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Office of Climate Change
California Air Resources Board
1001 I Street
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RE: ARB Proposed Regulation Order for a California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Dr. Kennedy:

Southern California Gas Company (SoCalGas) and San Diego Gas and Electric (SDG&E), jointly as Sempra Energy Utilities (SEu), appreciate the opportunity to submit these written comments concerning the Proposed Regulation Order (Proposed Regulation or PR) for a California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Cap-and-Trade Program). We thank the Air Resources Board Staff for considering stakeholder input on the Preliminary Draft Regulation and making changes to address the significant issues raised regarding mechanisms to reduce price volatility.

SEu's comments that follow are grouped into two categories – "major issues" that involve some of the main principles on which the draft regulations depend, and "clarification issues", where the draft rules are vague or have made errors in language choices that interfere with the intent of the draft rules. The comments below should be considered by the Board if it decides to adopt the Proposed Regulation establishing a California-only Cap-and-Trade Program.

Summary of SEu's Key Recommendations on the Proposed Cap-and-Trade Program

- **The PR should be modified with respect to treatment of natural gas local distribution companies (LDCs) to reflect that natural gas LDCs are already at the 1990 greenhouse gas emissions levels that AB32 requires:** The natural gas sector has already achieved the AB32 target of being below 1990 greenhouse gas (GHG) emissions levels. The PR offers no credit for energy efficiency measures implemented over the past two decades that have led to significant and sustainable emissions reductions in the natural gas sector. The PR improperly includes natural gas LDCs under the Cap-and-Trade Program for the actions of end users that they do not control. Accordingly, the natural gas LDCs should be excluded from the Cap-and-Trade Program because all further sustainable GHG reductions will continue to be the result of programmatic measures reviewed and approved by state regulators, not by markets.

- **The PR should treat publicly owned utilities similar to other electricity market participants and other load serving entities:** The PR is unreasonably discriminatory in favor of publicly owned utilities, and gives POU generation an unfair advantage in the market, and must be revised to eliminate the dichotomy in allocation of allowances for California's electric utilities. The cost of all electricity consumed in California should equally reflect the real cost of carbon. The PR requires first-deliverers of out-of-state electricity and investor owned utility generation to purchase allowances through the auction or purchase offsets. The PR should be corrected to require publicly owned utilities to purchase allowances through the auction or other means for their out-of-state electricity purchases and owned generation in the same manner as for other generators.

- **The allowances allocated for the purposes of industry assistance in Section 95870(d) should also include facilities providing the Pipeline Transportation of Natural Gas:** Establishments primarily engaged in the pipeline transportation of natural gas from processing plants to local distribution systems, NAICS code 486210, should be added to Table 8-1 as these entities have some leakage potential since interstate pipelines operating compressors outside of California have some substitution capabilities for facilities inside California. This industrial sector includes both compressor stations required for pipeline transportation of natural gas and the injection and withdrawal of natural gas from storage fields.

- **Ensure Equal Treatment of All Renewables That Qualify for RES or RPS:** The Mandatory Reporting Requirement Rules raise an additional issue that is intimately related to the rules proposed under the Cap-and-Trade program. The Proposed Regulation should assign a zero GHG attribute to all renewable energy that meets RPS or RES requirements. In general, all renewable energy that meets State standards to qualify for the RPS or RES should be GHG-reducing to comply with California law and to maintain benefits that parties expected when complying with the RPS statute. The discussion points of this recommendation are detailed in our **<u>Comments on the Proposed Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions</u>** and are not discussed further in these comments**.**

DETAILED DISCUSSION OF KEY RECOMMENDATIONS

1. **Treatment of Natural Gas LDCs Needs to Reflect that Gas LDCs Are Already at The 1990 GHG Emissions Levels That AB32 Requires.**

The Proposed Regulation would subject natural gas LDCs to the Cap-and-Trade provisions beginning in 2015 for the natural gas usage of small commercial and residential customers. Additionally, the PR leaves up in the air how to deal with the potential allocation of allowances for this sector.

There are several reasons why this approach is misguided and should be changed to remove natural gas LDCs from the Cap-and-Trade Program.

