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May 8, 2024

Dr. Steven Cliff
Executive Officer
California Air Resources Board

Ms. Rajinder Sahota
Deputy Executive Officer
California Air Resources Board

Re: Comments on Potential Amendments to the Cap-and-Trade Regulation

Dear Dr. Cliff and Ms. Sahota,

Thank you for the opportunity to submit comments following the public workshop held on April 23, 2024 (the "**Workshop**") regarding potential amendments to the Cap-and-Trade Regulation (the "**Regulation**"). These comments are submitted on behalf of our client the Coalition for California Climate Ambition (the "**CCCA**") and should be read together with the previous CCCA Comment Letters submitted on July 7, 2023, October 13, 2023 and December 15, 2023 (the "**CCCA Comment Letters**")[1].

The CCCA is an informal, unincorporated association of stakeholders supporting a continued role for the Cap-and-Trade Program (the "**Program**") as the most efficient mechanism to achieve California's climate goals including achievement of carbon neutrality by 2045. The CCCA has members from key Program stakeholder groups, including members of industry, private capital investors, and project developers. CCCA members have made hundreds of billions of dollars of long-term investments in multiple areas of the California economy, including in renewable power, energy transition, energy, transportation and infrastructure. CCCA members actively participate in the Program, including through participation in the California allowance auctions.

We would like to thank the California Air Resources Board ("**CARB**") staff for hosting the Workshop and for their continuous efforts to refine the Program. The comments from the CCCA are as follows.

1. The CCCA Supports Avoiding the Disruptive Effects of the 2030-2031 Discontinuity.

During the Workshop, CARB indicated that decreases of the annual allowance budgets are needed in order to meet California's 2030 and 2045 climate targets. CARB has proposed a cap trajectory

[1] CCCA Comment Letters on CARB's previous workshops dated 7.7.2023 (link), 10.13.2023 (link) and 12.15.2023 (link).

that includes a potential discontinuity in 2031. The CCCA believes that such discontinuity may have a disruptive impact on the market. The CCCA will share its position on this issue following the next workshop, once it has more information on CARB's proposed changes to the allowance allocations and removals.

2. The CCCA Suggests Changing the Holding Limit Formula to Provide a Linear Decline of the Holding Limit, Untied to the Annual Allowance Budget.

As the supply of allowances and the supply in the APCR are gradually reduced, CARB should consider allowing the holding limits to decline at a slower rate. CARB may do so by changing the holding limit formula, which is currently tied to the annual allowance budget, in either of the following methods: (i) setting a linear decline of the holding limits, independent of the annual allowance budgets; or (ii) calculating the holding limits based on the average annual allowance budget over a specific period, such as the previous 3-5 years, as opposed to taking into account only the allowance budget of a single year. This change to the formula could eliminate any discontinuity from 2030 to 2031, reduce the impact of budget fluctuations and enable market participants to retain more allowances in their accounts, serving as a buffer against possible future price increases for business planning purposes, and reduce the likelihood of price collapses should excess allowances in the system exceed allowed holdings as the Program becomes more restrictive in time.

3. The CCCA Supports Revising the Regulation to Confirm that Security Interests in Allowances are Generally Permissible.

CARB should use the upcoming rulemaking to revise the Regulation to confirm that entities may grant, and lenders may take, a security interest in "compliance instruments" (i.e., California Carbon Allowances ("**Allowances**") and offsets). In making it clear that security interests are permissible under the Regulation, CARB would promote practical market policies. Secured financings allow Program participants to finance their business activities, including further investments into the Program, which helps auctions to clear at full volumes and creates further liquidity in the market.

Section 95820(c) of the Regulation provides that "a compliance instrument issued by [CARB] does not constitute property or a property right." This statement creates uncertainty as to if a third-party can take a security interest in a compliance instrument because under the Uniform Commercial Code, a security interest is "an interest in personal property or fixtures which secures payment or performance of an obligation."[2] In 2010, CARB explained this provision is necessary in the broader context of a "takings" argument under the U.S. Constitution, as the State of California needs to maintain the ability to revoke compliance interests in certain cases.[3] However, in June 2023 CARB clarified that entities could grant security interests in Allowances by issuing

[2] UCC § 1-201(a)(35).

