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October 22, 2018

Rajinder Sahota
Chief, Climate Change Program Evaluation Branch
California Air Resources Board
1001 I Street – P.O. Box 2815
Sacramento, CA 95812

Re: SoCalGas Comments on the Proposed Amendments to the California Cap-and-Trade Regulation

Dear Ms. Sahota:

On behalf of the Southern California Gas Company (SoCalGas), we respectfully submit the following comments in response to the California Air Resources Board's (ARB) Proposed Amendments to Cap-and-Trade Regulation, released on September 4th, 2018. We appreciate this opportunity and offer specific comments on the following issues: 1) the use of allowance proceeds, 2) natural gas allowance allocation, 3) price ceiling, 4) post-2020 reserve tiers, and 5) offset limitations.

1. EQUITABLE TREATMENT FOR ALLOWABLE USES OF ALLOWANCE PROCEEDS

Staff proposed specific language in the Proposed Amendments that restricts natural gas utilities from using allocated allowance proceeds for activities other than as described. As currently drafted, the amendments contain more allowable uses for the electric distribution utilities (EDUs) than natural gas utilities. Staff lists as an allowable activity "Renewable Energy or Integration of Renewable Energy" under the section for EDUs. This is a broad category that encompasses construction and procurement of energy from renewable electricity projects but there is no comparable category for natural gas suppliers with respect to renewable natural gas projects, which also reduce GHGs (see benefits noted in Section 2). Similarly, the EDU allowable uses also include infrastructure or other support for "active transportation, zero-emission vehicles, or public transportation" but there is no allowable use for near-zero emission vehicles. In the interest of equitable treatment and to ensure that important GHG reduction activities are not excluded, SoCalGas urges Staff to address this discrepancy.

To assist with remedying these concerns, SoCalGas makes the following suggested edits to the regulation text (edited sections are in red):

1) Revised Section §95893(d)(3)

(3) ~~Auction proceeds and a~~Allowance value, including any allocated allowance auction proceeds, obtained by a natural gas supplier must ~~shall~~ be used ~~exclusively~~ for the primary benefit of retail natural gas ratepayers of each natural gas supplier, consistent with the goals of AB 32, and may not be used for the benefit of entities or persons other than such ratepayers. Allocated allowance auction proceeds ~~may~~must be used to reduce greenhouse gas emissions or returned to ratepayers using one or more of the approaches described in sections 95893(d)(3)(A)-~~(C)~~(D) and may also be used to pay for administrative and outreach costs described in section 95893(d)(4). ~~Any allocated allowance auction proceeds returned to ratepayers must be done in a non-volumetric manner.~~

(A) Biomethane Projects or Integration of Biomethane Projects. Funding programs or activities in the following categories:

1. *Construction of projects to develop biomethane (as defined in section 95802) that will directly interconnect with a common carrier pipeline in California, or procurement of biomethane by a natural gas supplier;*
2. *Support for biomethane projects that are ratepayer-owned or located within the natural gas supplier's service territory; or*
3. *Infrastructure projects or other projects supporting near-zero emission vehicles.*

~~(A)~~(B) Energy Efficiency. Funding programs or activities designed to reduce greenhouse gas emissions through reductions in energy use in the following categories:

1. Energy efficient equipment rebates;
2. Energy-efficient building retrofits;
3. Other projects that reduce energy demand;

~~(B)~~(C) Other GHG Emission Reduction Activities. Funding programs or activities other than energy efficiency, for which the natural gas supplier can demonstrate GHG emission reductions per section 95893(d)(5). This includes funding projects or activities that reduce emissions of uncombusted natural gas and that are not mandated by any federal, state, or local health and safety requirements, legal settlement, enforcement action, Senate Bill 1371 (Morrell, 2014), or the Greenhouse Gas Emission Standards for Crude Oil and Natural Gas Facilities (California Code of Regulations, sections 95665-95677).

~~(C)~~(D) Non-Volumetric Return to Ratepayers. Distribution of allocated allowance auction proceeds to some or all ratepayers in a non-volumetric manner, either on- or off-bill.

2) Revised section § 95893(d)(4).

