



California Council for Environmental and Economic Balance

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January 20, 2017

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: MRR and Cap-and-Trade Regulation 15-Day Amendments

Dear Ms. Sahota:

On behalf of the members of the California Council for Environmental and Economic Balance (CCEEB), we thank the California Air Resources Board (ARB) for this opportunity to comment on the proposed regulation for potential amendments to the Cap-and-Trade Program. CCEEB is a non-profit, non-partisan association of business, labor, and public leaders, which advances balanced policies for a strong economy and a healthy environment.

We apologize for the repetitive nature of some of these comments but the informal process outside of the Administrative Procedures Act does not require that those comments receive staff response. Many of the increasing requirements and additional restrictions being placed on a successful but young program seem unnecessary, burdensome, and without achieving additional environmental benefits.

Overview

With SB 32 (Chapter 249, Statutes of 2016) now law, CCEEB believes that additional emphasis on Cap-and-Trade is necessary to achieve cost-effective emission reductions and to send a clear market signal to facility operations and projects. CCEEB supports a well-designed Cap-and-Trade Program as the most economically efficient, transparent, and environmentally effective policy for California to achieve statewide greenhouse gas emission reductions and meet the 2030 goal.

The compliance flexibility provided by the Cap-and-Trade Program allows California businesses to select reduction strategies that best suit their unique needs and evolving circumstances, while delivering real emission reductions more efficiently and at less cost than direct measures. Cap-and-Trade continues to achieve GHG emission reductions while sending a clear and transparent price signal throughout California's economy. This in turn prompts behavior change that reduces emissions and spurs the investment and commercialization of advanced technologies. Additionally, Cap-and-Trade provides the potential to export the policy to other jurisdictions through linkage or sector-based offsets, providing a real platform for California to realize its goals as a climate leader.

Some of the proposed regulatory amendments, such as those requiring the release of market sensitive data, diminish the ability to use offsets, potentially retiring unused allowances, and sequestering unsold allowance into the Allowance Price Containment Reserve, set California on a limited path with narrow solutions that will ultimately be costlier, limit technological development, and lead to economic and emissions leakage. Our post-2020 policies should support the opportunity for new, emerging technologies and control strategies, and allow California to do what it does best – innovate.

Moreover, California cannot mitigate climate change alone. Policies that reduce greenhouse gases in the most economically efficient way will encourage other jurisdictions to link to California. Adding extraneous policies, stringency, or complexity that does not enhance the efficacy of the program will discourage rather than encourage other states, provinces, and countries to join the fight against climate change. Given today's economic realities, pursuing high cost program features that constrain Cap-and-Trade will only serve to further isolate California from potential sub-regional, national, and international partners. Other jurisdictions will not follow costly programs that create unsustainable economic pressures and drive business away. Even worse would be policies that limit or outright bar California from joining in partnerships with other jurisdictions, either through linkage or use of offsets. Insular policies may achieve in-state goals, but they will not solve global climate change.

ARB, with public input and strong collaboration with coalitions such as CCEEB, has spent the last decade developing a strong Cap-and-Trade Program. In light of SB 32's even more ambitious carbon reduction targets, now more than ever, a well-designed Cap-and-Trade Program is needed to help California meet its environmental goals while maintaining a strong economy.

AB 197 – Measured Response

Assembly Member Eduardo Garcia (D-Coachella), the author of AB 197, testified in Assembly Natural Resources Committee on August 24, 2016:

“I also want to just clearly state that we to are supportive of the Cap-and-Trade program, the leadership of the Senate who moved the bill out this week is in support of the Cap-and-Trade program, the leadership of the Assembly is in support of the Cap-and-Trade program, the governor of the state is in support of the Cap-and-Trade and has asked that 197 be sent to his desk as a package with SB 32. So, I wanted just to state that the intention is by no means to tamper with the Cap-and-Trade program.”

In an August 31, 2016 letter to the Assembly Journal, Assembly Member Eduardo Garcia stated, *“It is my intent that nothing in Section 38562.5 shall be interpreted to preclude ARB from adopting any market-based compliance mechanism pursuant AB 32.”*

Based on these statements, CCEEB urges ARB staff to be measured in its response to AB 197 and limit proposed amendments to the Mandatory Reporting Regulation and Cap-and-Trade

Program at this juncture. Now is not the time to propose radical departures from current program design based on inference of intent without explicit statutory guidance. It is clear that Assembly Member Eduardo Garcia, the Legislature, and the governor did not intend for ARB to substantially deviate from the existing Cap-and-Trade design.

Unfortunately, the proposed amendments would result in some troubling changes in the program. Issues of concern include a reduction of offsets, shifting the cost burden through reduction of industry assistance, and retiring allowances from the pre-2020 Allowance Price Containment Reserve (APCR). It is premature to make these changes prior to completion of at least two more compliance periods, when the full scope of the program will have been in effect and back-loaded elements of the Scoping Plan implemented. While AB 197 does list new priorities for ARB to consider when making changes to the Cap-and-Trade program, these do not supersede the existing priorities, listed in AB 32, of cost-effectiveness and technological feasibility.