Including the natural gas LDCs within the Cap-and-Trade program would serve no useful purpose because the ability for LDCs to change their "portfolio" of gas supplies is very limited, unlike the electricity sector. The scope and content of energy efficiency and the rate structures for almost all small natural gas customers are determined by the CPUC. The main actions that natural gas LDCs can carry out to cause emissions in this sector to decline is promotion of energy efficiency (and other programmatic measures) and rate structures, both of which are determined by the CPUC. Including gas LDCs within the Cap-and-Trade Program will not change that, and, accordingly, it serves no purpose other than being a tax. Sustainable reductions will be the result of programmatic measures and rate structures reviewed and approved by state regulators, not by markets.

Moreover, these long-standing programmatic measures have already enabled California to be among the lowest in the nation in natural gas use per customer[1], and they have enabled the natural gas sector already to have achieved the AB32 target of being below 1990 GHG emissions levels[2]. Accordingly, this sector has already carried out its responsibilities under AB 32. The sector is continuing to pursue programmatic measures through the CPUC that are anticipated to achieve further reductions to maintain GHG emissions at 1990 levels even with economic growth. It serves no purpose to subject the small natural gas customers to the added costs of the Cap-and-Trade Program when it has already done its share by incurring costs already for energy efficiency measures over the past two decades as well as implementing an inverted rate structure that provides incentives for conservation and energy efficiency.

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[1] American Gas Association, Knowledge Center Annual Statistics, TABLE 6-15 GAS UTILITY INDUSTRY AVERAGE ANNUAL CONSUMPTION BY STATE AND CLASS OF SERVICE –2008 www.aga.org/KC/RESEARCH/STATISTICS/ANNUALSTATS/Pages/default.aspx

[2] California Greenhouse Gas Inventory for 2000-2008 — by Category as Defined in the Scoping Plan and California Greenhouse Gas Inventory (millions of metric tonnes of CO2 equivalent) — Summary by Economic Sector (1990-2004), www.arb.ca.gov

For these reasons, the natural gas sector should be excluded from Cap-and-Trade. If, notwithstanding these crucial points, ARB nevertheless wants to subject small natural gas customers to the Cap-and-Trade Program, then it is essential to allocate allowances to the sector to reflect the unique position of this sector.

At a minimum, this means that the regulations should provide the following:

1. ARB should allocate allowance value to natural gas LDCs based on the sector's proportionate share of total capped sector emissions in 2015.

2. ARB should administratively allocate 90% of the allowances for customer benefit, which natural gas LDCs will be required to put up for auction or surrender for compliance during the period 2015 – 2020.

3. Revenues generated from the sale of the 10% of allowances in auctions should be allocated to the natural gas LDCs for the benefit of the customers to fund customer energy efficiency (CEE) and other greenhouse gas reduction programs.

4. For simplicity, it is reasonable to adopt a split of allowances for each natural gas LDC based on deliveries to customers in some multi-year historical period (e.g. 2011-2013 for allocations in 2015). Because natural gas usage varies based on different temperature conditions for a subset of customers, using a three-year average will provide an averaging of the weather conditions.

This approach is somewhat similar to the treatment of electric LDCs, except that electric LDCs do not have a compliance obligation.

Without an allocation of allowance value, in the ARB modeling of AB 32, the impact of the cap-and-trade and other complementary policies was higher on small natural gas consumers than on any other sector[3]. The impact of carbon costs associated with cap-and-trade may expose small end users to greater price increases than small end users in the electricity sector since there are fewer mitigation options. The modeling also revealed that this price impact appears to have limited effectiveness for obtaining significant additional GHG reductions.

On behalf of our small gas customers, we consider inclusion of the commercial and residential natural gas customers an unproductive action by the ARB. Including these customers with no allocation of allowance value seems entirely at odds with AB32's direction that ARB "Ensure that

3 Table B-8, on page 102 of the ARB, Updated Economic Analysis of California's Climate Change Scoping Plan, March 24, 2010.

entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions[4]."

2. **The Draft Regulations Arbitrarily Treat Publicly-Owned Utilities Differently than other Electricity Market Participants and Different than Other Load Serving Entities**

The Proposed Regulation has arbitrarily set up different rules for publicly-owned electric utilities (POUs) than for investor-owned electric utilities (IOUs), giving POUs unfair market advantages, and giving POU customers different GHG price signals than are required to be given to IOU customers. Specifically, under proposed section 95892, allowances allocated to IOUs must be monetized in a mandatory auction. In general, allowances are not given to generators directly, and to the extent that an IOU owns generation, that generation must obtain allowances through the auction or other means, but not by direct allocation. In contrast, allowances given to POUs need not be auctioned and the POU may apply them directly to their generating sources. Thus, in contrast to all other electrical generating sources, POU generation need not obtain allowances through the auction process or through offsets.