(4) Administrative and Outreach Costs. Allocated allowance auction proceeds may be used for administrative costs only in so far as those costs are solely limited to necessary costs for the implementation of sections 95893(d)(3)(A)-~~(C)~~(D). Allocated allowance auction proceeds may be used for outreach that supports the implementation of the approaches described in sections 95893(d)(3)(A)-~~(C)~~(D).

3) Revised section § 95893(d)(5).

(5) Natural gas suppliers must demonstrate GHG emissions reductions, pursuant to section 95893(e)(4)(B), as applicable, for each use of allocated allowance auction proceeds described in sections 95893(d)(3)(A)-~~(B)~~(C) that is undertaken.

RNG is an immediately available resource, representing a significant and unique opportunity to capture short-lived climate pollutants (SLCPs) while at the same time displacing more carbon-intensive fuels at the end-use. Investing in RNG does not come at the expense of other approaches to GHG reduction and is found be as cost-effective or better than many alternative methods of reducing GHGs.[1] Including additional activities that reduce GHG emissions such as bringing RNG into the natural gas system and supporting near-zero emission vehicles in the transportation sector would help meet the goals of AB 32. Therefore, SoCalGas supports equitable treatment in the allowable uses of allowance proceeds and requests that Staff consider the suggested regulation language revisions above.

2. CONTINUED CONSIDERATION FOR NATURAL GAS ALLOWANCE ALLOCATION

SoCalGas appreciates that staff included language in the Initial Statement of Reasons (ISOR) [2] acknowledging the need to revisit natural gas allocation if a renewable gas mandate or other changes to the sector occur. The natural gas sector in California is already making significant and material steps towards decarbonization, which require substantial investment.

Most notably, Senate Bill (SB) 1440[3] was passed by the Legislature and signed by the Governor on September 23, 2018. This law requires the California Public Utilities Commission (CPUC), in consultation with the ARB, to consider adopting specific biomethane procurement targets or goals for California's investor-owned utilities (IOUs). SoCalGas was an early supporter of SB 1440 and in favor of the CPUC setting up a program to foster cost-effective procurement of RNG in California.

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[1] https://www.socalgas.com/1443741887279/SoCalGas_Renewable_Gas_Final-Report.pdf

[2] ARB. Staff Report: Initial Statement of Reasons. Sept. 4 2018, page 67: https://www.arb.ca.gov/regact/2018/capandtrade18/ct18isor.pdf

[3] SB 1440 (Hueso). Energy: biomethane: biomethane procurement program: https://www.socalgas.com/regulatory/tariffs/tm2/pdf/GO-BCUS.pdf

Staff highlighted in the ISOR that the electric utility sector allocation recognizes the additional cost burden from decarbonization policies while the natural gas sector does not receive a similar allocation adjustment.

As the natural gas sector continues efforts to decarbonize, RNG will play a more important role in achieving the State's climate goals by providing a lower-emission, beneficial use for SLCPs that are currently being released directly into the atmosphere as methane or flared. There are many environmental and economic benefits to employing a decarbonization strategy that includes RNG, for example:

- Enables near-term GHG reduction of medium and heavy-duty transportation while also improving air quality and supporting successful implementation of the Low Carbon Fuel Standard;
- Provides cleaner fuel for ongoing thermal electric generation which supports integration of renewable resources;
- Offers cleaner fuel for customer end-uses, especially in difficult to electrify industrial applications; and
- Plays a critical role in furthering reliable deployment of renewable electricity by utilizing the natural gas pipeline as renewable storage, benefiting from its ability to firm intermittent power, provide storage capacity and scalability compared to other storage options.

SoCalGas looks forward to working with staff and the ARB Board to recognize the costs of these decarbonization efforts through adjustment to the natural gas sector allocation in future Cap-and-Trade rulemakings.

3. PRICE CEILING

SoCalGas appreciates the difficulty of determining an appropriate ceiling price while balancing the various and sometimes divergent objectives of setting this policy. We continue to urge ARB to use the criteria laid out in the AB 398 legislation to guide them, as required by law and not be distracted by other considerations, such as internal corporate carbon pricing and other concepts.