Additionally, we note that at the October 21, 2016 workshop, staff acknowledged that the Cap-and-Trade Program already helps achieve direct emissions reductions.

The Cap-and-Trade proposal appears to be designed with a “cost burden” assumption that higher compliance costs will result in increased direct emissions reductions. CCEEB disagrees with this premise. Rather, CCEEB believes that the post-2020 program needs to be designed to *increase* cost effectiveness, both as a means to maximize GHG emissions reductions (i.e., “biggest bang for the buck”) and as a way to prevent emissions and economic leakage in the post-2020 program as the declining cap drives up the cost of carbon.

Nancy McFadden, executive secretary for the governor, stated on August 4, 2016, “*Let this be clear: We are going to extend our climate goals and **Cap-and-Trade program** – one way or another. The governor will continue working with the Legislature to get this done this year, next year, or on the ballot in 2018.*” This statement stands, and while SB 32 sets a new 2030 climate goal, there is still need to explicitly adopt Cap-and-Trade. Legislation will likely be introduced in the 2017-18 Legislative Session that will explicitly address this; it is prudent to hold off on speculating legislative intent until there is legislation dictating how Cap-and-Trade should be designed post-2020.

Seven Percent

CCEEB is greatly concerned that staff selected 7% as an acceptable domestic drop. Some drop in productivity might be acceptable in an academic setting, it should not be factored into the state’s future economic plan. We are even more concerned that CARB would consider such a large economic drop acceptable since 7% is similar to the loss California experienced in the Great Recession during which the state lost 1,061,300 non-farm jobs, roughly 7.4%.¹ For CCEEB’s membership a similar downturn would result in thousands of lost high-wage skilled labor jobs with large multipliers that ripple through the California economy. ARB’s acceptance of a 7% domestic drop as normal economic fluctuation undercuts industry assistance factors and undercuts the AB32’s directive to minimize leakage and equates to the drop experienced during the 2007-09 great recession, allows these amendments to further cut industrial assistance factors. Reduction of industry assistance for trade exposed companies is a simple and minor protection to avoid both environmental and economic leakage. California businesses are trade exposed unless

¹ <https://data.bls.gov/cgi-bin/surveymost?sm+06>

their competitor is in a linked jurisdiction; these include both countries without such linkage as well as individual US states where industry will not have the burden of these costs. In the absence of national or international action comparable to California law CCEEB requests that ARB maintain current industrial assistance factors.

The Visible Hand - Release of Additional Market Data, Retirement of Unused Allowances, and Reduction of Offsets

CCEEB opposes the release of market sensitive information on holding and compliance accounts. The release of this information may make entities vulnerable to market manipulation and serves no purpose that cannot be met by compliance reporting already available to ARB. Further, this information is proprietary and competitively sensitive. Release of this confidential information could provide entities with competitive advantages that would ultimately impact the market itself. This data includes:

- Quarterly CITSS Registrant Reports
- Quarterly Auction Summary Results Reports
- Annual Compliance Reports
- Annual summary of transfer reports
- Quarterly Compliance Instrument Reports
- Other data related to Cap-and-trade including GHG emissions reporting and California Climate Investment fund proceeds and investments

CCEEB is willing to discuss what additional aggregated data could be included, but rejects the 15-day changes, as we believe that they will substantially damage the market.

The retirement of unused allowances further constricts the market. While this proposal might be in reaction to the limited participation in recent auctions, CCEEB rejects the proposal as it would have substantial unintended consequences. It would greatly reduce liquidity which can lead to market manipulation; i.e. decreased liquidity results in volatility. As previously stated, litigation and lack of post-2020 certainty are impacting participation in recent auctions. However, these issues will likely be addressed in the near future. Measures to tighten the market are premature given the external uncertainty that has affected the Program in recent years, and could result in substantial increase in costs for Californians as market certainty is restored and the market naturally tightens on its own during the 2021-2030 timeframe.

CCEEB is concerned with the restriction of offsets generated in Canada and Mexico. While we understand staff's assertion that these offset projects can now be handled through linkage, there is no compelling reason to limit an already limited market. Furthermore, CCEEB is concerned with the "guilty until proven innocent" approach these amendments take towards offset invalidations. These changes on offsets limit supply, add risk, and constrict a critical cost-containment mechanism for the program. Offsets extend the influence of Cap-and-Trade to sectors and jurisdictions not covered by California's climate policy. If the ultimate goal is to mitigate and reduce greenhouse gases, this policy change will reduce California's impact in achieving global emission reductions, yet increases costs to Californians.

Need for Open Data and Reproducible Study Results

CCEEB is concerned by the difficulty in analyzing the economic impacts of the proposed amendments due to the lack of information on trade exposure status, holding limits, and other cost containment policies (besides the Allowance Price Containment Reserve). ARB is being guided by leakage studies conducted by Resources for the Future and the University of California, Berkeley. However, the raw data and assumptions used for these highly caveated reports are not available. Furthermore, authors of both studies have cautioned against an over reliance on results. We fear that ARB has taken the conclusions from these studies as facts and are proceeding forward without due caution. Examples of the researchers concerns on use of the data:

In the UC Berkeley Paper, Meredith Fowlie explained that the results do not “estimate leakage potential for any particular industry with any degree of precision.” (Fowlie, et al, p. 41) The authors go on to state, “However, the general patterns that emerge are insightful.” (ibid, p. 42) These general patterns include conclusions such as the greater the level of competition, the higher the demand elasticity and the greater the potential for economic and emission leakage. This intuitive result does not appropriately provide a foundation for a leakage analysis that can provide results “with any degree of precision.”

