

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Integrate and Refine  
Procurement Policies and Consider Long-Term  
Procurement Plans.

Rulemaking 10-05-006  
(Filed May 6, 2010)

**COMMENTS OF CAMCO INTERNATIONAL GROUP, INC.  
ON TRACK III PROPOSED DECISION RULES**

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Pursuant to Rule 14.3 of the California Public Utilities Commission’s (“Commission”) Rules of Practice and Procedure and the Administrative Law Judge’s February 21, 2012 Proposed Decision in the captioned docket (“Proposed Decision” or “PD”), Camco International Group, Inc. (“Camco”) submits these comments on the Proposed Decision. By separate filing of the same date, Camco has submitted an application for party status.

**I. INTRODUCTION.**

Camco is the North American division of Camco International Ltd., a global developer of carbon offset projects and solutions to reduce greenhouse gas emissions with operations in the United States, the UK, China, Africa, Russia and Southeast Asia. We have been providing our clients with project development expertise, technical delivery capabilities and policy advice for over twenty years and generating offsets in North America for over five years. Based in Denver, Colorado, Camco holds the largest number of Livestock Gas Capture / Combustion projects registered on the Climate Action Reserve and is evaluating, investing in and developing Livestock Gas Capture / Combustion projects in California and other Western States. Offsets from these projects could provide organizations covered under California’s cap-and-trade

regulation with a flexible solution for meeting part of their compliance obligations at a lower-cost to those companies and California ratepayers.

Camco supports the Proposed Decision's reaffirmation of the important role of carbon offsets in meeting California's climate objectives and reducing costs to ratepayers. Camco supports California's policies to encourage energy efficiency, demand response and renewable generation, with carbon offsets serving as an important complement to that strategy to offset the environmental impacts of fossil generation.

Camco is concerned, however, that some of the Proposed Decision's rules with respect to IOU procurement of carbon offsets may have the unintended consequence of discouraging participation in the IOU procurement process, reducing the incentive for developers to generate offsets and unnecessarily raising costs to ratepayers. Taken together, the rules for IOUs to procure offsets may increase offset prices to a level at which there is no-benefit for IOUs to purchase offsets vis-à-vis allowances. The California Air Resources Board ("CARB") has undertaken significant analyses of the benefits offsets provide to the cap-and-trade program. The effect of the Proposed Decision may constrain offset supply and offset prices having a disproportionate impact on allowance prices, especially if there is a shortage of allowances. This is particularly true in the initial compliance period when IOUs are expected to make up a significant portion of the program. Camco also requests clarification as to the Proposed Decision's policy with respect to the allocation of the risk of invalidation to ensure consistency with the CARB's cap-and-trade regulations.

**II. RATEPAYER INTERESTS WILL BE BETTER SERVED THROUGH A MORE FLEXIBLE POLICY ON THE ALLOCATION OF RISK OF OFFSET INVALIDATION.**

Camco believes that ratepayer interests will be better served through a more flexible policy with respect to the assumption of risk of offset invalidation. The Proposed Decision would shift the risk of CARB invalidation of offsets from the “buyer” to the “seller”:

Because existing offsets, unlike allowances, face the risk of being invalidated if CARB finds they do not meet measurement or verification requirements, there is a question of who bears the risk of invalidation. The default under CARB regulations is that responsibility for invalidated offsets falls on the buying entity. In order to protect ratepayers against this risk, the utilities can only purchase offsets if the seller assumes the risk of invalidation. (Proposed Decision at 42).

Camco respectfully submits that the CARB decision represents a more fundamental policy interest than simply a “default” position that can be shifted by the Commission from buyer to seller. This issue was heavily contested and discussed extensively before CARB. The operative terms under the CARB Regulations are “Holding Account,” “Compliance Account” and “Retirement Account.”<sup>1</sup> If offsets are invalidated, they are removed from the Holding and Compliance Accounts.<sup>2</sup> If the offsets have already been retired into a Retirement Account, then the entity on whose behalf the offsets were retired is responsible for sourcing replacement credits within six months.<sup>3</sup> From an environmental integrity standpoint, the CARB framework makes sense, as these accounts track the entities claiming the emissions reduction benefits of the carbon offsets. Under the CARB framework, it is immaterial whether one is a buyer or a seller, or whether an offset was bought and sold multiple times, or not at all. Rather than simply establishing a default position, CARB specifically identifies the only situation in which it is appropriate to shift regulatory responsibility away from the current Holding or Compliance

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<sup>1</sup> 17 C.C.R. 95985(g).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* 95985(h).

Account holder or the entity on whose behalf the credits have been retired into a Retirement Account: if the entity on whose behalf credits have been placed into a Retirement Account no longer exists, then the responsibility for sourcing replacement credits falls to the Project Operator.<sup>4</sup>

Camco requests confirmation that the Commission is not seeking to alter, amend or enlarge upon the CARB framework with respect to regulatory responsibility for sourcing replacement credits for invalidated offsets that have been retired. Camco asks the Commission to confirm that, consistent with the CARB regulations, this responsibility remains with the entity on whose behalf the offsets were retired into the Retirement Account (except in the limited circumstance where the account holder no longer exists, in which case responsibility falls to the Project Operator). As a practical matter, Camco questions whether a utility would even have the authority to assign away contractually its regulatory responsibilities to another party.