The Initial Statement of Reasons (ISOR) describes the purpose of the rules applicable to IOUs as intended to ensure that "freely allocated allowances to a distribution utility will not affect competition in the electricity generation market[5]." Furthermore, staff argues that it is essential that "any rebates to residential customers [from auction revenues] should be made as separate payments and not simply deducted from customer bills. The purpose of this restriction is to ensure the carbon price is reflected in residential electric rates." This restriction is included in the rules governing the use of auction proceeds Section 95892(d)(3). However, since POUs are not required to auction allowances off in the first place, the same restriction does not apply for purposes of bills to POU customers.

As important as these principles are that they became essential elements of the proposed regulation, the draft rules deliberately ignore both principles completely in respect of POUs.

Staff identifies a single reason to explain this disparate treatment:

> "Most POUs own and operate their own generation and do not compete with independent generators in the way IOUs do. Because of this, allowances directly allocated to POUs may either be consigned for sale at the general quarterly auctions or used directly to meet their compliance obligations[6]."

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4 Health and Safety Code Section 38562(b)(3)

5 Initial Statement of Reasons, Appendix J, page J-60

6 Initial Statement of Reasons, Part 1, Volume 1, page II-32

POUs have historically both purchased and sold electricity in wholesale markets.[7] Presumably, their decisions on when to purchase as opposed to generating themselves, and on the terms and conditions of potential sales are driven by the same factors that affect other buyers and sellers of power – achieving the best economic outcome. If POUs are given free allowances directly that they can apply to their generation, while other generators must purchase allowances in wholesale markets, there is clearly a mismatch in the treatment of similarly situated generators with potentially uncertain effects on the electricity market. If it is important that IOUs must auction off allowances to avoid interfering with competitive markets, it would seem equally important for POUs to do the same. These provisions, applicable only to POUs, are arbitrary, discriminatory, and have no basis in law or fact to support them. There is no provision in AB32 that justifies it, and the ISOR offers no compelling justification.

The second area where POUs are given special, favorable treatment is the restrictions placed on allowance revenues from the auction that are not placed on the allocated allowances provided to POUs. If it is important that retail customers of IOUs receive price signals from monetizing allowances, it would seem equally important for retail customers of POUs to receive similar price signals. Furthermore, it is odd that the regulation requires IOUs, who are already subject to State regulation through the CPUC, to document how the allowance value is used, but does not require POUs, whose actions have no State oversight, to do the same. POUs have no oversight from the State regarding the use of allowance value except through ARB regulations.

The rules should be the same for both IOUs and POUs. The Proposed Regulation must be revised to eliminate the dichotomy in treatment of allowance revenue for electric POUs as compared with IOUs.

Subarticle 9, section 95892(b) Transfer to Utility Accounts should be amended as follows:

> *(1) Electric Distribution Utilities. The Executive Officer will place allowances in the limited use holding account created for each electrical distribution utility.*
>
> ~~*(1) Investor-owned utilities. The Executive Officer will place allowances in the limited use holding account created for each electrical corporation.*~~
>
> ~~*(2) Publicly owned Electric Utilities. At least 90 days prior to receiving a direct allocation of allowances, publicly owned electric utilities will inform the Executive Officer of the share of their allowances that is to be placed:*~~
>
> ~~*(A) In the publicly owned electric utility's compliance account, or*~~
>
> ~~*(B) In the publicly owned electric utility's limited use holding account.*~~

[7] For example, in LADWP's 2010 Integrated Resource Plan, it states – "The reach and capacity of LADWP's transmission portfolio also enables LADWP to purchase and sell energy in wholesale electricity markets using short and long-term agreements." Los Angeles Department of Water and Power Appendix I 2010 Integrated Resource Plan, at I-1.

