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California Air Resources Board
1001 I Street
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Re: Informal Stakeholder Comments of Shell Energy North America (US), L.P., on Discussion Topics at April 26, 2018 Workshop on Potential Changes to the Cap and Trade Regulations

To: Air Resources Board:

Shell Energy North America (US), L.P. ("Shell Energy") welcomes this opportunity to provide comments on potential changes to the ARB's cap and trade regulations in the post-2020 period. Shell Energy's comments focus on six topics addressed at the April 26, 2018 workshop, as follows:

- Rules to implement the "direct environmental benefits in the State" ("DEBS") criteria for offset projects after 2020;
- Offset "invalidation" process and compliance requirements;
- Preserving the value of pre-2021 allowances;
- Remove (or increase) the "holding limit;"
- Treatment of secondary dispatch through the Energy Imbalance Market ("EIM"); and
- Maintaining a 100 percent industry assistance factor ("IAF") for the third compliance period.

Shell Energy's comments on these topics are as follows:

I.
DIRECT ENVIRONMENTAL BENEFITS IN THE STATE

During the April 26 workshop, Staff advised that most stakeholders support using the precise DEBS language of AB 398 in the implementing regulation. Shell Energy agrees with this approach. Shell Energy also agrees that all offset projects located in California should be deemed to meet the DEBS standard. Out-of-State offset projects should be judged under the DEBS standard based on factual information demonstrating that the project is beneficial to the California environment.

For the reasons set forth in its March 16, 2018 comments, Shell Energy supports a broad application of the DEBS standard to out-of-State offset projects. In an interconnected world, GHG emissions -- and GHG emission reductions -- occurring anywhere have direct impacts everywhere, including in California. Liberal application of the DEBS standard to out-of-State offset projects will support ongoing initiatives across North America to facilitate GHG emission-reducing projects.

For example, tribal authorities have established offset projects that provide economic benefits to tribal communities located within and outside California. These tribal initiatives should be supported, in light of the State's commitment to foster improved conditions in disadvantaged communities. Support for tribal initiatives that harness and quantify GHG emission reductions should extend beyond 2020 by allowing out-of-State offset projects, including offset projects sponsored by tribal authorities, to demonstrate compliance with the DEBS standard. The ARB should provide a non-exclusive list of supporting materials that can be used by an offset project developer to demonstrate DEBS standard compliance.

Moreover, the ARB should not apply the DEBS standard retroactively. At the April 26 workshop, Staff indicated that most stakeholders oppose retroactive application of the DEBS standard to existing (pre-2021) offset projects. Shell Energy agrees. Offset credits from projects listed with an Offset Project Registry ("OPR") by December 31, 2020 should be deemed to have met the DEBS requirement.

Any offset project that is listed before 2021 should be exempted from (or automatically grandfathered under) the DEBS standard. The offset credits associated with pre-2021 projects should be fully eligible for use to meet a covered entity's compliance obligation. Requiring offset credits that have already been generated -- or offset projects that have already incurred significant costs -- to meet the new DEBS standard would be unfair to pre-2021 offset project developers and offset purchasers. Entities that have made a significant investment in an offset program based on existing rules should not be subject to additional requirements or restrictions after January 1, 2021.

Finally, the DEBS "exemption" should apply to offsets from projects that are "listed," in accordance with Section 95975, prior to 2021. An offset project developer cannot dictate the timing of "issuance" under Section 95980.1 or 95981, once its offset project has been listed. An offset developer should not face the uncertainty (and economic disadvantage) associated with the timing of "issuance," a matter over which a project developer has no control. The new DEBS standard should be applied prospectively, and only to offset credits generated by new offset projects that are listed on or after January 1, 2021.

II.
OFFSET "INVALIDATION" PROCESS AND COMPLIANCE REQUIREMENTS

At the workshop, Staff invited comments on whether (and if so how) the "invalidation" provisions should be revised, in order to narrow the types of activities or actions that result in invalidation of an offset project. Staff also asked stakeholders to comment on "revising offset project activities within [the] scope of [the] regulatory compliance evaluation list to cover all project types," and "further clarify assessments and timing of noncompliance."

Shell Energy supports Staff's efforts to clarify and narrow the types of activities that could render an offset project invalid. Offset project developers need certainty as they initiate projects and programs that meet the DEBS offset eligibility criteria. Offset project developers also require certainty as to the actions that would cause an offset project to be determined invalid.

As the ARB further refines the actions that constitute grounds for invalidation of an offset project, the reasons for invalidation should be limited to actions that compromise GHG emission reductions. Violations unrelated to GHG emission reductions are addressed by local, state, and federal regulators, and should not result in invalidation under the cap and trade program. If the risk of invalidation is limited to matters addressing GHG emission reductions, project developers will have greater certainty regarding the consequences of their actions.

On a related subject, the ARB could increase offset usage by switching from "buyer liability" to an integrated "seller liability" and "buffer pool" -- Environment Integrity Account ("EIA") approach (as designed by the Province of Ontario) -- when an offset project is deemed to be invalid. A "buffer pool" approach provides that in the event an offset project is (and offsets are) invalidated due to regulatory non-compliance, credits from the "buffer pool" are invalidated to maintain the integrity of the program. The existing California Forestry Buffer Pool is an example of such an approach. The Forestry Buffer Pool could be expanded to include all offset projects.

Shell Energy urges the ARB to consider a "buffer pool" approach, which would provide greater certainty to offset purchasers. Under this approach, replacement for offset project invalidation would be the responsibility of the project developer, not the purchaser of the offset. If the offset project developer does not perform, replacement offsets will come from the "buffer pool," to which all offset projects contribute.