Camco anticipates that the more important question from the Commission's standpoint is the allocation of cost responsibility for: (i) the economic value of the invalidated offsets removed from the utility Compliance Account, and (ii) costs for securing replacement credits for offsets retired on the utility's behalf that are subsequently invalidated. Camco recommends that the Commission focus its oversight on ensuring that the contractual agreements between the parties arrives at the best price and most efficient allocation of the risk of invalidation between the seller and the utility buyer. Based on Camco's experience negotiating similar issues domestically and globally, Camco believes that ratepayers stand to benefit considerably from a more flexible Commission policy than automatically allocating this cost responsibility risk to the seller. Buyers and sellers to carbon credit transactions routinely negotiate and make important trade-offs between purchase price and the allocation of contractual liability for market losses and

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<sup>4</sup> *Id.* 95985(h)(2)(B), subpart 1.

indirect and consequential damages. Importantly, carbon credit buyers are often able to command a better purchase price or other favorable commercial terms if the contract limits the seller's cost exposure for these types of losses.

Camco is concerned that placing the risk of offset invalidation solely on the seller may have the unintended impact of raising costs to ratepayers without knowing whether a more efficient allocation between seller and utility buyer may be possible. Camco anticipates that many offset suppliers may respond to the Proposed Decision by including a significant risk premium in their bid price or by deciding to forego offset sales to IOUs all together, both of which could be to the financial detriment of ratepayers. Camco requests that the Commission expressly acknowledge this potential trade-off between purchase price and allocation of invalidation risk to the seller. Otherwise, the IOUs would understandably have greater incentive simply to pass through higher than necessary prices for offsets -- rather than risk being second-guessed after-the-fact for having agreed to internalize some or all of that risk in exchange for lower offset prices.

In many instances, ratepayers may be better off if the utility assumes the risk of cost responsibility for invalidated offsets in exchange for a more favorable purchase price. This is because California IOUs will often be in a much better position than their seller counterparties to self-insure against the risk of invalidated offsets or having to source replacement credits. The IOUs will already be developing GHG Procurement Plans to address their systemwide GHG compliance obligations, one comparatively small component of which will be an offset acquisition strategy. This GHG Procurement Plan will be developed in coordination with the IOU's broader procurement and resource planning strategy to account for the myriad of variables and contingencies that affect the size of the utility's GHG compliance obligation. One of those

contingencies will presumably be the incremental risk of CARB invalidating offsets and imposing an obligation to source replacement credits, regardless of whether the IOU may ultimately have a contractual remedy against the seller to recoup the costs. The IOUs already have considerable in-house expertise in planning for and responding to these types of contingencies. From a ratepayer standpoint, the incremental cost to the buyer utility of accounting for the risk of CARB offset invalidation as part of a much broader GHG Procurement Plan may be significantly less than the price premium that an offset seller will charge if the Commission imposes that same level of risk on the seller.

Camco recommends that the Commission direct the utilities to design their RFPs and contracts so as to gather market information on the price premium associated with the risk of offset invalidation. This could be accomplished by creating flexibility in the RFP procurement process for sellers to offer offsets at different price points and based on the varying noncommercial terms. For instance, the utility could solicit bids to provide offsets where (i) the seller assumes the risk of invalidation (both with and without the posting of collateral that survives post-delivery), (ii) the utility buyer assumes the risk of invalidation, or (iii) the parties share in the risk of invalidation by, for example, capping the seller's replacement cost liability in proportion to the value of the transaction. The risk could be further allocated between the parties depending upon the grounds for invalidation. This type of information would put the utility in the position to compare the price premiums commanded in the market to its own internal system costs for assuming the risk of offset invalidation. It bears emphasizing that these types of trade-offs between commercial and noncommercial terms happen all the time in contract negotiations and, over time, are expected to gravitate towards the most efficient allocation of risk between the counterparties.



**III. THE COMMISSION SHOULD ALLOW THE FORWARD PURCHASE OF BOTH ALLOWANCES AND OFFSETS FROM CARB REGISTERED PROJECTS.**

From a ratepayer standpoint, there is no basis for treating the forward purchase of offsets differently from the forward purchase of allowances. Both types of forward purchases should be allowed. As with allowances, the forward purchase of offsets would enable utilities potentially to lock in lower prices for offsets without any incremental risk to ratepayers. By smoothing out utility demand over a longer period of time, the forward purchase of allowances and offsets may also help smooth out market volatility. This could be especially important if all three major IOU's enter the offset market at the same time during the first compliance period and create a spike in demand. From a practical business standpoint, developers of offset projects such as Camco look to lock-in anticipated future deliveries from offset projects – whose crediting periods are typically 10 years or longer – to provide a stable revenue stream for the project. For IOUs the ability to forward buy allows them to reduce price fluctuation and risk and develop familiarity with the underlying project.

