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California Air Resources Board
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April 8, 2016

Submitted electronically via: www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm

RE: Public Workshop on Cap-and-Trade Regulation Post-2020 Emissions Caps and Allowance Allocation

We commend ARB for engaging stakeholders on the important topic of cap-and-trade design post-2020 and want to thank ARB for their informative workshops and this opportunity to comment.

In over three years of implementation, California's cap-and-trade program has proven to be a success. Capped emissions are declining, California is adding jobs and growing the economy faster than the national average, the state is able to create more wealth with fewer emissions, Quebec and California are linked and holding quarterly joint auctions, almost all businesses have successfully complied with cap-and-trade requirements, and California communities - especially low-income, pollution-burdened communities - are seeing real benefits from cap-and-trade investments.

Because of this success we strongly support ARB moving forward with amendments to extend the cap-and-trade program beyond 2020 and believe this is the right time to do so. The cap-and-trade program needs certainty about future emissions reductions in order to continue providing robust incentives for reducing emissions. Similarly, because of the cap-and-trade program's success to date, we believe that there should be as much consistency as possible between the pre-2020 and post-2020 cap-and-trade program with updates to meet post-2020 needs and to best address the policy objectives of the cap-and-trade program. We believe that ARB has successfully balanced the need for consistency and flexibility to date and we look forward to seeing this continue.

In terms of this workshop topic, we would like to comment on three specific issues: cap setting through 2020, requirements for natural gas utilities to consign allowances to auction, and allocation to Electrical Distribution Utilities (EDUs).

Cap Setting

<u>Linear reduction vs. adjustment for actual emissions</u>:

We believe that it would be most appropriate to set the 2021 to 2030 cap based on the best estimate of actual emissions. Setting the cap in order to create a smooth linear reduction between 2013 and 2030 would unnecessarily loosen the cap, creating a surplus of carbon allowances. Setting the cap based on the best estimate of actual emissions is consistent with the cap setting strategy for the pre-2020 cap. There is no need for ARB to create additional

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allowances that represent the difference between the two cap setting strategies and place those allowances in a reserve because there was no previous expectation about post-2020 cap setting that ARB is required to honor. Rather, setting the cap based on a linear decline between the best estimate of actual emissions in 2021 and the 2030 target is the real trajectory of emissions reductions.

Fugitive Methane Emissions:

We believe that ARB should begin taking steps to accurately account for fugitive methane emissions in the cap post-2020. In reality, all natural gas is already under the cap since importers of natural gas and natural gas extractors have compliance obligations under the cap. However, those compliance obligations are based on the emissions associated with combusting that natural gas. When that natural gas is leaked from a pipe, for example, as methane, the greenhouse gas impact associated with that now fugitive methane is much higher.

When ARB initially set the cap before compliance began, measurement techniques were not yet sophisticated enough to accurately account for fugitive methane emissions. However, major progress has been made since that time in the ability to measure fugitive or leaked methane. ARB will need to do a thorough evaluation of the steps necessary to include fugitive methane in the cap and an evaluation of the available data. Much of that discussion is beyond the scope of these comments but we look forward to engaging with ARB on this topic. We do encourage ARB to complete this effort in time to include fugitive methane in the post-2020 cap starting with the 2021 compliance year.

Allowance Allocation

Consignment Requirements for the Natural Gas (NG) Sector:

EDF supports the staff proposal to increase the percentage of allowances NG suppliers are required to consign to auction. Some transition assistance was appropriate. However, increasing the consignment percentage for the NG sector will create more parity with electric utility sector and create a more even price signal across the cap-and-trade program. Furthermore, EDF supports ARB continuing to disallow a volumetric return of allowance value to customers. In the electricity sector, the climate credit provided by utilities to households is providing a progressive benefit that shields low-income customers from overall increased costs while preserving an incentive to implement like energy efficiency that will lower electricity use. Moving to 100% consignment without a volumetric return of value in the NG sector will have a similar effect. EDF supports ramping up to a 100% consignment rather than jumping from 50% to 100% between 2020 and 2021. However, EDF supports a ramp that will get to 100% consignment as quickly as possible, preferably by 2021.

Including Purchased Electricity or Steam in Industrial Benchmarks:

EDF strongly supports ARB's proposal to include purchased electricity and steam in the calculation of industrial benchmarks, and strongly advocates that ARB apply EDU or purchase-

specific (in cases where an industrial source purchases electricity directly from and EGU, for example) emissions factors. Applying EDU or purchase-specific emission factors will provide the correct economic incentives to industrial sources to substitute between electricity and steam supplied by an EDU, or other third party, and on-site combustion. In contrast, applying a state average emission factor would unduly penalize sources of electricity and steam with emission factors below the state average and unduly advantage sources with emissions factors above the state average, potentially distorting technology choices of covered industrial sources and leading to higher GHG emissions.

ARB should reduce the annual allocation to each EDU by an amount equivalent to the total annual allowance allocation to industrial sources for electricity or steam purchased from that EDU. This netting out should be conducted on an updating annual basis in concert with the allocation to industrial sources for purchased electricity and steam. As opposed to forecasting approaches, which would reduce the allocation to EDUs by projecting emissions associated with purchases of electricity or steam by covered industrial sources, this approach guarantees that allocations to EDUs are appropriately adjusted for net sales, avoiding under or over compensation associated with sales of electricity or steam to covered industrial sources.

Allocation to EDUs for Increase End-use Electrification:

The question of whether and how to update allowance allocation to EDUs to account for expanded electrification deserves further study and consideration. Driven by decarbonization of the grid, electrification increasingly presents an opportunity for deep carbon reductions in a variety of sectors, most notably the transport sector. As emissions in those other sectors fall, increased demand for electricity will result in greater emissions associated with the electric sector, potentially warranting greater allocation to fund direct investments in decarbonization. That said, it will be critical that allowances are not used to blunt the carbon price signal in electricity rates. Using allowances to distort the price signal in electric rates could potentially disadvantage alternative technologies, leading to higher GHG emissions and delaying (or derailing) critical innovations.

Another potential source of risk in updating allocations to EDUs stems from the method used to update the allocations. If allocation are updated based on changes in load, as opposed to well-identified instances of substitution toward electric alternatives (i.e., by measuring the change in electricity demanded by the EV fleet, for example), there is potential to disincent energy efficiency. That is, if allocation is based on changes in load, as opposed to changes in load driven by specific, and well-quantified, instances of electrification, then EDUs will have a strong disincentive to invest in activities that reduce load.