects located in U.S. states outside of California (or even within California) from choosing among offset protocols offered by other linked jurisdictions; therefore, a project can select the option that offers the lowest standards. Furthermore, the WCI agreements specifically allow any WCI partner to "issue offset certificates for projects located…outside the WCI Partner Jurisdictions within North America." This obviously includes U.S. states outside of California.

A WCI partner could propose a forest offset protocol with lower environmental standards than the protocol adopted by ARB, other WCI partners would be able to adopt the protocol with lower standards, and California would be forced to accept offset credits generated under those less stringent protocols. This scenario could place California in a position that violates the letter and intent of AB 32, which gives ARB the sole authority to adopt offset protocols, and specifically requires ARB to verify and enforce the quality of offsets used for compliance in California. Also, even if California were to reject credits generated under less stringent protocols—in fact, even if WCI were to reject a protocol, and a protocol was acknowledged only within a single partner jurisdiction—the fungible nature of offset credits in an auction system means that those credits still would effectively become part of California's compliance market.

Response: The Board did not take any action on the linkage amendments. No further response is needed.

Comment: The ISOR fails to acknowledge or analyze potential environmental impacts of projects that will generate offset credits that become part of the California market.

The ISOR implies that because Quebec has not adopted a forest protocol, there is no need to analyze potential impacts to forest resulting from linking. "*The proposed amendments to the cap-and-trade regulation would not change how entities would comply as evaluated in the FED for California's cap-and-trade regulation. Therefore, implementation of the Proposed Amendments to the cap-and-trade regulation would not result in any potentially significant agricultural and forest resources impacts, as evaluated and disclosed in the FED summarized above*." ISOR at 53.

However, this ignores the possibility that Québec may develop a forest protocol in the future, and under the regulation California would be committed to accepting offset credits from that protocol. This also ignores the fact that British Colombia, also a WCI partner, has already adopted a forest offset protocol that fails to ensure the value of the reductions and fails to protect forest environmental values.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Rather than analyze the potential environmental impacts of forest offset protocols issued by other jurisdiction, the ISOR largely defers to the environmental analysis in the FED for the cap-and-trade regulation. "*The environmental analysis for the proposed amendments to California's cap-and-trade regulation relies on the analysis conducted for the cap-and-trade regulation FED and the environmental analysis for the Landfill Regulations to the extent that the environmental impacts of the proposed amendments would be consistent with the impacts addressed in those prior documents*." ISOR at 44. At the same time, the ISOR does acknowledge that forest offset programs have the potential for significant adverse environmental impacts, and that linking to partner jurisdictions could increase demand in California for offset credits generated in other jurisdictions.

However, the FED explicitly stated that it did not analyze the potential impacts of linking. "*No linkages are proposed at this time; however, future linkages are anticipated. Each linkage would be approved by the Board and subject to its own environmental review*." FED at 33 "*Each compliance response project implemented by a covered entity in California, offset protocol adopted by ARB, or linkage agreement approved by ARB, that constitute a "project" as defined by CEQA, section 21065, would be subject to CEQA environmental review.*" FED at 130.

Furthermore, the FED, in its analysis of potential environmental impacts of forest offsets, acknowledged the need for environmental criteria. The FED also acknowledged that linking to jurisdictions with lower environmental criteria could result in discrepancies in the environmental quality of offsets. Also, the FED acknowledged the need for comprehensive environmental standards to apply to protocols in all linked jurisdictions.

"*A linkage program with comprehensive environmental protection standards adopted as conditions of approval would create the opportunity to gain GHG reduction benefits while avoiding or minimizing the potential for other environmental impacts. Protocols could be established to require achievement of environmental standards, including definition of the standards, monitoring procedures, regular reporting of monitoring results to California, and adaptive environmental management for refining the standards and approaches for their achievement over time. Variations in the approvals of linkages could influence environmental impacts of allowances and offset credits created under other linked programs. A primary question related to the environmental impacts of linked programs is the degree of environmental review and protection/mitigation requirements in the other jurisdictions where linked programs would be approved . California environmental laws are typically more protective than the laws of other states and nations. If linkage was restricted to California programs only, the state's environmental laws would maintain protections through environmental impact assessment of public agency actions (under CEQA) and other laws protecting natural resources. Restricting linkage to California may have some advantages for environmental protection; however, the capacity to develop emissions credits would be substantially limited. Also, the overall cap-and-trade program includes accepting offset projects from outside California, so a geographic limitation on linkage would not result in a substantial environmental advantage on its own.*