The Allowances Allocated for the Purposes of Industry Assistance in Section 95870(d) Should Also Include Facilities Providing the Pipeline Transportation of Natural Gas

The allowances allocated for the purposes of industry assistance in Section 95870(d) only include the industrial sectors in Table 8-1. Omitted from that list are facilities providing the Pipeline Transportation of Natural Gas[8]. Establishments primarily engaged in the pipeline transportation of natural gas from processing plants to local distribution systems, NAICS code 486210, should be added to Table 8-1. This industrial sector includes both compressor stations required for pipeline transportation of natural gas and the injection and withdrawal of natural gas from storage fields. They are covered entities under Section 95811(a)(8) or (12). Companies in this sector include more than natural gas utilities (e.g., interstate pipelines, and independent storage operators), and so should be included here rather than in Section 95870(c)(2). These entities do have some leakage potential since interstate pipelines operating compressors outside of California have some substitution capabilities for facilities inside California. For example, El Paso Natural Gas has compressor stations in Arizona, across the California border from stations operated by Southern California Gas Company. And a recent California Energy Commission Report indicated that there is 90 BCF of storage capacity connected to California, but outside California, in competition with 219 BCF of utility-owned and independent storage in California. This sector should be added to Table 8-1 and should be evaluated by the same criteria as the industries already included in Table 8-1.

Clarification ISSUES (in order by section number)

A. Section 95802. Definitions

Section 95852.2(a) references emissions from sources which do not have a compliance obligation specifically excepting biogas from digesters. However the term "Biogas" is not defined. A definition should be added to section 95802 as follows:

Biogas - gas from the anaerobic digestion of organic wastes.

Also Section 95852(e) specifically lists emissions of Biomethane from animal and other organic waste and landfill gas and wastewater as specifically exempted from creating a compliance obligation and yet "Biomethane" is likewise not defined. A definition for "Biomethane" should be added to section 95802 as follows:

[8] Footnote: California Energy Commission, Barriers to Expansion of Natural Gas Storage Facilities in California, CEC-500-2008-036, April, 2008, Table 26, page 92.

Biomethane — is biogas that has been upgraded or otherwise conditioned to meet CPUC natural gas specifications and is suitable for injection into natural gas pipeline systems operated by public and private utilities.

B. Section 95813 (e). Opt-in Covered Entities

The allowance budgets set forth in Article 6 for the first compliance period should change as entities opt-in. The allowance budget is set for 2012 based on the expected GHG emissions of covered entities in 2012, with reductions in subsequent years. If the universe of covered entities changes, the allowance budgets should change accordingly. No change is necessary for 2015-2020 budgets since these opt-in customers would otherwise be part of the GHG emissions covered by the fuel providers.

Section 95813(e). Opt-In Covered Entities should be amended as follows:

> ~~*(e)Opt-in participation shall not affect the allowance budgets set forth in subarticle 6.*~~

C. Section 95831. Account Types.

This section specifically identifies types of account sand the how the accounts are populated. Pursuant to the discussion on Section 95857(d)(2)(A) which requires the Executive Officer to transfer penalty allowances to the highest-priced tier of the Allowance Price Containment Reserve Account, transferring allowances into the Price Containment Reserve Account will remove those allowances from the first market the auction and may inadvertently tighten the cap.

Sections 95831 and 95857(d)(2)(A) need to be modified to correct this error. Changes to Section 95831 are shown below. Recommended corrections to Section 95857(d)(2)(A) are contained in Section F, below:

Section 95831(c) Accounts under the Control of the Executive Officer. The accounts administrator will create and maintain the following accounts under the control of the Executive Officer:

(1) A holding account to be known as the Allocation Holding Account into which the serial numbers of compliance instruments will be registered when the compliance instruments are created;

(2) A holding account known as the Auction Holding Account into which allowances are transferred to be sold at auction from:

(A) the Allocation Holding Account;

(B) the holding accounts of those entities for which allowances are being auctioned on consignment pursuant to 95831(b)(1)(B); and

(C) the limited use holding accounts of those entities consigning allowances to auction pursuant to subarticle 8.

(D) Into which the serial numbers of allowances submitted to fulfill an entity's excess emissions obligation pursuant to section 95857(c) will be transferred.

Section 95831(c)(4) A holding account to be known as the Allowance Price Containment Reserve Account:

(A) Into which the serial numbers of allowances allocated by ARB for auction that remain unsold at auction will be transferred.

(B) Into which the serial numbers of allowances directly allocated to the Allowance Price Containment Reserve under subarticle 8 will be transferred.

