

**Comments of the Western Power Trading Forum on Possible  
Amendments to the Cap and Trade Program**  
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## ***Introduction***

The Western Power Trading Forum<sup>1</sup> (WPTF) welcomes the opportunity to provide input to the California Air Resources Board (CARB) on its consideration of possible amendments to the Cap and Trade program for the third compliance period and the post-2020 program, including changes necessary for California's compliance with the Clean Power Plan (CPP).

WPTF is encouraged that staff are fully considering opportunities for linking the California cap and trade program with other allowance trading programs that may emerge under the CPP. As we indicated in our October comments, WPTF recommends that CARB aim to develop a trading-ready program that would allow trading with any other states that have an EPA approved program, rather than specifying linkages with particular states. Linked allowance trading programs throughout the west and nationally would have significant advantages in terms of delivering long-term emission reductions and ensuring a common and consistent carbon price signal for generator dispatch and investment.

Our comments below address the following issues relating to amendment of the cap and trade program:

- Timing of regulatory amendments and submission of a final CPP compliance plan to EPA
- Analyses of the direction and magnitude of allowance flows
- Clarifications on the net allowance import/export adjustment from EPA
- Changes to California's program to enable linking
- Changes to California's program to conform with the CPP
- Treatment of electricity imports

## **Timing of Regulatory Amendments and submission of CPP Compliance plan**

At the October 2<sup>nd</sup> workshop, staff indicated that amendments for both the third compliance period and the post-2020 program would be addressed in the same rule-making. To enable the regulations to be in effect by 2018, staff intends to complete rule-making by May 2017. Staff further indicated the possibility of submitting a draft CPP plan to EPA by September, 2016.

WPTF believes that it is essential to have certainty regarding any program changes for the third compliance period by May 2017. Because resolution of changes to the regulations for the third compliance period are more urgently needed than the new regulations for the post 2020 program (which will need to carefully considered in conjunction with emerging CPP implementations programs of other states, and the treatment of electricity imports given the expansion of the Energy Imbalance Market and potential regionalization of the CAISO), WPTF recommends that CARB split the rule-making into two phases. The first phase would address regulation changes applicable to the third compliance period, and the second would address changes for the post 2020 program.

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<sup>1</sup> WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 80 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

This would enable timely adoption of amendments for the third compliance period, while enabling additional time for consideration of changes after 2020.

WPTF also recommends that CARB not submit a complete draft CPP plan to EPA in September. Instead, staff should provide an 'initial submission' that meets EPA's requirements to enable an extension of time to file the final compliance plan.

### **Analyses needed of the direction and magnitude of allowance flows under linkage scenarios**

Linking of California's multi-sector program with other state CPP trading programs creates challenges. On the one hand, although electricity sector emissions are likely to be substantially below California's CPP mass target, there are scenarios under which the export of allowances from California to other states could put California at risk of triggering the CPP backstop. On the other hand, the purchase and use of CPP allowance by other sectors (i.e. not electricity generating units) covered by the cap and trade program could undermine achievement of the state's 2030 GHG emission goals.

In order to fully evaluate options and develop appropriate amendments to the cap and trade program, analyses of the magnitude and direction of allowance flows under various linking scenarios is needed. Such scenarios should consider a range of possible allowance prices, as well as options for partial linkage. (For instance, if CARB determines that full program linkage to other CPP states could undermine achievement of 2030 emission goals, the program could be modified so entities in all covered sectors could use California and Quebec-issued allowances for compliance, but only EGUs could use allowances issued by other CPP states.)

### **Clarification needed from EPA on the net allowance import/export adjustment**

WPTF recommends that CARB seek clarification from EPA, and modification of the CPP, if necessary, regarding the means for determining the quantity of the net allowance export/import adjustment for evaluating California's compliance with its CPP target if California's program is linked with other CPP trading programs.