A linkage program with comprehensive environmental protection standards adopted as conditions of approval would create the opportunity to gain GHG reduction benefits while avoiding or minimizing the potential for other environmental impacts. Protocols could be established to require achievement of environmental standards, including definition of the standards, monitoring procedures, regular reporting of monitoring results to California, and adaptive environmental management for refining the standards and approaches for their achievement over time." FED at 387.

The FED offers a list of reasons it fails to provide a good-faith, reasoned analysis of the regulation's environmental impacts as required by CEQA, *see* CEQA Guidelines16 sections 15144, 15151. None are valid.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: First, the FED seeks to rely on the environmental document prepared for the overall cap-and-trade regulation. Such reliance ("tiering" in CEQA parlance) is appropriate, however, only to the extent that the specific environmental impacts associated with the linkage regulation were already identified, analyzed, and mitigated to the extent feasible in the FED for the cap-and-trade regulation. The current FED makes no real attempt to demonstrate whether, or to what extent, this is the case. Indeed, the linking regulation may have a number of impacts not identified in the prior FED simply because it anticipates acceptance of credits under protocols developed—or, in many cases, not even developed yet—by partner jurisdictions. To the extent that these protocols incent activities that may have environmental impacts, those impacts could not have been discussed in the cap-and-trade FED. Therefore, they must be disclosed and analyzed here.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Second, however, the FED claims that it need not analyze these impacts because they cannot be determined with any specificity. ISOR at 45 ("The FED relied on the agencies with local permitting authority to analyze site- or project-specific impacts because the programmatic FED could not determine with any specificity the project-level impacts . . . ."). Again, this is incorrect. ARB, must make a good-faith effort to disclose all it reasonably can about these projects. Where protocols exist, and underlying environmental standards are ascertainable, ARB must do its best to forecast the reasonably foreseeable environmental consequences of offset projects. These are not projects that would happen anyway; indeed, if any of these projects are truly additional—which the linking regulation ostensibly requires—they would not happen but for the incentives created by the linking regulation. Accordingly, the environmental consequences of these projects are, if not direct, then at least indirect effects of the regulation. Nor may the FED simply state that all projects are expected to comply with legal standards applicable in the host jurisdiction. The fact that a project may comply with legal standards alone does not relieve a lead agency of its obligation to determine whether its environmental impacts are significant. *See, e.g.*, *Californians for Alternatives to Toxics v. Dept. of Food & Ag.* (2005) 136 Cal. App. 4th 1.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Third, the FED argues that it is a "program" document and thus lacks specificity. Again, the argument fails. Under CEQA, a program environmental document still must disclose all reasonably available information, and is most helpful if "it deals with the effects of the program as specifically and comprehensively as possible." CEQA Guidelines § 15168(c)(5). Indeed, a program document can provide "an occasion for a more exhaustive consideration of effects and alternatives that would be practical" in analyzing individual actions. *Id.*, § 15168(b)(1). This is especially the case here, where *only* at the programmatic level can all of the incentives governing underlying project activities be disclosed and considered. Rather than prepare a program-level document in accordance with these CEQA principles, ARB has largely declined to offer any meaningful analysis at all. This is improper.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Finally, ARB claims it has no authority to require mitigation. ISOR at 45 ("ARB does not have the authority to require project-level mitigation for specific projects carried out to comply with California's cap-and-trade regulation or protocols.") Again, the claim is patently false. Program-level review specifically allows agencies to "consider broad policy alternatives and programwide mitigation measures at an early time when the agency has greater flexibility to deal with basic problems or cumulative impacts." *Id.*, § 15168(b)(4). ARB cannot plausibly claim that it has no role in mitigating the environmental harm potentially caused by offset projects that would not occur absent the linking regulation. ARB is designing the regulation and has ultimate responsibility under AB 32 for adopting methodologies and protocols governing these projects. ARB therefore has both legal and practical authority to condition the acceptance of offsets in a way that minimizes minimize and avoid environmental impacts. ARB has not shown that its own mitigation measures are legally infeasible. It cannot simply abdicate its responsibility to consider feasible mitigation measures for projects *entirely* subject to its own design, authority, and control.