~~(C) Into which the serial numbers of allowances submitted to fulfill an entity's excess emissions obligation pursuant to section 95857(c) will be transferred.~~

(D) From which the Executive Officer will withdraw allowances to sell to covered entities pursuant to section 95913.

D. Section 95841. Annual Allowance Budgets for Calendar Years 2012-2020

The Proposed Regulation includes specific allowance budgets for each year that are in error due to inappropriate adjustment to the Scoping Plan 2020 Greenhouse Gas target. The Scoping Plan clearly sets the 2020 target for AB 32 at 1990 emission levels,[9] as required by the law,[10] and sets the target for the sectors covered by the Cap-and-Trade program at 365 MMT[11]. The budget for 2020 in Table 6-1 of the Proposed Regulation is 334.2 million metric tons CO2e (MMT).

The Proposed Regulation can change the 2020 target to the extent the scope of sectors participating in the cap-and-trade program is changed. Appendix E of the Proposed Regulation, describing the Setting of the Cap, indicates no specific types of emissions no longer covered by the Cap-and-Trade program. However, Staff provided information in discussions that the exclusions were for non-covered emissions in capped sectors and directed attention to ARB's website for the forecast of 2020 emissions.

Staff calculated a new broad scope 2020 allowance budget of 334 MMTCO2e by multiplying the Scoping Plan 365 MMTCO2e 2020 budget estimate by the ratio of the improved estimate of 2008 broad scope emissions (403 MMTCO2e, determined using information from mandatory reporting of

[9] California Climate Change Scoping Plan, ES-1

[10] CALIFORNIA GLOBAL WARMING SOLUTIONS ACT OF 2006, An act to add Division 25.5 (commencing with Section 38500) to the Health and Safety Code, relating to air pollution.

[11] California Climate Change Scoping Plan, page 16

GHGs at the facility level) to the 2008 emissions inventory estimate for broad-scope sector categories (440 MMTCO2e, calculated used the Scoping Plan accounting). However, in the Scoping Plan, the Recycling and Waste sector was omitted from the industrial sector as shown in Figure 3 of the Scoping Plan. Assuming that the landfill gas and wastewater treatment were already deducted in the Scoping Plan, the method used by ARB to reduce covered sector emissions double counts the Recycling and Waste sector emissions. The 11.7 MMT in this sector should be excluded before creating the ratio since they were excluded in the Scoping Plan. This means that 403 would be divided by 429.3 and multiplied by 365 totally 342.6 MMT.

Table 6-1 should be changed as shown below to reflect the proper adjustment.

Table 6-1: California GHG Allowances Budgets

	Budget Year	Annual Allowance Budget (Millions of CA GHG Allowances)
First Compliance Period	2012	165.8
	2013	162.8
	2014	159.7
Second Compliance Period	2015	394.5
	2016	384.1
	2017	373.7
Third Compliance Period	2018	363.4
	2019	353.0
	2020	342.6

E. Sections 95854 and 95856(b)(2). Annual Limits

The Proposed Regulation appears to create annual limits on the use of allowances and offsets. This element of the PR inappropriately reduces fungiblity of allowances and offsets within the three-year compliance period. This defect should be corrected.

If only 2012 allowances are valid for surrender to meet compliance obligations for 2012, as currently stated in Section 95856(b)(2) and only 8 percent of 2012 compliance obligation can be met with offsets as indicated in Section 95854, the three-year compliance period is in actuality a series of one-year compliance obligations. However, during workshops ARB explained its intent that allowances and offsets would be fully fungible during the three-year compliance period to be able to smoothing out weather and economic growth variations. Accordingly, offsets should be limited only to 8 percent of the triennial compliance obligation; there should be no annual limit. Similarly, the requirement for allowances should be modified to indicate that they must be issued during the same triennial compliance period, or before, unless conditions (A) or (B) are met. Allowances issued for 2013 or 2014 should be allowed to be used in 2012.

