

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.

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

**RESPONSE OF THE CLIMATE TRUST TO THE ADMINISTRATIVE LAW JUDGE'S
PROPOSED DECISION ON RULES TRACK III GHG PRODUCT PROCUREMENT
POLICIES**

March 12, 2012

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I. Introduction and Summary

The Climate Trust respectfully submits these comments, in accordance with Rules 14.3, 1.9, and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure, on the Administrative Law Judge's Proposed Decision Regarding GHG Product Procurement Policies.

Thank you for providing The Climate Trust with the opportunity to submit comments to the California Public Utilities Commission (CPUC). We commend California for its pioneering lead in the establishment of greenhouse gas emission reduction goals and policies.

The Climate Trust is a non-profit organization whose mission is to provide expertise, financing, and inspiration to accelerate innovative climate solutions that endure. The Climate Trust was established in response to the United States' first regulation of greenhouse gases under the Oregon Carbon Dioxide Standard. The Climate Trust solicits, negotiates, and contracts to purchase offsets on behalf of its funders, including regulated power plants, businesses and individuals. Since its founding in 1997, The Climate Trust has managed a 20Million carbon project portfolio that is expected to generate 3 million metric tons of carbon dioxide reductions.

These comments include the following key points:

- **Quantitative procurement limits for GHG compliance units should be assessed based on the actual quantity of compliance units held by or for each Investor Owned Utility.** The Climate Trust believes assigning a fixed cap on the quantity of compliance GHG units procured may have undesirable effects on market liquidity and increase the volatility of prices for compliance units if this cap is assessed based on the quantity of compliance units contracted in any particular year (in the case of offsets) or compliance period (in the case of allowances). Evaluating procurement limits against the quantity of compliance units actually delivered to IOUs would maintain flexibility to encourage trading within the cap-and-trade program while also still allowing for prudent regulation to preclude market manipulation.

- **The 8% annual procurement limit for offset credits is unnecessarily restrictive and may expose IOUs to higher cost of compliance. This quantitative limit should be refined to be assessed at 8% of the compliance obligations over each compliance period and allow for IOUs to procure credits up to the quantity allowed for the current and subsequent compliance period.** Procurement limits on offset credit procurement should retain the full flexibility allowed under the Air Resources Board’s cap-and-trade regulations. Procurement limits assessed on the quantity procured each year may preclude IOUs from achieving cost-reductions through the full use of offset credits allowed under ARB regulations.
- **Comparable to the proposed procurement structure for allowances, offset credits should also be eligible for procurement using forward and future contract types.** The Climate Trust believes limiting offset procurement solely to spot transactions would likely raise costs of compliance for IOUs and result in an undersupply of offset credits to the market because most offset projects require current funding or contractual assurance of future funding prior to completing the costly verification and related procedures necessary to have offset credits issued.
- **The requirement that IOUs reassign liability for offset credit invalidation is unnecessary and costly. Reassigning offset credit invalidation liability would raise the cost specifically for IOUs to acquire offsets relative to other buyers even though invalidation risk could be handled sufficiently using internal risk mitigation practices.** The Climate Trust recognizes the uncertainty regarding invalidation of offset credits following compliance use and the desire to shield ratepayers from such risks. The proposed fix however, would raise the costs uniquely for IOUs even though each IOU could achieve sufficient risk management without such a reassignment of liability, for example, through the use of an internal “buffer” pool.
- **IOUs should retain the flexibility envisioned by the CPUC regarding procurement for other commodities, including the ability to enter into brokered transactions and private over-the-counter transactions.** The Climate Trust believes the cost-saving aspects of a cap-and-trade scheme will be most fully realized if practical limits to trading activity are minimized. The Climate Trust supports CPUC development of a positive list of pre-approved brokers as well as a requirement for “strong showing” that each private over-the-counter transaction would benefit ratepayers.
- **The CPUC should create positive list for pre-approved exchange platforms and brokers to enable IOUs sufficient access to the market without the requirement of case-by-case review.** The Climate Trust believes trade-by-trade review in the form of Tier 2 advice letters prior to any brokered or exchange-traded contract will substantially reduce market liquidity and increase the risk that price

volatility increases compliance costs for IOUs.

II. The Climate Trust responses to proposed GHG product procurement rules

1. Regarding the metric for assessing Order 8.a.

The quantitative limitation of allowance and offset credit procurement seems to be based on the gross quantity of compliance units contracted for purchase in each year (in the case of offsets) or each compliance period (in the case of allowances). Especially when considered alongside the requirement that IOUs must submit advice letters and receive CPUC-approval before re-selling compliance instruments, applying procurement limitations in this manner will significantly constrain the ability to each IOU to engage in trade of units in the spot market, reducing market liquidity and increasing price volatility. This approach to limitation is unnecessarily restrictive and runs counter to the principle component of trading within the AB32 cap-and-trade program to achieve cost-savings through a liquid market.

The Climate Trust recommends CPUC assess limitations on compliance instrument procurement based on the quantity of credits held in each IOU's holding and compliance accounts with ARB rather than the gross quantity of allowances or offset credits contracted for purchase in any specific calendar year or compliance period. This approach is already used in ARB's quantitative limits on holding accounts to protect against market manipulation while still allowing the flexibility required for a liquid market.