[3] Specifically, CARB has stated in the past that "…property rights cannot attach to the compliance instruments because, in the event of federal preemption in the cap-and-trade market or other conditions, California must have the ability to revoke the compliance instruments without creating a loss to the people of California."
See "Staff Report: Initial Statement of Reasons," dated October 28, 2010, p. IX-18, available at https://www.arb.ca.gov/regact/2010/capandtrade10/capisor.pdf.

(i) the revised "Supplemental Request for Information" form, which removed language that stated "allowance specific security interests as a form of loan collateral is prohibited pursuant to [the Regulation]" and (ii) CARB's updated VAE Guidance.[4]

The CCCA proposes the simple change below to Section 95820(c). The resulting language will continue to address the concerns identified by CARB in 2010, while at the same time bring additional certainty to the market with respect to the creation of security interests over compliance instruments, consistent with CARB's clarification from June 2023. The CCCA's proposed amendment to Section 95820(c) is as follows:

> **Current**:
>
> "A compliance instrument issued by the Executive Officer does not constitute property or a property right."
>
> **Proposed Amendment**:
>
> "As against the State of California and its agencies, a compliance instrument issued by the Executive Officer does not constitute property or a property right. However, notwithstanding the foregoing, solely as among third parties the foregoing shall not be construed to limit their private property rights or their ability to grant security interests in any compliance instrument."

The CCCA also proposes that CARB consider revising Section 95921(f)(1) of the Regulation (commonly understood to be the Regulation's "beneficial holdings prohibition") to state that security interests in and of themselves do not constitute an "ownership interest" in compliance instruments/allowances, nor do security interests necessarily provide the secured party with an impermissible level of control over compliance instruments/allowances.

4. The CCCA Urges CARB to Re-Examine the Proposed Changes to Corporate Association Group Triggers and to Solicit Further Feedback from Stakeholders before Implementing any CAG Changes.

During the Workshop, CARB indicated it is evaluating whether to update the Regulation's current Corporate Association Group ("**CAG**") rules to include additional measures of control in order to avoid potential coordination among investment structures. CARB has been quick to point out that it has seen no evidence of entities exercising undue market power or market manipulation, but rather is interested in taking preemptive steps to better ensure the Program does not present opportunities for such behaviors. The CCCA appreciates and supports these objectives with respect to CARB's assessment of CAG rules. The changes to the CAG triggers presented in the Workshop generally focused on the role of third parties, such as individuals providing cap-and-trade consultant or advisory services, and the potential for market coordination on the basis of these individuals. Specifically, the Workshop materials focused on the risk of market manipulation or coordination between investment structures (i.e., voluntarily entities) rather than covered entities.

[4] Available at https://ww2.arb.ca.gov/sites/default/files/2023-06/nc-VAE_Guidance.pdf.

The CCCA is not aware of any public data or allegations of any such improprieties. The CCCA supports CARB's ongoing efforts to continuously explore potential improvements to the Program; however, the CCCA also encourages CARB to continue to evaluate the need for, and scope of, any potential changes to the Regulation's CAG triggers, especially on an expedited timeline for a 2024 rulemaking.

A. The Proposed Changes to the CAG Trigger Could Significantly Delay the 2024 Rulemaking and Prevent CARB from Implementing Critical Program Updates.