To correct this discrepancy, Section 95854. Quantitative Usage Limit on Designated Compliance Instruments—Offset Credits should be amended as follows:

> *The number of offset credits that each covered entity may surrender to meet its ~~annual or~~ triennial compliance obligation must conform to the following limit:*
>
> *O/S must be less than L*
>
> *Where:*
>
> *O = Total number of compliance instruments that are designated as subject to this quantitative usage limit pursuant to subarticle 4, section 95821(b), (c), and (d).*
>
> *Sector-based offset credits as defined in section 95821 cannot represent more than 25% of O in the first and second compliance periods and 50% of O in all other periods.*
>
> *S = Covered entity's ~~annual or~~ triennial compliance obligation.*
>
> *L = Quantitative offset credit usage limit, set at 0.08.*

95856(b)(2). Timely Surrender of Compliance Instruments by a Covered Entity should be amended as follows:

> *To fulfill any compliance obligation, a compliance instrument must be issued from an allowance budget year within or before the ~~year during which the compliance obligation is calculated ,~~* ***end of the compliance period*** *unless:*
>
> *(A) the allowance was purchased from the Allowance Price Containment Reserve pursuant to section 95913; or*
>
> *(B) the allowance is used to satisfy an excess emissions obligation*

F. Section 95857(c) and Section 95857(d)(2)(A). Untimely Surrender of Compliance Instruments by a Covered Entity.

95857(c) Recovery of the Untimely Surrender Obligation, states the obligation to surrender allowances for excess emissions is immediately due and upon determining that a covered entity has excess emissions, the Executive Officer is allowed to prevent any transfers of compliance instruments from an entity's holding account to transfer any and all allowances from the Holding Account to its compliance account until the retirement obligations of this section are met. It is not appropriate to allow the Executive Officer to restrict an entity's Holding Account if ARB alleges an entity is determined to be in violation of provisions of this article. This provision circumvents dispute resolution procedures and allows the ARB substantial opportunity to force reconciliation of an enforcement matter when an entity disagrees that there is non-compliance. For example in the situation where there is a dispute that insufficient allowances were retired ARB could "restrict" the entity's allowance account, potentially causing additional future noncompliance because the account cannot be accessed. This section would prevent the company alleged to be out of compliance from transferring any allowances from their account until the excess emissions "penalty" is reconciled. If a dispute is under consideration among the entities at the time of the next compliance deadline, the entity would basically be forced into noncompliance AGAIN because it would not be able to transfer allowances from its account to meet the new compliance obligation.

Section 95857(c) is neither appropriate nor productive, as written and should be revised as follows:

> *(c) Recovery of the Untimely Surrender Obligation.*
>
> *(1) The obligation to surrender allowances for excess emissions is immediately due;*
>
> ~~*(2) Immediately upon determining that a covered entity has excess emissions, the Executive Officer shall prevent any transfers of compliance instruments from the holding account controlled by the covered entity;*~~
>
> ~~*(3) The Executive Officer shall transfer any remaining allowances from the Holding Account controlled by the covered entity with excess emissions to its compliance account until the retirement obligations of this section are met;*~~
>
> *(2)* ~~*(4) If the Executive Officer is unable to retrieve sufficient allowances using the above process,*~~ *the Executive Officer shall provide the deficient covered entity 30 days to secure the allowances needed to cover its untimely surrender obligation;*
>
> ~~*(5) If the covered entity fails to transfer allowances equal to the untimely surrender obligation pursuant to this section to its compliance account within the period specified in 95857(c)(4), the Executive Officer will:*~~
>
> ~~*(A) Identify holding accounts controlled by affiliates of the deficient covered entity to which the covered entity has transferred compliance instruments during the compliance period for which a compliance obligation remains unfilled; and*~~
>
> ~~*(B) The Executive Officer will prevent transfers from the holding accounts identified in (A) above, and retrieve allowances from those accounts to meet the untimely surrender obligation pursuant to this section.*~~
>
> *(3)* ~~*(6)*~~ *Additionally, if the covered entity or opt-in covered entity does not surrender sufficient allowances equal to its untimely surrender obligation pursuant to this section by the end of the 30-day period, the Executive Officer may pursue enforcement activities pursuant to subarticle 15.*

Section 95857(d)(2)(A) states that when the covered entity meets its obligations pursuant to subsection (c) "Recovery of Untimely Surrender Obligations", the Executive Officer shall transfer three-fourths of the allowances to the highest-priced tier of the Allowance Price Containment Reserve Account. As discussed earlier in these comments transferring allowances into the Price

Containment Reserve Account will remove those allowances from the first market the auction and may inadvertently and unnecessarily tighten the cap.