As part rationale for its disparate treatment between allowances and offsets, the Commission states that “at this time we do not want the utilities guessing which offsets will ultimately be CARB-certified,” (PD, p.42). Camco understands this sentiment. However, the forward sales agreement can easily be structured in a way that the utility does not have to guess. The utility buyer could simply insist that it will only forward purchase offsets from projects listed on a CARB-approved registry.<sup>5</sup> As with the forward purchase of allowances, the delivery risk and responsibility for ensuring that the offsets are properly issued under CARB regulations is shouldered entirely by the seller. If the offsets are not properly authorized by CARB, of if they are issued under some other standard, then the utility buyer has no obligation to complete

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<sup>5</sup> See 17 C.C.R. 95975.

the purchase and may have a contract claim against the seller. Moreover, in a typical forward transaction, to the extent that the quantity of offsets issued to the project falls short of the projected amounts, then that risk falls to the seller and the utility buyer simply pays for the quantity delivered. From a planning standpoint, the utility buyer and ratepayers are no worse off than if it had been prohibited from making the forward purchase of offsets in the first instance.

The Proposed Decision also notes that, unlike allowances, offsets face the risk of losing their certification (PD, p.40). This is correct, but it does not follow that the forward purchase of offsets should be prohibited. If CARB invalidation of offsets does take place, it will take place after the offsets have already been issued -- regardless of whether those offsets have been purchased on a forward basis or as a spot transaction. The invalidation risk profile for offsets is the same regardless of whether the offsets are purchased forward or after they have been issued.

The size of offsets as part of the utility compliance obligation relative to allowances does not provide sufficient justification for prohibiting the forward purchase of offsets. The Commission notes that utilities can only meet up to 8 percent of their compliance obligation through the use of valid offsets (PD, pp.40-41).<sup>6</sup> While the size of the potential offset market for electric utilities may be small relative to the allowance market, the overall size of the offset market is still significant. The Climate Action Reserve projects that approximately 30 million Climate Reserve Tonnes (“CRT”) will be issued under CARB-approved protocols in 2014.<sup>7</sup> The availability of even a relatively small quantity of forward-purchased offsets may have the added benefit of imposing downward pricing pressure on the forward purchase of allowances.

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<sup>6</sup> The PD incorrectly refers to a CARB requirement limiting utilities to purchasing no more than eight percent of their “annual compliance obligation” in the form of offsets. (PD, p.41) CARB regulations impose an 8 percent limit per compliance period, not per year. 17 C.C.R. 95854(b). Camco requests that the Commission make the appropriate correction in the final decision.

<sup>7</sup> Climate Action Reserve, “Projections of Future CRT Issuance,” PowerPoint dated September 8, 2011 (available at [www.climateactionreserve.org](http://www.climateactionreserve.org)).

**IV. PURCHASING COMPLIANCE INSTRUMENTS EXCLUSIVELY THROUGH RFPs MAY UNDULY RESTRICT SELLER PARTICIPATION.**

Camco is concerned that the exclusive reliance upon RFPs as the vehicle for securing compliance instruments may discourage seller participation and stifle innovation. Camco understands the historical value of RFPs and believes they should continue to play an important role in the process. However, Camco questions whether the exclusive use of RFPs for securing compliance instruments may place utilities at a significant disadvantage to other buyers in the marketplace in securing the best prices for ratepayers.

From a timing standpoint, many sellers may be reluctant to lock up credits and a price for the four-month timeframe it often takes to go through the utility RFP procurement process, especially for compliance instruments that have already been issued. By way of comparison, Camco has observed that many bilateral spot transactions in the voluntary market typically take one to three weeks for negotiation and execution of the contract and delivery of the credits.

The standardized terms in many RFPs may discourage the types of negotiation and trade-offs between price and risk allocation that can lead to the most efficient price/risk combination for ratepayers. For example, a project developer may offer a more attractive price for the forward purchase of credits if the sale is on a unit contingent basis rather than guaranteed volumes. Similarly, as discussed previously, an IOU may be able to self-insure against some or all of the risk of offset invalidation in exchange for a more attractive purchase price.

Camco recommends that the Commission direct IOUs to continue to use the RFP process but that they also allow IOUs to procure compliance instruments through direct negotiations with sellers outside the RFP process. Bilateral contract negotiations outside the RFP process will enable the utilities to take advantage of lower-cost and time sensitive market opportunities that are not able to conform to the utility RFP timeframe. Bilateral contract negotiations may also

allow greater flexibility to develop a more favorable price and efficient risk allocation for the purchase of compliance instruments. If deemed necessary, the Commission could restrict the scope of purchases outside the RFP process to shorter-term transactions (*e.g.*, spot purchases of issued offsets, forward purchase of offsets for delivery within 3 years) and/or by size of purchase (*e.g.*, 50,000 offsets or less).

V. **CONCLUSION.**

Wherefore, Camco requests that the Commission consider and accept these comments on the Proposed Decision. Camco thanks the Commission for its attention to these issues.

Respectfully submitted,



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