Changes to CAG Triggers Will Have a Significant Impact on the Market and Market Participants Need Sufficient Time to Consider the Changes and Provide Comment. The development and subsequent implementation of new CAG triggers would be one of CARB's most significant regulatory changes since the inception of the Program and could potentially disrupt well-established agency practice. As CARB knows, changing market rules mid-stream, particularly when the Program is functioning as designed, can lead to un-intended impacts on the market that have the potential to eclipse any perceived benefits of those changes. Thus, any changes must be subject to careful analysis and stakeholder engagement. Given the anticipated impacts, in addition to the technical and complex nature of the CAG changes, market participants will need sufficient time to review, analyze and consider the practical impacts of the changes on both their particular structures and the Allowance market generally. If CARB intends to finalize its rulemaking in 2024, then the opportunity for CARB to engage in meaningful stakeholder engagement may not present itself for this topic, as the concepts for revising CAG triggers were only introduced in April 2024 with specific proposals to follow.

The 2024 Rulemaking Should Prioritize Emissions Reductions Over Updates to CAG Triggers. The CCCA recommends CARB reserve any significant review and update to the Regulation's CAG triggers for a future rulemaking, and the CCCA looks forward to cooperating with CARB on any such effort. The practical reality is that, especially in the absence of data that indicates compliance or coordination issues, the most critical changes for the 2024 rulemaking relate to adjustments to the Allowance cap. The adjustments to the Allowance cap will drive further emission reductions in the near-term and long-term, and such reductions are a core element of California's climate goals. Any delays to the 2024 rulemaking due to an outsized focus on reviewing CAG triggers will unnecessarily postpone those more critical emissions reductions elements and in turn, have a direct impact on the most vulnerable communities within California.

B. The Regulation's Current CAG Rules Sufficiently Safeguard the Allowance Market.

The CCCA believes the historical success of the Program, from both a compliance and an economic perspective, evidence that the Regulation's current CAG triggers are sufficiently robust to prevent coordination among market participants. CARB's Workshop materials demonstrate that interest in the Program has steadily grown since 2012. The operational efficiency and increased liquidity of the Allowance market over the same period of time also evidences the success of the Program. Further, the CCCA has not identified and is otherwise unaware of any material "non-compliance" events or allegation of market improprieties (such as market power and market

collusion) based on publicly available information. The success of the Program, combined with this high degree of compliance, demonstrates the Regulation, including the current CAG triggers, has sufficiently and robustly prevented market manipulation and undue coordination concerns amongst market participants.

C. Cap-and-Trade Consultants and Advisors Play a Vital Role in the Allowance Market, Including Facilitating Access for both Covered and Voluntarily Associated Entities.

Program Participants Rely on Cap-and-Trade Consultants and Advisors to Access the Market and Comply with its Complex Rules. It is important to recall that the Regulation contains a number of requirements that are unique amongst nearly all other compliance carbon markets globally.[5] "Cap-and-Trade Consultants and Advisors" play a critical role in facilitating and supporting the activities of Program participants, both covered and voluntarily entities alike. Covered entities, particularly smaller or less sophisticated entities, rely on Cap-and-Trade Consultants and Advisors to assist with the foundational principles of the Program, including compliance and reporting obligations. Voluntarily entities, especially financial participants and investors, typically rely on Cap-and-Trade Consultants and Advisors to access the market in a regulatory compliant manner, as they often lack the resources and knowledge required to go through the long and complex Program registration and auction participation processes. Investors often rely on fiduciaries, such as investment managers, to facilitate their participation in the Program because the investors lack the expertise in the complex field of financial markets, carbon markets and cap-and-trade programs. Further, many institutional investors, such as state pension plans and endowments, are legally or by regulation required to use third-party advisors.

The updated CAG triggers that CARB identified in the Workshop, if implemented, may force certain Cap-and-Trade Consultants and Advisors to limit the scope of their services. In turn, as such Cap-and-Trade Consultants and Advisors limit their services, certain investors, such as state pension plans and endowments, could be barred from accessing the Program due to the legal and regulatory restrictions. These types of limitations would directly constrain many active market participants and burden less sophisticated and/or smaller sized entities most acutely, which undermines the efficiencies CARB envisioned when the Program was designed.