CEQA requires that ARB act with full knowledge of the environmental consequences of its actions. Because of the extraordinary nature of this regulation—seeking to commit California to accepting offset credits from protocols that do not yet exist—the review of environmental impacts will need to be extraordinarily conservative and circumspect. If linking to a partner jurisdiction commits California to accepting offset credits even when the offset protocols lack even the insufficient environmental safeguards of protocols adopted by ARB, it will not be possible to dismiss the effects of future offset projects in those jurisdictions as too speculative for analysis.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: In conclusion, the regulation fails to ensure that carbon offsets generated in other jurisdictions will not result in negative impacts to forest ecosystems, will not undermine the integrity of California's cap-and-trade program, and will not contradict the mandate of AB 32 to maximize environmental co-benefits. The regulation should include environmentally rigorous standards and require affirmative determination by ARB that offset protocols in other jurisdictions—and in California—will not result in negative environmental impacts.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: Environmental Defense Fund (EDF) and the Natural Resources Defense Council (NRDC) support CARB's efforts to consider linking California's cap-and-trade program to Quebec's through a formal rulemaking process that has the potential to lead to a mutual recognition of compliance instruments issued by either program, should CARB determine upon thorough evaluation, that Quebec's program meets California's rigorous standards for environmental integrity. EDF and NRDC's paramount interest is to preserve the integrity of California's cap-and-trade program. That said, linking, or mutual recognition between strong programs, can, in principle, provide additional flexibility and cost-saving opportunities for regulated entities in both California and Quebec. It was clear from the linkage workshop that CARB's decision on whether to recognize the validity, for compliance purposes, of compliance instruments in the

Quebec program will be based on CARB's thorough consideration, and continuing assessment, of what will provide the strongest and most effective means of reducing greenhouse gas (GHG) emissions and protecting California from the impacts of climate change. We strongly encourage CARB to maintain that perspective throughout the rulemaking process. (EDF3)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: We support the current proposal to amend the cap-and-trade regulation to allow California to accept compliance instruments from linked jurisdictions and specifically to link with Quebec. Showing that two separate governments, in two separate countries, with two separate economies, can effectively partner to put a price on carbon and reduce greenhouse gas emissions is a transformative step for North America; a step that can jumpstart a regional effort to join the growing international movement that is desperately needed to combat the threat of climate change.

In general, expanding California's carbon market will provide both economic and environmental benefits for the state in the form of greater market liquidity and an expanded base of emission reduction opportunities. Based on the analysis provided in the staff report, linkage with Quebec will also help drive capital flows into the state to buttress California's clean energy sectors and capture in-state reductions, offering even greater benefits.

Our primary interest in this rulemaking has been and remains ensuring the environmental integrity of California's cap-and-trade program. Because California and Quebec have been part of the Western Climate Initiative, they have been on parallel tracks towards designing cap-and-trade programs with substantially similar core programmatic elements such as: the stringency of the cap, the reliability of mandatory reporting requirements, the stringency of offset protocols, limits on borrowing, and the adequacy of penalty and enforcement mechanisms. This provides a critical layer of certainty about the equivalency and environmental integrity of Quebec's program. CARB's efforts through this rulemaking to identify the programmatic elements such as joint auctions, a shared compliance instrument tracking system, and equivalent holding limits that require harmonization will also enhance the integrity of both programs.

Response: The Board did not take any action on the linkage amendments. No further response is needed.

