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April 15, 2016

Rajinder Sahota
California Air Resources Board
1001 I Street
Sacramento, CA 95184

Re: Comments in Response to Public Workshop on Cap Setting and Allocation in the Post-2020 Cap-and-Trade Program

Dear Ms. Sahota:

On behalf of the Natural Resources Defense Council, and our more than 72,000 members in California, we appreciate the opportunity to comment on the material and proposals presented by staff at the March 29, 2016 workshop regarding cap setting and allocation in a post-2020 cap-and-trade program. We focus these comments on the issues below, and look forward to providing additional comments on other issues raised at the workshop in the run up to the release of the draft regulatory package.

I. Topic Overview & Summary

- <u>Cap Setting</u> – support Option 2 and recommend use of Fifth Assessment GWP values
- <u>EDU Allocation</u> – support formal prohibition on volumetric return of allowance value and oppose continuation of POU option for consignment
- <u>Natural Gas Supplier Allocation</u> – support Option 1

II. Cap Setting

a. Post-2020 Trajectory

We strongly support staff's proposed Option 2, which would bring the cap in line with expected covered entity emissions starting in 2021. As Chair Nichols recently remarked, while ARB has successfully implemented an economy-wide cap-and-trade program, the carbon price that has been established is "not enough to actually drive changes in behavior," and is well short of what will be required to achieve the state's long-term climate goals.[1] The principal reason for the relatively low carbon prices seen in the market has been the oversupply of compliance instruments relative to demand. While this is in part a testament to the success of California's suite of complementary measures that are delivering reductions in capped sectors, a lax cap undermines the efficacy of the program in driving the scale and timeliness of investments needed to put California on a path toward deep decarbonization. Absent correction, market forecasts predict this imbalance will only grow in proportion.[2]

In recent comments to EPA on the Clean Power Plan model rule, ARB highlighted the importance of taking corrective action in the event a mass-based cap significantly exceeds covered emissions.[3] To prevent that scenario, ARB recommends that EPA include a pre-established mechanism in the rule to revisit and adjust mass-based targets for states as needed based on actual emissions in the years leading up to the start of the program in 2022, recognizing that "a lax cap would result in minimal carbon reductions beyond the status quo."[4]

Option 2 represents that same corrective action in California. Option 2 should accordingly serve as the *floor* of ambition for the start of the post-2020 program, not as the more stringent option as staff has proposed. We note the pre-2020 cap began at forecast business-as-usual emissions levels for the (original) start of the program in 2012. In light of Chair Nichols' comments, it is perplexing that the post-2020 program will, at best, start from the same position. As the end point in 2030 is the same under either scenario, we see no justification for perpetuating the oversupply of allowances in the early years of the post-2020 program reflected in Option 1.

Similarly, we find no basis for directing allowances equal to the "adjustment" from a linear trajectory into the Allowance Price Containment Reserve. While this issue is intimately related to the cost-containment proposals presented at the April 5th workshop (in particular, whether the enormous supply of untapped allowances in the APCR – more than 120 million – carries over into the post-2020 program and whether and to what extent the existing price tiers are lowered to narrow the gap with the auction reserve price), the proposal seems to presume that covered entities require some form of recompense for merely bringing the cap in line with actual emissions. They do not.

Facing a similar situation in the wake of the recession, which dramatically reduced emissions relative to business-as-usual forecasts, the RGGI states in 2012 reduced their program cap by 45% to bring it in line with actual emissions.[5] ARB should do the same here and proceed with Option 2 for the post-2020 program.

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[1] Transcript from "Senate Standing Committee on Environmental Quality & Senate Select Committee on Climate Change and AB 32 Implementation Hearing" (February 03, 2016), available at: https://digitaldemocracy.org/hearing/739.

[2] See, e.g., CaliforniaCarbon.info, "2020 baseline emissions forecast for California cap and trade," (finding the allowance market will remain oversupplied by a cumulative total of 120-140 million tons by 2020).

[3] http://www.arb.ca.gov/cc/powerplants/arbcommentsfedplan-01_21_2016.pdf.

[4] *Id.* (at 19-20).

[5] See http://www.rggi.org/docs/PressReleases/PR011314_AuctionNotice23.pdf

b. Global warming potentials

Staff proposes to base the post-2020 program on global warming potentials (GWPs) for covered greenhouse gases from the IPCC's Fourth Assessment. While we support staff's proposal to update the GWPs relative to the Second Assessment, on which the pre-2020 cap was set, we recommend staff employ the most recent Fifth Assessment values. At the workshop, staff remarked they would consider updating to the Fifth Assessment if/when it is in more general use and common practice in other jurisdictions. We find this explanation puzzling: when has California ever waited on other jurisdictions as an excuse not to incorporate the most recent climate science in its pioneering programs? California's entire climate program is predicated on establishing common practice, not waiting for it to materialize. While we appreciate the need to coordinate any changes in GWP values with California's linked partner jurisdictions, we urge staff to revisit this decision as the rulemaking unfolds and move swiftly to the most recent GWPs contained in the Fifth Assessment.