The CPP defines the adjustment in relation to holdings in EGU entity holding accounts:

*"Net allowance export/import means a net transfer of CO2 allowances during an interim step, the interim period, or a final reporting period which represents the net number of CO2 allowances (issued by a State) that are transferred from the compliance accounts of affected EGUs in that state to the compliance accounts of affected EGUs in another State. This net transfer is determined based on compliance account holdings at the end of the plan performance period. Compliance account holdings, as used here, refer to the number of CO2 allowances surrendered for compliance during a plan performance period, as well as any remaining CO2 allowances held in a compliance account as of the end of a plan performance period."*

This definition poses a number of problems.

- First, the suggestion that allowances can be transferred from one compliance account to another is incorrect under both EPA's rule and the California program. Units held in compliance accounts have been retired and cannot be transferred to other entity accounts.

- Second, the reference to EGU holdings implies that the determination of net export/import would be based on a comparison to some initial total quantity of EGU allowances holdings. California's program does not and should not create sector-specific caps within the overall emission allowance budget.
- Third, this approach would require knowledge of the retirement status of California-issued allowances exported to other CPP states, either via linked tracking system or from EPA.
- Finally, the definition inappropriately limits allowances included in the export adjustment to those retired by EGUs, rather than the full quantity of allowances transferred to other CPP states.

To address these issues, CARB should seek clarification or technical modification from EPA that net allowance export/import adjustment is to be based on the total quantity of allowances transferred out of/into a multi-sector emission trading program. Such an approach would enable the adjustment to be determined by CITSS without the need for information on the allowance retirement status in other programs. The adjustment quantity could be officially determined for CPP compliance purposes following retirement deadlines, but could also be tracked by CARB on an ongoing basis to monitor performance against the CPP interim targets.

Additionally, staff have correctly identified ambiguity in the CPP with respect to the import/export adjustment in the case of trading between two multi-sector states (state measures states). Section 60.5740 of the CPP does not appear to provide an import adjustment to the importing state, but appears to require an export adjustment from the exporting state. If correct this yields an absurd result, as the quantity of allowances transferred would be effectively deducted from the overall aggregate emission caps of trading states.

For transparency and clarity, CARB should ask EPA to clarify that when two multi-sector states trade directly, that there will be an import/export adjustment on each side of the transfer.<sup>2</sup> Since the compliance of each multi-sector state will be determined by total EGU emissions, as adjusted by the import/export adjustment, overall environmental integrity will be maintained.

### **Modifications of the cap and trade program to enable linkage with other CPP states**

Changes to the cap and trade program would be necessary to enable linkage to other CPP allowance trading programs in two areas: rules for use of CPP allowances and modification of the Compliance Instrument Tracking System Service (CITSS).

On the first point, the cap and trade regulation would need to be amended to provide for the use of allowances issued by other CPP states to be used by California covered entities for compliance. As noted above, CARB could authorize the use of these allowances by entities in all sectors, or only by EGUs.

Second, CITSS would need to be modified so that market participants can see whether allowances were issued by California or Quebec (or any other linked Canadian province). Such a provision is

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<sup>2</sup> WPTF notes that if this clarification is not made, it is not likely to have any practical effect – provided that at least one EGU-only trading state is linked to the two multi-sector states. Under this scenario, allowances issued by a multi-sector state could be swapped for an allowance for an EGU-only state for import into the second multi-sector state. This would enable the import adjustment to be used by the importing state.

necessary because Quebec-issued allowances would not be eligible for use by entities in an electricity-only CPP allowance trading state.

### **Modification of the cap and trade program for conformity with the CPP**

CARB staff have identified three other potential areas for modification of the cap and trade regulation for conformity to CPP requirements. These are the inclusion of a “backstop” mechanism, possible elimination of the limited borrowing provisions in the current program and of alignment of program deadlines.

#### *Backstop mechanism*

On the question of a backstop mechanism, the CPP does not appear to provide much flexibility regarding design - the backstop must take the form of EGU standards, which could optionally be implemented via allowance trading. The backstop itself must be included in the final plan, but the level of the backstop cap could be adjusted at the time the backstop is triggered to ensure that any emission overage is made up<sup>3</sup>.