EDF2

Name, Affiliation: Erica Morehouse, Environmental Defense Fund; Michelle Passero, The Nature Conservancy; Alex Jackson, Natural Resources Defense Council; Jennifer Martin, Center for Resources Solutions
Written Testimony: 06/27/2012
45-Day Linkage Comment #: 16

Comment: We appreciate CARB's ongoing commitment to develop the cap-and-trade program in an open and public process and we urge CARB to continue this practice with stakeholders and other branches of government as linkage with Quebec and other jurisdictions progresses. Specifically, we urge the Board to direct staff to establish a clear process that will provide the public with notice and opportunity to comment on any significant changes that may occur within a linked jurisdiction. The Board, in conjunction with any staff, public or legislative input, should explicitly retain the authority to make regulatory changes affecting linkage if future adjustments are necessary. California must ensure that any changes made within a linked jurisdiction do not threaten the environmental integrity or overall benefits that California seeks to achieve through linkage. (EDF2)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

Comment: In considering whether to link California's program with Quebec's, the primary question and the ultimate driver behind CARB's action should be what is best for the integrity of California's cap-and-trade program and for California in its efforts to protect its citizens from the threats of climate change. While we await the final proposed regulatory language and full rulemaking package, we are encouraged by CARB's direction as evidenced in the discussion draft and workshop to remain focused on maintaining the high standards of California's program and that the iterative process of harmonizing certain provisions with Quebec's has been undertaken with any eye towards clarifying and strengthening those provisions. As we noted in our initial comments, EDF and NRDC see many potential benefits to California from linking into a broader market, including providing additional flexibility and cost-effective reduction opportunities for regulated entities and building broader support for actions to combat climate change. We look forward to receiving further information from the documents that CARB will release when the formal comment period begins such as the initial statement of reasons, the economic impacts analysis and the CEQA analysis.

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

EDF4

Name: Erica Morehouse
Affiliation: Environmental Defense Fund
Oral Testimony: 06/28/2012
Hearing Witness #: 3

Comment: And the main thing with other jurisdictions that meet California's rigorous environmental standards can provide both economic and environmental benefits, including increasing market liquidity and broaden the emission reductions that are possible and also expanding the demand for emission reduction technology, many of which are made here in California. (EDF4)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

PFT1

Name: Paul Mason
Affiliation: Pacific Forest Trust
Written Testimony: 06/27/2012
45-Day Cap-and-Trade Amendment Comment #: 18

Comment: Establish a public process to evaluate offset protocols adopted by other linked jurisdictions in order to evaluate whether the offsets that will generate compliance instruments used in California are fully consistent with California standards and requirements. Such an evaluation should happen prior to those compliance instruments being accepted into the system and used by a covered entity to meet a compliance obligation. (PFT1)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

TWS1

Name: Ann Chan
Affiliation: The Wilderness Society
Written Testimony: 06/27/2012
45-Day Linkage Comment #: 7

Comment: TWS seeks specific clarification regarding the process and any remedies for addressing findings that proposed or amended protocols for offsets available in linked jurisdictions either: (1) fail to meet the WCI Offset System Essential Elements Recommendations for ensuring that offsets are real, quantifiable, permanent, enforceable, additional and verifiable, and/or (2) have the potential for generating significant adverse, environmental impacts that are not adequately avoided or mitigated including, but not limited to, any transboundary environmental impacts or environmental impacts not otherwise subject to a NEPA-equivalent environmental impact assessment. TWS commends and supports ARB's long-standing approach to program implementation that incorporates transparency, public engagement, and on-going evaluation and adaptive management of implementation of programs and regulations, including any needed updates and adjustments. (TWS1)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

TWS2

Ann Chan
Affiliation: The Wilderness Society
Oral Testimony: 06/27/2012
Hearing Witness #: 14

Comment: We'd also like to see additional clarification regarding any remedies that might be available pursuant to a finding that any after-adopted protocols or amended protocols or not in compliance with the WCI offset essential elements recommendations for additionality, verifiability, and additionality. And also any remedies that might be available for findings that after adopted protocols or modifications are in violation or inconsistent with other relevant environmental laws. (TWS2)

> **Response:** The Board did not take any action on the linkage amendments. No further response is needed.