III. EDU Allocation

a. Prohibiting volumetric return

We are pleased to see staff move formally to prohibit a volumetric return of allowance value for all electric distribution utilities starting in the third compliance period, mirroring the prohibition already in effect for natural gas suppliers.[6] While the California Public Utilities' Commission revenue allocation framework eschews volumetric returns in favor of lump-sum Climate Credits for IOU customers, volumetric rate reductions are occurring with a portion of the allowance value allocated to the POUs.[7] Moreover, as we noted back in 2013,[8] ARB is well within its legal authority to prohibit a volumetric return without infringing on the CPUC's authority to set customer rates. For ease of reference, and because this issue was raised again at the workshop, we excerpt from those comments below:

…

Prohibiting a volumetric return of allowance value does not unlawfully infringe on the California Public Utilities Commission's authority to set customer rates

The utilities argue that prohibiting a volumetric return of allowance value to natural gas customers, as staff proposes, unlawfully infringes on the California Public Utilities Commission's authority under the California Constitution to conduct ratemaking. We disagree.

First, it is not clear that setting broad policy parameters around the distribution of allowance value constitutes ratemaking. The California Constitution provides only that the "Commission may fix rates."[9] The notion of exclusivity comes from case law, first elucidated by the court of

[6] § 95893(d)(3)
[7] "Summary of Vintage 2013 Electrical Distribution Utility Allocated Allowance Value Reports," at: http://www.arb.ca.gov/cc/capandtrade/allowanceallocation/edu-v2013-allowance-value-report.pdf (figure 2, p.7).
[8]

[9] Cal. Const., art. XII, section 6.

appeal in *City of Vernon.*[10] Yet there, the court held that the Commission's exclusive authority covers rates the public utility earns for *services furnished by the utility*.[11] In contrast, the distribution of allowance revenue is not a service furnished by the utility; it is the creation of ARB's cap-and-trade program. Indeed, ARB could have elected to bypass the utilities altogether through other allocation methodologies.

Yet even if the distribution of auction revenues were considered ratemaking, prohibiting a volumetric return does not unlawfully infringe upon the Commission's authority. The Commission does not have "exclusive jurisdictional control over any and all matters having any reference to the regulation and supervision of public utilities."[12] While the Commission's ratemaking authority may be exclusive over local governing entities, this has not been established where *state-level* statutory schemes are at issue.[13] Rather, courts have frequently found that the Commission does not have exclusive authority when its jurisdiction is concurrent with another comprehensive statutory scheme (such as AB 32) and where the Commission has yet to issue relevant competing regulations (as here).

Accordingly, cases involving competing state laws and accompanying agency jurisdictional conflicts have come to very different holdings than cases involving conflicts between local governments (which the utilities rely on).[14] In *Leslie v. Superior Court*, for instance, the Court held that state housing law and Commission rules and regulations were of equal dignity, especially where no overt conflicts existed from the Commission generating its own rules.[15] And in *Orange County Air Pollution Control*, the California Supreme Court held the Commission must share its jurisdiction where it is concurrent with another comprehensive, statutory scheme.[16]

…

b. POU Consignment

While acknowledging the importance of prohibiting the volumetric return of allowance value, staff proposes to continue the so-called 'POU option,' which affords POUs the option – unlike the IOUs – of turning in freely allocated allowances directly for compliance. That in turn operates as an ***implicit volumetric return*** by preventing retail electricity rates from reflecting the

[10] *City of Vernon v. Southern Cal. Edison Co*., 191 Cal.App.2d 378, 387 (App. 2 Dist. 1961)
[11] *Id.* (emphasis added).
[12] *San Diego Gas & Electric Co. v. Sup. Ct.*, 920 P.2d 669, 700 (Cal. 1996), citing *Vila v. Tahoe Southside Water Utility* 233 Cal.App.2d 469, 477 (Cal. Ct. App. 1965)).
[13] *See, e.g., Leslie v. Superior Court* (1999) 73 C.A.4th 1042, 1049, 87 C.R.2d 313 and *Orange County Air Pollution Control Dist. v. Public Util. Com.*, 4 Cal.3d 945, 954 (Cal. 1971).
[14] Compare *City of Anaheim v. Pac. Bell Tel. Co*., 119 Cal. App. 4th 838, 842-43 (Cal. Ct. App. 2004) and *City of Vernon v. Southern Cal. Edison Co*. 191 Cal.App.2d 378 (App. 2 Dist. 1961) with *San Diego Gas & Electric Co. v. City of Carlsbad* (1998) 64 Cal.App.4th 785, 797 (noting "the PUC has been held to have paramount jurisdiction in cases where it has exercised its authority, and its authority is pitted against that of a local government involving a matter of statewide concern. Where its jurisdiction conflicts with other than a local agency, commission directives have not been given such controlling effect.") (emphasis added).
[15] *Leslie v. Superior Court* (1999) 73 C.A.4th 1042.
[16] *Orange County Air Pollution Control Dist. v. Public Util. Com*., 4 Cal.3d 945 (Cal. 1971).