It is recommended the language be changed as follows:

> *(d) When the covered entity or opt-in covered entity meets its obligations pursuant to subsection (c) above, the Executive Officer shall:*
>
> *(1) Remove the restrictions on transfers from the holding accounts controlled by the covered entity and affiliated entities;*
>
> *(2) Transfer the allowances used to fulfill the untimely surrender obligation in the following manner:*
>
> *(A) Three fourths to the highest-priced tier of the* ***Allowance Auction Holding Account*** ~~*Price Containment Reserve Account*~~*; and*
>
> *(B) One fourth to the Retirement Account.*

G. 95870(b) and (f). Disposition of Allowances, Advance Auction and Auction Proceeds for AB 32 Statutory Objectives.

Proceeds from the Advance Auction and all remaining allowances not allocated for uses specified in sections 95870(a)-(e) will be designated for sale at auction. The Proposed Regulation designates funds from the sale of these allowance pools will be deposited into the Air Pollution Control Fund and will be available for appropriation by the Legislature for the purposes designated in California Health and Safety Code sections 38500 et seq. During the rulemaking to consider adoption of proposed AB 32 Cost of Implementation Fee Regulations staff stated "As the state's cap-and-trade program becomes more developed funding the administrative costs associated with AB32 will be considered if appropriate." At the time ARB disagreed that the regulation itself should clarify that the Fee proposed therein will only be an interim funding measure as it is premature to assume that funding will come from a cap-and-trade program, or any another source[12].

It is timely to insert into Sections 95870 (b) and (f) language that recognizes this mode of funding administrative costs:

> *The proceeds from the sale of these allowances will be deposited into the Air Pollution Control Fund and will be available for appropriation by the Legislature for* ~~*the*~~ ***funding the cost of implementation of AB 32 and other*** *purposes designated in California Health and Safety Code sections 38500 et seq.*

[12] Page 61 AB 32 COST OF IMPLEMENTATION FEE, Final Statement of Reasons for Rulemaking, Including Summary of Comments and Agency Response

H. Section 95913. Allowance Price Containment Reserve Sales

Section 95913 is excessively ambiguous because it is much more complicated than it should be and requires clarification. The allowance reserve will be fairly large compared to quarterly sales of allowances in the auction since it is made up of the equivalent of 4 percent of allowances from 36 auctions. Accordingly, it would be far simpler to fill the excess need of compliance entities from the Price Containment Reserve if the price ceiling is reached in the auction and there is excess demand at the price ceiling. If compliance entities requested 10 MMT more than available at the ceiling price, the added 10 MMT would come from the Price Containment Reserve. The price ceiling would be the same as the Tier 1 level until it was exhausted, then the ceiling price in the following auction would increase to the Tier 2 level.[13] Such a procedure would avoid a second auction and the complex rules in Sections 95913(e) and (f).

I. Section 95914. Disclosure of Direct and Indirect Corporate Associations

Section 95914 needs to be modified to recognize the CPUC's affiliate transaction rules. Section 95914 requires the identification of Direct and Indirect Corporate Associations. California public utilities can disclose names of parent and affiliated companies, but have limited knowledge of the unregulated business affiliates. Utilities subject to the jurisdiction of the California Public Utilities Commission must comply with rigorous affiliate compliance rules in their dealings with their unregulated affiliates. Identification of the names of the parent and affiliated companies may be provided, but information sharing or any economic transactions between the regulated and unregulated entities are subject to stringent regulations. The public policy behind these rules is to protect utility ratepayers from being negatively impacted, economically or otherwise, by any actions of a utility's unregulated affiliates. Unregulated affiliates are not to be provided any information or economic benefit from the utility that could give such unregulated affiliate any information that is non-public, or would put it in a preferential position in any transactions or dealings. Any proposed rules and regulations that would aggregate or transfer benefits, responsibility or penalties between regulated and unregulated companies would likely be in contravention of CPUC rules or regulations need to be eliminated from any proposed ARB regulations.

Accordingly, the following language is needed to ensure consistency with CPUC affiliate rules:

> *Add to Section 95914: (c) (4) Any registered entity subject to affiliate compliance rules promulgated by state or federal agencies shall not be required to disclose information or take other action in contravention of such rules.*

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[13] If there was excess demand at the Tier 1 level that would exhaust tier 1 level of allowances the excess demand could be prorated, and compliance entities would have to wait until the next auction to access Tier 2 allowances.