WSPA1

Name: Catherine Reheis Boyd
Affiliation: Western States Petroleum Association
Written Testimony: 06/27/2012
45-Day Linkage Comment #: 8

Comment: Relationship of CEQA to Cap-and-Trade

WSPA continues to have significant concerns regarding the interplay between the requirements of CEQA and the AB32 C/T program. For example, one could envision emission reductions from a C/T program as mitigation for project-related impacts if the reductions exceed project emissions. In other words, allowances purchased under the C/T program that are in excess of project-related emissions should be considered as valid mitigation under CEQA. Yet, ARB staff stated during the presentation that actions under the C/T program are not intended to address CEQA requirements. ARB has provided no explanation for its unwillingness to address this obvious and important issue. It would be very useful to know from the outset that GHG reductions under the C/T program count for CEQA mitigation.

Recommendation: We strongly urge ARB to address the potential of GHG reductions under the CTR as mitigation for CEQA to industries working within the AB32 Cap-and-Trade market-based mechanism. (WSPA1)

> **Response:** This comment falls outside the scope of the current rulemaking. ARB does not have any authority related to what other lead agencies may accept as valid CEQA mitigation. AB 32 provides ARB only the authority to establish and implement the cap-and-trade program.

REFERENCES

California Air Resources Board. *Functional Equivalent Document prepared for the California Cap on GHG Emissions and Market-Based Compliance Mechanisms*. October 28, 2010. (Appendix O of the ARB Staff Report for the California Cap on GHG Emissions and Market-Based Compliance Mechanisms). http://www.arb.ca.gov/regact/2010/capandtrade10/capv5appo.pdf

California Air Resources Board. *Initial Statement of Reasons:* California Cap on GHG Emissions and Market-Based Compliance Mechanisms *Staff Report to the Air Resources Board.* October 28, 2010. http://www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf

California Air Resources Board. *Initial Statement of Reasons: Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions. Staff Report to the Air Resources Board.* May 9, 2012. http://www.arb.ca.gov/regact/2012/capandtrade12/isormainfinal.pdf

ATTACHMENT B: ACRONYMS

ACR	American Carbon Registry
ARB	California Air Resources Board
AVA	Account Viewing Agents
CAISO	California Independent System Operator
CAR	Climate Action Reserve
CARBIS	California Air Resources Board Information System
CCA	California Carbon Allowance
CCR	California Code of Regulations
CEA	Commodities Exchange Act
CEQA	California Environmental Quality Act
CFTC	Commodity Futures Trading Commission
CHP	Combined Heat and Power
CITSS	Compliance Instrument Tracking System Service
CO_2	carbon dioxide
CO2e	carbon dioxide equivalent
CHP	combined heat and power
CPUC	California Public Utilities Commission
DOJ	Department of Justice
EDU	Electrical Distribution Utilities
EO	Executive Officer
EPA	U.S. Environmental Protection Agency
ETS	Emissions Trading Scheme
EU ETS	European Union Emissions Trading System
FED	Functional Equivalent Document
FERC	Federal Energy Regulatory Commission
FINRA	Financial Industry Regulatory Authority
FSA	financial services administrator
FSOR	Final Statement of Reasons
GHG	greenhouse gas
GWP	global warming potential
ICE	Intercontinental Exchange
IETA	International Emissions Trading Association
IOU	investor-owned utility
IPP	independent power producer
ISOR	Initial Statement of Reasons
JPA	Joint Powers Agency
KYC	Know Your Customer
LADWP	Los Angeles Department of Water and Power
LAO	Legislative Analyst’s Office
LSE	load serving entity
LUHA	limited use holding accounts
MRR	Mandatory Reporting of Greenhouse Gas Emissions Regulation
NAFTA	North American Free Trade Agreement
NEPA	National Environmental Policy Act

NERC	North American Electric Reliability Corporation
NFA	National Futures Association
NOx	oxides of nitrogen
ODS	ozone depleting substance
POU	publicly owned utility
PSE	purchasing-selling entity
QE	qualified export
REC	Renewable Energy Credit
RGGI	Regional Greenhouse Gas Initiative
RPS	Renewables Portfolio Standard
SEC	Securities and Exchange Commission
UNFCCC	United Nations Framework Convention on Climate Change
UOG	Utility-Owned-Generation
VAE	voluntarily associated entity
WCI	Western Climate Initiative
WREGIS	Western Renewable Energy Generation Information System