In the ISOR, Staff proposes a price ceiling that begins at $65 in year 2021 and escalates at a rate of 5% plus the rate of inflation until reaching an estimated $119.50 in 2030.[4] A price ceiling that reaches well beyond $100 in the later years, when the ceiling is more likely to be hit, is very concerning to SoCalGas. Some independent experts have found that in cap-and-trade markets with a finite compliance period and with hard floor and ceiling prices, the equilibrium price will

[4] The 2030 value assumes a 2% inflation rate and is in nominal prices.

most likely be at the floor or ceiling.[5] This phenomenon should be carefully considered when evaluating potential ceiling prices.

While SoCalGas is hopeful that compliance entities will be able to find cost-effective abatement opportunities below the price ceiling, it is not a forgone conclusion that they will. Therefore, it is critical for the protection of California consumers and to adhere to the legislative direction of AB 398 to set the price ceiling at a point that will "avoid adverse impacts on resident households, businesses, and the state's economy" and "the potential for environmental and economic leakage."[6] We are not aware of analysis conducted or commissioned by ARB that demonstrates a $120 allowance price will avert these potentially damaging outcomes.

Furthermore, SoCalGas feels that it is important to use a relevant and defensible price ceiling to protect from threatening the long-term viability and support for the Cap-and-Trade Program within the Western Climate Initiative (WCI) and other jurisdictions with which it might link in the future.

We recommend the elimination of the 5% escalator in the price ceiling calculation or the utilization of a real price adder to the floor price at a value of $60 or below. The price adder recommendation would constitute a price ceiling very similar to today's current regulation of the single price tier, set to begin in 2021.

4. POST-2020 RESERVE TIERS

As acknowledged in Staff's summary of stakeholder input, many take the position that the Reserve Tiers would be more effective if spaced evenly between the floor price and ceiling price, rather than being clustered together near the ceiling. SoCalGas also holds this position. If the Reserve Tiers are placed too close together or too close to the ceiling price we fear they would be ineffective and fail to act as a brake on short-term price spikes as intended by the authors of AB 398.

The Reserve Tier proposed in the ISOR set at 50% and 75% between the floor and proposed ceiling price were 1) skewed too high due to the overly aggressive price ceiling escalator, and 2) set too closely together, jeopardizing their effectiveness. SoCalGas maintains that the Reserve Tiers be spaced equally between the floor and ceiling at one-thirds and two-thirds, respectively.

In addition to the prices selected for the Reserve Tiers, ARB must allocate allowances to each tier. SoCalGas believes that for the Reserve Tiers to be effective they must have sufficient volume. We support ARB's proposed allocation structure and urge Staff to consider any

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[5] "Expecting the Unexpected: Emissions Uncertainty and Environmental Market Design", Severin Borenstein, James Bushnell, Frank A. Wolak, and Matthew Zaragoza-Watkins, Energy Institute at Haas Working Paper 274, August 2016.

[6] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180AB398

alternatives that would bolster the Reserve Tiers in order to reduce the chances of ever hitting the price ceiling. Maintaining robust Reserve Tiers will both mitigate harmful impacts on the economy as required by AB 398 and reduce the possibility of triggering the provision for ARB to assume the backstop position of maintaining environmental integrity of the program.

5. OFFSET LIMITATIONS

SoCalGas supports using precise statutory language in the amended regulation for defining Direct Environmental Benefits (DEBs). All projects located in California should automatically meet DEBs standards and out-of-state offset projects can meet the standards by demonstrating they provide environmental benefit to California. Limitations beyond the letter of the law could stifle the offset market when it already faces additional post-2020 restrictions to California-based offsets and the reduced offset usage limits. Additionally, on this topic, we urge ARB to move quickly in forming the new Compliance Offsets Compliance Protocol Task Force so that more offset protocols that benefit California can be developed and made available to compliance entities.

SoCalGas appreciates this opportunity to comment on the ARB's Proposed Amendments and we look forward to additional dialogue. Please contact me if you have any questions or concerns about these comments.

Sincerely,

Tim Carmichael

Tim Carmichael
Agency Relations Manager – Energy and Environmental Affairs
SoCalGas