III.
PRESERVE THE VALUE OF PRE-2021 ALLOWANCES

At the workshop, Staff reported that some stakeholders have proposed to "de-value" pre-2021 allowances in the post-2020 period. For example, some stakeholders propose to limit the ability to apply banked allowances for compliance after 2020. The stated purpose of such a de-valuation would be to mitigate what some stakeholders view as an "over-allocation" of allowances in the pre-2021 period, and thereby increase the value of post-2020 allowances.

As a threshold matter, Shell Energy disagrees with the suggestion that there is (or has been) an oversupply or an over-allocation of allowances in the pre-2021 period. There is no factual basis for this argument, and there is no justification for de-valuing pre-2021 allowances. Information showing that the State is on track to achieve the 2020 GHG emissions target (early) means that the cap and trade program is working as intended. Any effort to de-value pre-2021 allowances based on the success of the current program would disrupt the stable market that has developed under the program.

In the post-2020 period, pre-2021 allowances must remain available under the same terms and conditions under which they were acquired. Entities have made investments based on rules established under the current program. Significant and arbitrary "mid-course changes" would alter the basis for companies' decisions, and would punish entities that have taken early actions to reduce GHG emissions.

Obligated parties should not have to develop a compliance strategy (or make investment decisions) based on a moving target. Changing the value of pre-2021 allowances would send the wrong signal to the market. Allowances have been issued, auctioned and tracked based on existing market conditions and compliance expectations. Any effort to de-value pre-2021 allowances would de-stabilize the allowance market, erode confidence in the allowance allocation process, and unlawfully "take" individual allowance holders' property rights without just compensation.

IV.
REMOVE THE HOLDING LIMIT IN THE POST-2020 PERIOD

Shell Energy requests that the ARB consider removal of (or an increase to) the "holding limit" under Section 95920 in the period beginning January 1, 2021. Extension of the cap and trade program beyond 2020 creates an opportunity for the ARB to evaluate whether the existing holding limit is supportable through the additional program period.

The ARB should eliminate or increase the holding limit for entities and groups of entities with a direct corporate association, as the holding limit currently provides an undue advantage to smaller entities. Removal of the holding limit altogether, or in the alternative allowing entities to sell allowances from their compliance accounts, would help reduce the impact of market price volatility and increase liquidity as allowances become more scarce and the GHG emissions cap declines.

V.
TREATMENT OF GHG EMISSIONS ASSOCIATED WITH SECONDARY DISPATCH THROUGH THE ENERGY IMBALANCE MARKET

The ARB has implemented an interim ("bridge") solution to address emissions associated with secondary dispatch under the cap and trade program. It is not necessary to adopt changes to the bridge EIM GHG accounting approach at this time. The ARB should continue to work with the CAISO and stakeholders to find a viable, long-term solution that can be incorporated into a day-ahead and/or a regional market approach, or if other states adopt carbon pricing.

VI.
MAINTAIN THE 100 PERCENT IAF FOR THE THIRD COMPLIANCE PERIOD

California has successfully built a cap-and-trade market structure while simultaneously protecting its robust economy. Other jurisdictions have failed, thus far, to follow California's lead. A key feature of the cap and trade program is the allowance price floor. Another important feature is the allocation of allowances to trade-exposed industries. These provisions have helped to reduce environmental and economic leakage in the early years of the program; continuing such protections becomes more vital as the GHG emissions cap begins to aggressively decline in the 2020s.

The IAF provides the ARB the opportunity to scale the quantity of allowances directly allocated to trade-exposed energy-intensive industries. The IAF was initially set at 100 percent for all industries in the first compliance period, and out of caution the ARB properly chose to continue a 100 percent IAF for the recently concluded second compliance period. Through AB 398, the legislature directed the use of a 100 percent IAF for the fourth compliance period and beyond. In Resolution 17-21 (July 27, 2017), the ARB Board directed the Executive Officer to propose regulations that use the same assistance factors for the 2018-2020 compliance period as were in place for 2013 to 2017. Adherence to Board Resolution 17-21 means that the 100 percent IAF should be employed in the third compliance period.

Maintaining a 100 percent IAF for the third compliance period is prudent, as the adoption of carbon pricing in jurisdictions outside California has not proceeded at the pace expected. As the GHG emissions cap continues to decline, and as emission reduction measures become increasingly expensive, industry assistance takes on greater importance as a means to insulate in-State companies from competitive pressure from out-of-State companies. Without sustained, consistent industry assistance, trade-exposed in-State industries will not be able to compete as long as out-of-State competitors are not subject to the same carbon pricing rules or compliance costs.

Staff correctly observed at the April 26 workshop that if there was a ubiquitous global carbon price, industry assistance would not be required. However, until such time as a carbon price exists for the global economy, industry assistance is a necessary feature of this State's cap and trade program.

Maintaining a 100 percent IAF in the third compliance period also will enhance market stability. A temporary reduction in the IAF, followed by restoration of 100 percent IAF in the fourth compliance period, would result in an uneven demand requirement for vulnerable industries. This could lead to volatility and uncertainty in the allowance market. These concerns can be easily addressed by following the directive in the Board Resolution.

VII. CONCLUSION

Thank you for the opportunity to comment on the topics addressed during the April 26 workshop. If you have any questions regarding these comments, please feel free to contact the undersigned.

Sincerely,

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Attorneys for Shell Energy North America (US), L.P.

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