2. Regarding quantitative limits for offset credits in Order 8.c.

The offset credit procurement limitation to 8% each year could prevent each IOU from utilizing the full 8% offset amount allowed under ARB in a compliance period if the IOU failed to acquire 8% of estimated annual obligation every year. CPUC procurement guidelines should ensure IOUs retain the flexibility allowed under current ARB regulations to acquire at least the number of offset credits equivalent to 8% of their emissions obligations throughout the course of each compliance period, regardless of the year the offset credits are procured. Removal of such flexibility would result in higher costs for compliance to IOUs who are unable to utilize the full quantity of offset credits ARB allows. In addition, the entry of additional sectors is expected to generate higher allowance and offset prices in the second compliance period. IOUs will be stuck acquiring offset credits at higher prices during the second compliance period—increasing overall compliance costs—if they are prohibited from acquiring offset credits beyond the 8% limit eligible for use in the first compliance period.

The Climate Trust recommends the limitations to offset volume should be revised to allow each IOU to hold a sum of offsets (holding account + compliance account) equivalent to 8% of the current compliance period's expected cumulative obligations, plus 8% of the following compliance period's expected cumulative obligations.

3. Regarding offset credit contract structures under Order 8.b. and 8.f.

The current limitation of offset credit procurement solely to spot transactions is unnecessarily restrictive, is likely to result in an underdeveloped supply of offset credits, and a higher cost for offsets for IOUs (especially in comparison to other offset buyers in the marketplace). With ongoing development of ARB rules for offset verification, the supply of offset credits in 2012 and 2013 remains uncertain. In addition, the supply of offset credits is closely tied to the ability for projects currently in the pipeline to secure funding or at least contractual assurance of future funding before completing the costly verification and other procedural steps required under ARB and CAR (in the case of early action projects). IOUs may include common underperformance or similar provisions in contracts to address the risk that credits are not delivered as stipulated in purchase agreements.

The Climate Trust recommends procurement guidelines for IOUs be expanded to include both forwards and futures contracts for offset credits for project types allowed under approved ARB offset protocols. Doing so will help ensure IOUs are not confined to procuring offset credits at a higher cost than other buyers in the market and allow the IOUs to secure a stream of credits into the future when they are likely to be transacting at higher prices.

4. Regarding offset credit invalidation liability in Order 8.d

The requirement that offsets sellers assume liability for future invalidation by ARB is likely to produce a substantial increase in the price offset sellers demand for credits to be purchased by IOUs. In addition, this policy does not appear to recognize ARB's differential treatment of liability for offset credits from forest projects which contain no buyer liability once they are retired. Alternative mechanisms are available for IOUs to mitigate the risk of credit invalidation such as the maintenance of an internal self-insurance or "buffer" pool of offset credits that IOUs could use to replace any invalidated credits. Such risk management strategies would achieve the same outcomes as the proposed requirement to reassign liability to sellers of offset credits without resulting in a higher cost for IOUs to acquire offsets.

The Climate Trust recommends removing the requirement that IOUs only be allowed to procure offsets if the sellers of such credits are assigned liability for invalidation. Alternative risk management strategies are available to IOUs that would not result in an increased cost to purchase credit while achieving comparable risk management.

5. Regarding allowed procurement methods in Order 8.g.

The limitation to procurement of allowances and credits only through auctions, RFOs, and pre-approved exchange trades is unnecessarily restrictive, potentially costly, and is inconsistent with earlier CPUC policies regarding allowed procurement approaches for other commodities. IOUs may utilize alternative procurement approaches such as brokered transactions or over-the-counter bilateral transactions to secure compliance units at lower cost or when the desired units cannot be obtained from other

procurement methods.

The Climate Trust recommends IOUs also be allowed to procure compliance units through brokered and over-the-counter bilateral transactions. The Climate Trust recommends CPUC adopt a positive list for pre-approved brokers. For over-the-counter bilateral transactions, CPUC may require IOUs to demonstrate “strong showing” consistent with existing policy for other products where IOUs must demonstrate that such bilateral transactions would benefit ratepayers.

6. Regarding pre-approval of exchange trades in Order 8.h.

The requirement that each intended sale of allowances or credits by an IOU be preceded by a Tier 2 advice letter with ensuing CPUC approval is likely to significantly limit the trading of these compliance units and would substantially reduce the IOUs’ capability to hedge against rising prices. Similar to other CPUC-approved procurement guidelines, a positive list of approved brokers and exchange platforms would achieve comparable assurance of confidence in brokers and market infrastructure without inhibiting the trading activity that is necessary for the cap-and-trade program to develop transparent pricing and cost-saving outcomes.

The Climate Trust recommends removing the requirement that IOUs submit Tier 2 advice letters for approval before selling any compliance instruments. The Climate Trust recommends CPUC institute a list of approved brokers and exchange platforms that IOUs may utilize to buy and sell compliance units without requiring case-by-case review of trades before the CPUC. Any new additions of broker or exchange platforms to these positive lists would be subject to consideration and approval by CPUC.

Dated: March 12, 2012

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **“RESPONSE OF THE CLIMATE TRUST TO THE ADMINISTRATIVE LAW JUDGE’S PROPOSED DECISION ON RULES TRACK III GHG PRODUCT PROCUREMENT POLICIES”** in the matter of **R. 10-05-006** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on March 12, 2012 at Portland, Oregon.



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