

California Council for Environmental and Economic Balance

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October 23, 2013

Chairman Nichols and Members of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Via email: <http://www.arb.ca.gov/lispub/comm/bclist.php>

RE: Proposed Amendments to the California Cap-and-Trade Program

Dear Chairman Nichols and Members of the Board:

The California Council for Environmental and Economic Balance (CCEEB) is a non-partisan, non-profit coalition of business, labor, and public leaders that advances strategies for a strong economy and a healthy environment. CCEEB appreciates the work the California Air Resources Board (ARB) has completed since the adoption of the California Cap-and-Trade Program (Cap-and-Trade). We would also like to thank you and your staff for being open and accessible to our membership as this program developed.

Cost Containment

Resolution 12-51 directed ARB staff to examine several parts of the Cap-and-Trade program for cost containment. While this work may have taken place internally, it is important for ARB to present its findings to stakeholders along with potential amendments to or justifications for the program's status quo. Additionally, CCEEB recommends that ARB incorporate the "Three Key Elements of Cost Containment" as described by the Joint Utility Group (JUG)¹. The three elements include:

- A) Measures that take effect now to reduce the likelihood of prices rising above the Allowance Price Containment Reserve (APCR) by: 1) reducing demand for compliance instruments; 2) increasing the supply of compliance instruments; and 3) ensuring that compliance instruments are accessible in the marketplace.

¹ <http://www.arb.ca.gov/cc/capandtrade/meetings/062513/industry-present.pdf>

- B) Measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time. An example trigger is a percentage level of depletion of the APCR.
- C) Measures that, when triggered, would keep allowance prices at the third tier of the APCR regardless of current demand, while preserving the environmental integrity of the Cap-and-Trade Program over time.

Implementation of the JUG recommendations should address many of the directions to staff from Resolution 12-51 and will provide certainty that there are mechanisms in place to avoid prices reaching third tier costs of the APCR.

ARB correctly acknowledges the special challenges posed by a state-level cap-and-trade program. Lacking national greenhouse gas policies, California businesses will be trade exposed as they attempt to internalize the cost of carbon, which in turn is directly set by regulations and policies adopted under AB 32.² The proposed extension the industry assistance factor (IAF) for an additional compliance period plus further research on trade exposure will do much to help ease the state's transition to a low carbon economy. Specifically, the proposed changes to the IAF and the broader coverage for new or opt-in entities provide additional time to study the leakage potential of California businesses and other possible negative economic impacts. This additional time is particularly important since the method of analysis for trade exposure is yet untested and may need to be corrected for errors. CCEEB recommends ARB take a conservative approach by assuming that an entity is trade exposed. Furthermore, evaluation must be done before the start of the second compliance period in order to prevent changes in the IAF resulting in unintended and harmful economic impacts. CCEEB appreciates the currently proposed changes to the industry assistance factor (IAF) and the broader coverage for new or opt-in entities.

CCEEB recommends that ARB continue dialogue with stakeholders on implementation issues, such as:

- How likely is it that reductions in allowance allocations could lead allowances to leakage of jobs and emissions to facilities outside the state?
- What documentation is needed in order to evaluate the affect of allowance allocation on cap-and-trade compliance entities as well as the state economy as a whole?
- What options exist to reduce the impacts on energy-intensive and trade-exposed entities?

² For example, the 10 percent allowance withholding under cap-and-trade works to increase the price of carbon by limiting the number of allowances available to the market.

Market Design

CCEEB believes that an open market allows participants to comply at the lowest increment cost, thereby improving program cost effectiveness and freeing market entities to find the best and most innovative solutions to reduce GHGs. Unfortunately, portions of the current regulation may unnecessarily constrain market liquidity. Of particular concern are:

Holding Limits

- The current holding limit is too restrictive for regulated entities with large compliance obligations and unnecessarily locks away significant amounts of allowances that might otherwise be available to the market. This creates an uneven playing field that favors traders over regulated entities. Compliance entities, especially those with large compliance obligations, must be able to hold and trade a larger portion of their allowances in order to adequately manage risk.
- CCEEB recommends that the program allow compliance entities to hold, in holding accounts, sufficient allowances to cover their obligation for the entire compliance period based on a rolling three-year emissions obligation. This change would free up allowances for the major compliance entities and improve market liquidity because an entity could hedge its forward risk without major complications. While there are still allowances locked in compliance accounts in some years, the increase in holding limits makes these limitations much more manageable.
- Holdings limits are intended to prevent one entity from cornering the market. However, holding limits also place significant strain on compliance entities. Instead, CCEEB recommends moving towards monthly auctions, which would prevent any one entity from cornering the market while at the same time improving liquidity market.

Compliance Process

- Business fluctuations at the end of a compliance period are anticipated. These fluctuations could adversely impact the smooth operation of the market. CCEEB recommends that current vintage allowances (i.e. borrowing from the current year) be allowed during the true-up period (i.e. the time between the end of a compliance period and when that compliance period's obligation is due). This will provide a mechanism for end of compliance period true-up that will increase market confidence.

Timely Surrender of Compliance Obligations

The new proposed section 95856(h)(2) imposes new requirements for the Executive Officer to retire compliance instruments in a certain order. This action continues to include additional restrictions and constraint on trading. The regulation should not require covered entities to retire

allowances in a certain order. Instead, the market is best served if the covered entities are able to select which compliance instrument they wish to retire based on their economic decision. Taking away this ability to choose reduces the incentive to behave economically and will reduce market efficiency. At the same time it does nothing to promote ARB's goals of market liquidity or decreasing the potential for market manipulation.