For California, this means that the electricity sector would need to be severed from other sectors under the cap and trade program. For the following years, there would have to be separate electricity sector cap with designated allowances and no fungibility of allowances between the electricity sector and other covered sectors. The use of banked or borrowed allowances by EGUs for compliance under the backstop would also be prohibited.

Triggering of the backstop would be extremely disruptive to California and other linked carbon markets. While triggering the backstop is low probability, CARB should seek to ensure that it never occurs. As a first step, CARB should monitor the net allowance export/import adjustment on an ongoing basis and compare adjusted emissions to the CPP targets. Second, CARB should consider other provisions that could be implemented in advance of triggering the backstop if CPP compliance emissions/net exports appear to be going off track. WPTF does not have a position on these provisions, but suggests that an increase of the allowance price floor should be evaluated as a possible tool.

#### *Borrowing*

On the issue of the conformity of current program rules allowing limited borrowing with the CPP requirement, WPTF does not see a problem. Under a state measures approach California’s ongoing compliance with the CPP would be determined by comparing total electricity emissions to its CPP targets, rather than by a demonstration that EGUs are complying with the EGU standards. Other than the transfer of allowances to/from other CPP states, the source and use of compliance instruments used with the California cap and trade program itself are irrelevant for CPP compliance: the import to and export from California of CPP allowances would alter California’s reported CPP emissions, the use of other compliance instruments – borrowed allowances, allowances issued by Canadian province, offsets – would not. Thus, we would argue that section 60.5815(f) of the CPP should be read as applying to allowance trading under an EGU standard approach only.

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<sup>3</sup> CPP Section 60.5740(3)

### *Alignment of program deadlines*

Staff have identified two areas where cap and trade program deadlines might need to be modified to comply with the CPP – emissions reporting and retirement. On the reporting side, the CPP would require CARB to report total electricity emissions for the previous year to EPA by July. Because this deadline is prior to the current program deadline for verification, staff have suggested possible modification of the reporting and verification schedule under the cap and trade program.

WPTF opposes further tightening of the reporting and verification schedule, which is already burdensome. Further, we do not consider it necessary for CARB to report electricity GHG emissions to EPA based on verified data. Direct reporting by affected EGUs to EPA under the Clean Air Act will presumably be the official source of data used by EPA in evaluating compliance under the CPP. As this data is not subject to third party verification, we do not see a need for the state's report to EPA to be based on verified data. Instead, CARB should maintain the current reporting and verification schedule under the Mandatory Reporting Regulation (MRR) (and use this data for determining compliance under the cap and trade program), and base the state compliance report to EPA on reported data.

Regarding retirement of allowances, WPTF recommends that after 2020 the cap and trade compliance periods be aligned with the two-year compliance periods under the CPP. The expansion of the carbon market via linkage to other CPP programs would more than compensate for any loss of compliance flexibility caused by going from three to two-year compliance periods.

### **Electricity import Issues**

Finally, WPTF reiterates that CARB must also consider changes to the treatment of electricity imports after 2020. WPTF does not consider it appropriate for CARB to attribute GHG emissions to imported electricity from generation that is subject to GHG regulation in its home state. Thus, it will be necessary for CARB to consider the emerging CPP compliance strategies of other western states in developing the post 2020 rule.

In the shorter term, the implications of the California ISO Energy Imbalance Market's expansion and transformation of the CAISO to a regional organization also merit careful consideration. First, as the EIM/CAISO footprint expands, the quantity of electricity that is imported into the state but not scheduled via e-tag will increase. Second, the participation of more entities/states in the CAISO markets will increase pressure to change GHG accounting in the CAISO algorithm. Current practice of considering the cleanest power as being dispatched to California will be more controversial as EIM participating entities face enhanced GHG and RPS policies in their own states. WPTF does not take a position on these issues at this time, but flags them for further discussion.