Further, authors explained that it is difficult to accurately identify the point of origin of U.S. trade exports. “This makes it difficult to separately identify California trade flows.” (ibid, p. 16) Authors go on to explain how they use a proxy for purposes of this exercise.

These are but two examples of the difficulty of accurately evaluating the impact of California-only policy on Energy-Intensive Trade-Exposed industries. Given this uncertainty, policy makers must remain focused on the primary goal, reduced GHG emissions.

We ask ARB to work with stakeholders and make the missing information publicly available so that others can reproduce results from the leakage studies. Peer review is essential. This is important since the proposed amendments seek to substantially reduce industry assistance to all sectors, in many cases by half or more compared to today. Regulated entities need access to this information in order to verify findings and determine how proposed program changes will affect California’s businesses and economy.

Based on the limited information we currently have available, CCEEB makes the following observations:

- ARB appears to be focused on only preventing emissions leakage, to the exclusion of other program goals, including prevention of economic leakage.^[1] Although it might be expected that California facilities are so efficient that emissions leakage and economic

^[1] Page 3, Section 38501 (h) It is the intent of the Legislature that the State Air Resources Board design emissions reduction measures to meet the statewide emissions limits for greenhouse gases established pursuant to this division in a manner that minimizes costs and maximizes benefits for California’s economy, improves and modernizes California’s energy infrastructure and maintains electric system reliability, maximizes additional environmental and economic co-benefits for California, and complements the state’s efforts to improve air quality.

leakage are the same, this is not always the case. As applied to manufacturing, which must operate at a relatively efficient capacity, economic leakage could result in reduced investment and manufacturing loss. For example, in both cases below, the manufacturer loses market share to out-of-state competitors even as emissions remain the same or even potentially increase if production is replaced by less efficient sources, i.e., economic leakage occurs without emissions leakage:

- Demand destruction: If California's demand for products decreases, then the amount of emissions associated with California's carbon footprint also decreases. California would consider emissions leakage for products for which there is California demand. If demand drops, however, and industry increases exports but faces out-of-state competition, this results in economic leakage. For example, if demand goes from 100 units to 90, in-state supplied 50 but now 30 and out-of-state supplied 50 but now 60, ARB would only address 10 units, not the full 20.
- Increases made by out-of-state producers that have the same emissions as in-state producers may not be considered emissions leakage, but it is economic leakage.
- Emissions Leakage may not be one for one. If emissions leakage occurs because production shifts to a less efficient out-of-state facility, with products transported to California to meet in-state demand, then emissions leakage is greater than 1:1. If actual emissions leakage is not 1:1, then ARB is under estimating the potential for leakage by basing their assumptions on a 1:1 exchange.

Mandatory Reporting Regulation Verification Deadline

CCEEB is pleased that ARB has indicated a willingness to revisit the proposed change to move up the MRR verification deadline in light of the nearly unanimous stakeholder testimony at the September Board Meeting that this would be difficult for compliance entities to accommodate. CCEEB's business sector members run complex, large-scale operations that require a great deal of time and expertise to evaluate and verify accurately. CCEEB looks forward to participating in the promised forthcoming workshop to identify a verification deadline that is workable both for compliance entities and ARB staff to ensure that emissions can accurately be accounted for in the state.

Waste-To-Energy


CCEEB supports the proposal to retain the limited exemption for waste-to-energy facilities through the second compliance period. Solid waste management is at a critical juncture here in California and keeping the three waste-to-energy facilities in operation, at least through the second compliance is critical to achieving the legislative goals outlined by SB 1383, and CARB, through the draft Short-Lived Climate Pollutant Reduction Strategy (SLCP).

Conclusion

CCEEB thanks the ARB for considering our comments on the 15-day amendments to the Cap-and-Trade regulation. CCEEB represents a broad cross-section of the covered entities in California. As such, CCEEB is able to represent diverse industry sectors and offer our assistance to the ARB in developing these ideas further. CCEEB looks forward to playing an integral role

in the future development and operability of California's Cap-and-Trade Program. Should you wish to discuss our comments in more detail, please contact me or Jackson R. Gualco, Kendra Daijogo or Mikhael Skvarla, CCEEB's governmental relations representatives at The Gualco Group, Inc. at (916) 441-1392.

Sincerely,

A handwritten signature in black ink, reading "Gerald D. Secundy". The signature is written in a cursive, flowing style.

GERALD D. SECUNDY
President

cc: Honorable Chair & Members of the Air Resources Board
Mr. Richard Corey, the Air Resources Board
Mr. William J. Quinn, CCEEB
Ms. Janet Whittick, CCEEB
The Gualco Group, Inc.