AB 32 Implementation Group

Working Toward Greenhouse Gas Emission Reductions
And Enhancing California's Competitiveness

TO: The Honorable Mary Nichols, Chair
California Air Resources Board

FROM: AB 32 Implementation Group

DATE: October 23, 2013

SUBJECT: Proposed Amendments To The California Cap On Greenhouse Gas Emissions And Market-Based Compliance Mechanisms

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The AB 32 Implementation Group is comprised of industry and taxpayer organizations advocating for policies to reach AB 32 emission reduction goals in a cost---effective manner to protect jobs and the economy.

INDUSTRY ASSISTANCE

The AB 32 Implementation Group (AB 32 IG) continues to support the California Air Resources Board (ARB) proposal to shift the "industry assistance factor" change by one compliance period of the cap-and-trade program. This proposal will reduce some of the compliance costs with AB 32 which is critical as California's competitors have no such obligation. We appreciate that the proposal and statements of support that recognize that it is the cap on emissions that will ensure that the AB 32 emissions reductions goals will be met and not how allowances are distributed.

We urge ARB to make the assistance factor for the first compliance period the default assistance factor for the entire cap-and-trade program. Any withholding of allowances creates costs on California businesses that competitors are not subject to and will result in emissions and economic leakage out of state undermining both the economy of California and the environmental goals of the program.

The cap-and-trade program imposes a statewide limit for greenhouse gas emissions and directly regulates large sources in three compliance periods between 2013 and 2020. In the first period (2013 to 2014), every large manufacturer is receiving allowances up to an established "benchmark" based on an average energy efficiency level for companies in the industry sector, less 10 percent.

Using these stringent benchmarks for distributing allowances is already placing significant cost pressures on all obligated entities, requiring most companies to buy additional allowances to cover emissions for their normal operations, even in the first compliance period.

Extending the first compliance period assistance factor means California's most efficient companies will be able to continue operations without having to spend millions of dollars simply to maintain current production levels, and more importantly for the state, no jobs will be threatened.

OFFSETS:

Offsets are an important cost-containment strategy for AB 32 implementation. Based on research and the experience of other programs, offsets provide a means of reliably reducing greenhouse gas emissions. Offsets, as part of cost-containment, are an important program element to avoid leakage of emissions to other states and countries, and preventing the loss of thousands of jobs.

The AB 32 IG also believes that the proposed regulation needs additional measures to address potential long-term imbalances to allowance supply and demand given the potential for future adverse economic impacts. For example, AB 32 IG supports broader use of offsets, both through increasing the percentage of offsets allowed beyond the current 8% and not imposing arbitrary geographic or other limits on where offsets originate.

Carbon offset project types are already limited to those that the ARB approves through adoption of stringent protocols and the validation of each offset approved for use under AB 32. Industry analysts expect the program to need as many as 220 million compliance-eligible offsets. The four protocols that have been approved by ARB will not produce the needed supply for cost-effective compliance options under AB 32's requirements. Recent analysis by the American Climate Registry finds that there will be a significant shortage of offset supply by 29 percent in the first compliance period and up to 67 percent by the third compliance period.

In the proposed rulemaking, ARB would add a protocol that has the potential to substantially reduce this shortfall. The Mine Methane Capture Protocol targets reductions that are measurable based on sound technology, and result in a significant potential US supply of GHG reductions that would not otherwise occur under business as usual.

The AB 32 IG supports the Mine Methane Capture Protocol as an important step towards increasing the supply of offsets.

Further, the AB 32 IG supports the removal of the offset limit, which inhibits investment in offset programs and undermines the very goal of AB32, which is the reduction of CO2 emissions.

<u>NATURAL GAS</u>

ARB should provide 100% transition assistance to natural gas suppliers and public utility gas corporations without requiring consignment: ARB proposes to provide natural gas suppliers an allowance allocation based upon their 2011 compliance obligation and the cap decline factor. However, as noted by staff, the public utility gas corporations will be required to consign a portion of their allowances to the auction. While 2013 and 2014 will be 100%, starting in 2015, utilities must consign 25% of the allowances increasing by 5% each subsequent year.

As detailed in the utilities presentation at the July 17, 2013 workshop, natural gas customers in California have already spent over $2 billion on energy efficiency programs aimed at reducing natural gas use and associated greenhouse gas (GHG) emissions. More importantly, California's gas utilities' efforts have resulted in significant improvements and major reductions in emissions, the direct result being that California's natural gas sector is already below its 1990 GHG emissions levels years before the 2020 deadline.

ARB's proposal fails to take into account non-cap-and-trade related costs that will result in significant increases in the cost of natural gas. The California Public Utilities Commission (CPUC) is engaged in ongoing proceedings concerning the implementation of the Pipeline Safety Enhancement Plan (PSEP). The CPUC decision will impact California industries subject to the cap-and-trade as the repair or replacement of transmission or distribution pipelines is expected to increase the cost of natural gas through increases in transportation rates for natural gas. Current estimates place potential cost increases between 14% to 60% in order to pay for the implementation of the PSEP. ARB should recognize that such dynamic and burdensome costs will impose an extreme hardship on industrial gas users, threaten the economic recovery and put jobs at risk.

The AB 32 IG agrees with other stakeholder groups and recommends ARB eliminate the consignment provision associated with the allowance allocations to natural gas suppliers and instead, provide the utilities with 100% of their allowances in 2015 with a small decline in free allowances through 2020. This proposal will keep costs manageable for all ratepayers, allowing for a phasing in of the carbon price to natural gas customers, while rewarding the industrial sector facilities for taking early actions to reduce emissions.

CONCLUSION

We remain on track to meet AB 32 GHG emission reduction goals. Taking into account the above suggested modifications to adjusting the industry assistance factor in the third and last compliance period, including additional necessary offset protocols, such as mine methane capture, and modifying the treatment of natural gas will strengthen the proposed regulatory amendments.

Thank you for considering these comments. Should you have any questions, please contact Shelly Sullivan at (916) 858-8686.

cc: California Air Resources Board Members
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