J. Section 95920(b)(3). Holding Limits

The proposed holding limit, which translates to roughly 6 MMT, is far too low for a three-year compliance period for large compliance entities such as SoCalGas, even with the limited exemption that does not count the allowances in the compliance holding account. It would essentially eliminate banking by those entities. While such holding limits are appropriate for entities without a compliance obligation, the holding limits should be increased for compliance entities.

One approach would be to make the holding limit a function of the cumulative Annual Allowance Budgets within the three-year compliance period (e.g., year 2 holding limit based on the sum of year 1 and year 2 allowance budgets) for compliance entities.

Section 95920(b)(3) - Holding Limits should be amended to add the following:

Calculation for compliance entities: The holding limit will be calculated and applied within each compliance period using the following formula:

$$\text{Holding Limit} = \sum_{i=1}^{t} \left[0.1 * \text{Base} + 0.025 * (\text{Annual Allowance Budget}_i - \text{Base})\right]$$

In which:
"Base" equals 25 million metric tons of CO2e.
*"Annual Allowance Budget$_i$" is the number of allowances associated with the budget year **i** pursuant to subarticle 6.*
"t" equals the current year in the compliance period(1,2, or 3)

K. Section 95973. Requirements for Offset Projects Using ARB Compliance Offset Protocols.

Section 95973(a)(3), states the offset projects can be done within the U.S., Canada or Mexico however, it does not specifically identify U.S. Territories. This is inconsistent with the Livestock Manure (Digester) Offset Protocol, which identifies the United States and U.S. Territories.

The two should be consistent. It is suggested the language be amended as follows:

*(3) be located in the United States **and United States Territories**, , Canada, or Mexico.*

L. Section 96011. Authority to Suspend, Revoke, or Modify

As also discussed in Section F, above, it is not appropriate to allow the Executive Officer to restrict an entity's Holding Account if ARB alleges an entity is determined to be in violation of provisions of this article. This provision allows the ARB substantial opportunity to force reconciliation instead of following accepted dispute resolution processes during an enforcement matter when an entity disagrees that there is non-compliance. For example in the situation where there is a dispute that insufficient allowances were retired ARB could "restrict" the entity's allowance account potentially causing additional future noncompliance because the account cannot be accessed.

Section 96011 is neither appropriate nor productive and should be removed from the regulation.

~~*96011. Authority to Suspend, Revoke, or Modify.*~~

~~*(a) The Executive Officer may suspend, revoke, or place restrictions on the Holding Account of a voluntarily associated entity determined to be in violation of any provision of this article.*~~

~~*(b) The Executive Officer may place restrictions on a Holding Account of a covered entity or an opt-in covered entity determined to be in violation of any provision of this article or of article 2 of this subchapter.*~~

~~*(c) The Executive Officer may suspend or revoke the registration for an entity registered pursuant to 95814(b).*~~

~~*(d) The Executive Officer may suspend, revoke, or modify any Executive Order issued under this article or under article 2 of this subchapter, including an order accrediting a verifier, for a violation of any provision of this article.*~~

M. Section 96022. Reserved Provisions

Volume I, Initial Statement of Reasons discussed staff's concerns and the real threat of lost value and stranded assets in the event of mandated pre-emption to a Federal greenhouse gas program[14]. The Proposed Regulation should address this issue to ensure allowances held in accounts under the control of the Executive Director retain the invested value in the event of Federal preemption.

ARB recognizes in the ISOR that effective market oversight is a necessary component of GHG cap-and-trade compliance programs. The Proposed Regulation notes that unanticipated effects and results could occur over the life of the program. While ARB proposes periodic reviews, the ARB should also establish a market oversight committee that meets regularly to assess whether the market is functioning as expected. This committee, similar to the one that reviews CAISO markets, should make recommended changes to the program to ARB on a periodic basis and be able to recommend that the Governor suspend the program if the market fails, creating unforeseen and harmful impacts to consumers.

[14] Should a federal cap-and-trade program be established that preempts California's program, staff supports the establishment of a mechanism for the exchange of State-issued allowances for federal allowances to provide for an orderly transition and avoid the creation of stranded allowances. IV-7 Cap Initial Statement of Reasons

Thank you for the opportunity to offer these comments on the Proposed Regulation.

Sincerely,

Tamara Rasberry