Cap-and-Trade Consultants and Advisors Must Be Allowed to Provide Services to More than One Market Participant. From the inception of the Program in 2012, it has been well established that Cap-and-Trade Consultants and Advisors can provide their specific expertise to multiple Program participants without automatically triggering a CAG. This approach is not only rational, but it is also required because, simply put, there are more market participants than there are advisors. This approach also aligns with comparable programs such as RGGI and the EU ETS, which allow for advisors to provide services to any number of participants. As noted above, the Program's rules on the matter, including requiring disclosure of Cap-and-Trade Consultants and

[5] See Section 7 of the December 15, 2023 CCCA Comment Letter (link).

Advisors, are already more stringent and extensive than these comparable programs, and CARB should be mindful not to restrict access to advisors.

Cap-and-Trade Consultants and Advisors Have Professional Obligations that Address Market Manipulation Concerns. Professional Cap-and-Trade Consultants and Advisors often have an obligation, such as a fiduciary duty (or an ethical obligation if the consultant/advisor is an attorney), to maintain the best interests of their clients; meaning, the Cap-and-Trade Consultant and Advisor cannot prioritize the interest of one client over another. This is the same basis the Securities and Exchange Commission ("**SEC**") takes when a registered entity advises on multiple mandates or for multiple investors. In the SEC context, fairness is paramount and the fiduciary duty to ensure all participants are treated equally is enshrined in federal law under the Investment Advisers Act. In other words, a Cap-and-Trade Consultant and Advisor is legally prohibited from leveraging the position of any one registrant it advises against another registrant it advises. Further, similar to any investor and advisor relationship in any financial market, Cap-and-Trade Consultants and Advisors must ultimately follow the directions and instructions of the investors within a structure. The investors dictate the advisory relationship and investors retain full agency to hire, fire and modify the terms of any advisory relationship based off the investor's own review, understanding and conclusions regarding the advisor's performance.

D. The Implementation of any Changes to CAG Triggers Should Extend Over a Multi-Year Period to Avoid Disruption to Currently Well-Functioning Market Activities.

For the reasons outlined above, the CCCA believes that relative to CAG triggers, there are other more critical elements of the 2024 rulemaking for CARB to prioritize. With that in mind, the CCCA supports CARB setting aside full-scale updates to the Regulation's CAG triggers at this time, and in any event, opting to implement any changes to the CAG triggers until 2031 as suggested in the Workshop. This would allow CARB to more precisely evaluate what changes to CAG triggers are in the best interest of the Program, as well as provide all market participants, and CARB, with sufficient time to efficiently adjust to any new or revised CAG triggers.

In the event CARB proceeds with advancing changes to CAG triggers as part of this rulemaking, the CCCA strongly encourages that CARB provide an implementation transition period, with an effective date for any changes to be over a multi-year period, such as on or after 2031 as discussed at the Workshop. This will provide greater confidence that the market can plan for and adjust to changes without shocks that have the potential to seriously undermine the effectiveness of Program.

One option proposed in the Workshop was a 30-day disclosure period, with a one year delayed application of any shared holding limits and purchase limits. This proposal would not be sufficient given the number of Program participants, as well as the number of Cap-and-Trade Consultants and Advisors in the market. Additionally, as CARB is well aware, investment structures are typically complex. This is demonstrated by the fact that CARB often requires more than a year to review and approve investment structures and related account applications. It is clear that a multi-year transition period, at a minimum, would be required for Program participants and their advisors to review their structures and relationships to ensure compliance with any update to the Regulation.

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With these factors in mind, CARB should implement new CAG triggers over an extended period of time in order to provide a clear and accommodating timeline for Program participants and their advisors to work both with each other and with CARB directly.

We appreciate the opportunity to provide comments following the Workshop. We remain available to discuss these matters further at your convenience.

Sincerely,

/s/ Michael Romey

Michael Romey

of LATHAM & WATKINS LLP

/s/ Jean-Philippe Brisson

Jean-Philippe Brisson

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