There may be business reasons why companies choose to retire instruments in a different order than that specified by the amendments. For example, companies may place different values on different instruments for reasons that are not clear at this time. By specifying the order, ARB could be indirectly interfering in business optimization. Companies should have the option of specifying order of retirement. Where a company does not specify the order, ARB could follow the retirement protocol. While we understand that ARB wants to make sure that the surrender "happens", it should be the option of the company to determine the preferred order of instrument surrender.

Furthermore, the amendments would grant ARB inappropriate authority at the triennial surrender to enter a company's CITSS account and "take" compliance instruments (e.g. allowances) to meet the triennial surrender obligation. While this surrender is required for compliance, it is more appropriate for companies to have the option to execute this surrender voluntarily. Only if the surrender is not done by a specified date, should ARB have the capability and authority to initiate the surrender.

CCEEB believes that the proposed rule should allow covered entities to specify the types and quantity of compliance instruments to retire and the order for retirement and that the new proposed requirements in 95856(h)(2) be removed.

Offset Protocols

CCEEB supports the use of high-quality offsets to constrain costs and believes that offsets should only be limited based on quality, not quantity or geography. In the event that the price containment reserve becomes depleted, we ask the board to consider lifting quantitative and geographic limitations as an economic backstop measure.

Economic studies on Cap-and-Trade clearly demonstrate that offsets can be used to contain costs. In some models (most notably those by USEPA, CRS and CRA), program costs are reduced by as much as 40 percent to 80 percent depending on the model and combination of offset. Within California and the nation, studies show that offset projects can provide near-term opportunities for cost-effective, verifiable GHG reductions that deliver long-term, sustained emissions reduction benefits.

Concerns about offsets and localized "hotspots" have been largely addressed by the ARB Co-Pollutant Emission Assessment,³ which found de minimis co-pollutant co-benefits from quantitative and geographic restrictions of offsets. This analysis has dispelled concerns over

³ Cap-and-Trade Initial Statement of Reasons, Part I, Volume VI, Appendix P, Co-Pollutant Emissions Assessment

greater potential increases in co-pollutant emissions as well as assumptions that communities could significantly benefit from additional co-pollutant reductions. As such, there is little reason to limit the use of offsets as a compliance instrument; indeed, offsets provide long-term cost containment and are consistent with efforts to protect the environmental integrity of the program.

Geographic restrictions—in the false hope that substantial local co-benefits will be achieved—runs contrary to the fundamental aim of offsets, i.e., maximizing total GHG reductions (and thus, climatic benefits) by prioritizing the most effective and efficient reduction opportunities.

Unwarranted limits only increase California compliance costs, which in turn could prompt economic and emissions leakage. Similarly, needlessly high program costs could erode political support for state climate programs as costs begin to pass through to California consumers and ratepayers.

Besides benefits in California, offsets also encourage adoption of GHG policies in other jurisdictions, particularly in developing economies that use more energy to fuel economic growth. That is, offsets play an important role influencing international leadership on climate change, which is ostensibly the primary goal of AB 32.

In the event that long-term demand for allowances begins to drain the price containment reserve, ARB should act to (1) delegate issuance of ARB offset credits (ARBOCs) to third party registries, (2) adopt additional offset protocols, (3) recognize regional, national and international offset programs, and (4) work with state and regional agencies and other stakeholders to facilitate the development of offset projects in California. Additional supply options should include:

- a) Use of additional Climate Action Reserve Protocols;
- b) Use of applicable American Carbon Registry approved methodologies
- c) Supporting the development of Pilot REDD Projects;
- d) Allow use of Climate Action Reserve Landfill Credits generated before 2012;
- e) Approve protocols developed by California air districts, as appropriate;
- f) Approval of the Mine Methane Capture Protocol.

AB 32 implementation is still in a critical stage of regulatory development and ARB should give significant consideration to achieving state goals in a manner consistent with the statute, which clearly enumerates that the policy should, “achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions.”

Regulatory Burdens

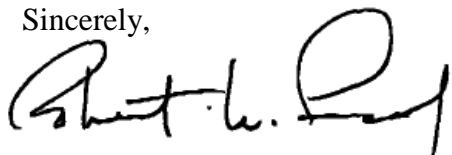
A number of additional and overly burdensome administrative requirements have been amended in the following sections of the regulation:

- Registration of names of employees (95830(c) (1) (I))
- Registration of Cap-and-Trade Consultants and Advisors (95830(c) (1) (J))
- Updating Registration Information (95830 (f) (1))
- Disclosure of Corporate Associations (95833 (a))
- “Know-Your Customer” Requirements (95834)

It is unclear to CCEEB how many of these requirements benefit the program and their inclusion presents a significantly increased administrative burden on compliance entities in an already complicated regulation. CCEEB would recommend eliminating these changes, as they do not appear necessary.

Thank you for considering our comments. If you wish to discuss this matter further, please contact Bob Lucas at 916-444-7337.

Sincerely,



Robert W. Lucas
Climate Change Project Manager



Gerald D. Secundy
President

cc: The Honorable Jerry Brown, Governor, State of California
Nancy McFadden, Executive Secretary to Governor Brown
Cliff Rechtschaffen, Senior Advisor to Governor Brown
Matthew Rodriguez, Secretary, California Environmental Protection Agency
Member, California Air Resources Board – c/o Charlyn Frazier, Board Member Liaison
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