full price of carbon. And as ARB's 2013 summary report on EDU allowance value reveals, that is what is happening with ***84% of the allowances*** allocated to the POUs.[17]

Staff explicitly acknowledges the importance of consignment in the context of allocation to natural gas suppliers, noting (correctly) that it "incentivizes GHG reductions and creates equity between below- and above-threshold facilities" and that "full price pass-through will more closely align NG supplier allocation with EDU allocation."[18] Yet this rationale is mystifyingly absent as applied to the POUs. At the workshop, staff attempted to distinguish the disparate consignment requirements for IOUs and POUs on the grounds that most POUs own and operate their own generation, and would accordingly be buying back a significant portion of the allowances consigned to auction (as they hold the compliance obligation). Of course, that is exactly the same situation as California's natural gas suppliers, and in that context staff still requires consignment – and indeed now proposes to *accelerate* the consignment schedule.

The POU option also penalizes more efficient users relative to a scenario where, like the IOUs, the full range of allowance value is returned to customers independent of usage. That is also regressive, as on average higher income customers tend to consume more electricity. As new research demonstrates, the combination of consignment and Climate Credits provides *net financial benefits* for low-income households of the IOUs.[19] By proposing to continue the POU option, ARB is foreclosing the same opportunity for low-income households in POU service territories.

Accordingly, to truly align with the EDU allocation (not just the IOU allocation), we propose staff phase-in a consignment obligation for POUs alongside gas suppliers, with full consignment achieved by the start of the compliance period staff proposes for 2025-2027:[20]

<u>Proposed POU Consignment Schedule</u>

Year	2021	2022	2023	2024	2025
Percent Consigned	20	40	60	80	100

At a minimum, the onus is on ARB staff to justify disparate treatment for the POUs when for all other sectors ARB has recognized clearly the importance of consignment to preserve the carbon price in both wholesale and retail energy prices to encourage GHG reductions, reward more efficient users, maintain equity across sectors that compete for the same end uses, and increase liquidity in the market.

[17] "Summary of Vintage 2013 Electrical Distribution Utility Allocated Allowance Value Reports," at: http://www.arb.ca.gov/cc/capandtrade/allowanceallocation/edu-v2013-allowance-value-report.pdf (figure 2, p.7).
[18] http://www.arb.ca.gov/cc/capandtrade/meetings/20160329/caps_allocation_032916.pdf (slide 26).
[19] UCLA Luskin Center, "Protecting the Most Vulnerable: A Financial Analysis of Cap-and-Trade's Impact on Households in Disadvantaged Communities Across California," at http://innovation.luskin.ucla.edu/sites/default/files/FINAL%20CAP%20AND%20TRADE%20REPORT.pdf
[20] http://www.arb.ca.gov/cc/capandtrade/meetings/022416/arb.cpp.feb2016.pdf (at 4).

IV. Natural Gas Supplier Allocation

For all the reasons stated above and in previous comments,[21] we strongly support staff's proposal to accelerate the consignment schedule for natural gas suppliers. Then, as now, we see no justification for a ramp up to full consignment (we propose the above schedule for electric POUs only as a compromise approach). With the current minimum consignment level at only 30%, most of the carbon price in retail gas rates is muted, and the monetized allowance value that is proposed to be returned to IOU households in Climate Credits (~$12-15, once a year) will not be enough to drive meaningful additional reductions or to substantially raise awareness.

We accordingly support staff's proposed Option 1, which would require full consignment starting in 2021. Based on staff's current proposed rulemaking schedule for the post 2020 program (with final regulations effective October 2017), that still affords gas suppliers ample lead time to plan accordingly, but will resolve more expeditiously the cross-sector equity issues and incentivize more reductions. As staff previously identified, reductions in natural gas use in response to a price signal alone may be able to achieve more than half of the gas sector's emission reductions under the cap.[22]

Thank you for considering these comments. We look forward to engaging with staff and stakeholders to develop a post-2020 program that supports California's exemplary climate and clean energy leadership.

Sincerely,

Alex Jackson
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NRDC

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[21] See e.g. "NRDC Comments on the July 18 Workshop on Proposed Amendments to the Cap-and-Trade Program" (August 2, 2013).

[22] ARB, "Suppliers of Natural Gas: Background and Options," slide 14 (June 3, 2013), available at: http://www.arb.ca.gov/cc/capandtrade/meetings/060313/natural_gas_suppliers_workshop_presentation.pdf.