16 March 2018

California Air Resources Board
1001 I Street, Sacramento, California 95814
Submitted Online: www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=ct-3-2-18-wkshp-ws&comm_period=1

IETA COMMENTS TO CALIFORNIA AIR RESOURCES BOARD (CARB)

POTENTIAL REVISIONS TO CALIFORNIA CAP AND TRADE REGULATION POST-2020

The International Emissions Trading Association (IETA) appreciates this opportunity to provide comments on California Air Resources Board (CARB)'s "Preliminary Discussion Draft on Potential Regulatory Language for Post-2020 Cap and Trade Amendments" ("**Discussion Draft**") and "Price Containment Points, Price Ceiling and Allowance Pools Concept Paper" ("**Concept Paper**"). We also welcome CARB's recent decision to expedite rule-making activities, so post-2020 amendments are adopted by December 2018.

IETA encourages CARB to take into account several key considerations while moving forward with potential amendments. Our detailed comments are structured around the following areas:

1. **Cap and Trade is Working;**
2. **Perceived Allowance Oversupply;**
3. **Price Ceiling & Auction Reserve Prices;**
4. **Environmental Integrity;**
5. **In-State Direct Environmental Benefits;**
6. **Additional Offset Protocols & Regulation Amendments; and**
7. **Assistance Factors.**

1. CAP AND TRADE IS WORKING

Cap and trade should continue to be the instrument of choice for California policy-makers to reduce greenhouse gas (GHG) emissions. An active and transparent carbon market, which empowers and drives market efficiencies, will prove essential in galvanizing private investment in the most cost-effective solutions for California. IETA hopes to see CARB focus significant efforts on strengthening the cap and trade program, design improvements, and cross-border linkages to increase market participation, support cost-containment, and drive deeper emissions reductions across the economy.

2. PERCEIVED ALLOWANCE OVERSUPPLY

IETA believes the current program is working as evidenced by the reduction of emissions under the cap. We also believe that a carbon price should send an appropriately strong signal to market participants to continue reducing emissions while investing in low-cost abatement. The current market environment, largely influenced by the recession and aggressive complementary policies, indicates that allowance supply exceeds demand. However, in reality, the most relevant and robust market analyses indicate that cumulative allowance demand will in fact exceed supply (including banked allowances) before 2030, signaling that the program is not overallocated.[1]

IETA believes that the current cap, as set pursuant to the legislation, should not change. Instead, we believe that CARB should consider allocating allowances from post-2020 budgets to the Reserve Tiers ("speedbumps") in order to incent continued investment in the market today. In turn, this would send a price signal that would continue to drive the transition to a low-carbon economy.

CARB is considering placing 2.0% from 2026-2030 allowance budgets into the Reserve. IETA does not support this change. CARB set budgets for the post-2020 program in the 2017 amendment process – at a time when the program's offset usage limit was still 8.0%. The legislature then lowered the offset usage limit from: 8.0% to 4.0% for 2021-2025; and 8.0% to 6.0% for 2026-2030. In both these timeframes, the usage limit becomes more restrictive, which is the opposite of the initial adjustment to the limit from 4.0% to 8.0% to account for the removal of allowances to fill the Allowance Price Containment Reserve (APCR). To be consistent with its 2010-2011 approach, we feel that CARB should correspondingly increase the post-2020 allowance budgets to account for the new lower offset usage limit. At the very least, CARB should not exacerbate the impact of Assembly Bill 398 (AB 398)'s reduction of the offset usage limit by further removing allowances from the post-2020 market. The increased prices that will result from a reduced allowance supply may reduce broader political and stakeholder support for the program. Inflated prices could also dampen support for alignment and linkage with other jurisdictions.

The allocation of budgets should be based on strong economic analysis of both short and long-run fundamentals of the program, and they should be established to conform with CARB's approach to strong, but steadily declining, caps. Any analysis should also consider the full scope of the program, including its full 18-year length (2013-2030), the effects of complementary policies, and linkage impacts.

3. PRICE CEILING & AUCTION RESERVE PRICES

CARB staff proposes setting the allowance price ceiling in 2030 at a level between US$81.90/tonne (in 2015 dollars) and US$147/tonne. IETA recognizes that the purpose of a hard price is to provide for the continued economic stability and political support of the program. However, many market players have expressed concerns about the proposed price levels, and their underlying assumptions/rationale. Given that allowance prices flow directly through to energy prices, IETA posits that CARB's proposed 2030 price ceiling range may be too high to ensure allowance prices do not rise to economically and politically unacceptable levels. We strongly encourage CARB to host a series of meaningful, fully-transparent and comprehensive stakeholder consultations related to levels of acceptability and potential implications associated with various price ceiling options.

[1] For example, see Brattle http://files.brattle.com/files/11768_the_future_of_cap-and-trade_program_in_california_final_12.4.17.pdf; ICIS https://www.icis.com/energy/carbon-emissions/; BNEF https://www.bnef.com/core/insights/17155; and Borenstein et al https://ei.haas.berkeley.edu/research/papers/WP281.pdf

IETA recommends that the "Reserve Tier" prices (e.g., Price Containment Points or "PCPs") be spaced more proportionately to allow them to achieve the intended effect of preventing rapidly rising prices in the allowance market. At US$70/tonne (2015 dollars) the Tier 1 Reserve price in the first PCP would be over 80% from the floor to ceiling price. This could create a risk that the Tier 1 Reserve would not have time to achieve its desired effect of preventing price spikes. It could also fail to provide the necessary time for the Independent Emissions Market Advisory Committee (IEMAC) to inform stakeholders of options to manage the rising prices. It is critical to avoid sparking market instability that might interrupt a smoothly functioning, effective carbon market. IETA suggests that placement of the Reserves tiers at price points approximately one-third and two-thirds between floor and ceiling prices could provide the optimal ability for these price containment points to achieve their intended function as per AB 398.

With regard to the APCR, IETA supports the idea of moving "extra" allowances for 2021 into Reserve Tiers. This approach would increase their capacity to mitigate rising allowance prices while helping ease the transition to higher prices. Putting these allowances in the price ceiling would not support cost-containment since CARB is already implementing a hard price ceiling that allows for the issuance of additional tons and would basically serve the same purpose once the ceiling price is reached. This is a reasonable and defensible approach to increase supply when prices increase.

4. ENSURING EVIRONMENTAL INTEGRITY

AB 398 directs CARB to maintain environmental integrity by using revenues from the sale of "additional metric tons" at the price ceiling to procure at least equivalent metric tonne reductions outside of the program. The sale of these additional tons at the price ceiling indicates that further emissions reductions from capped sectors are more expensive. As such, IETA believes that CARB should have discretion to procure a broad range of instruments and reductions from projects meeting statutory criteria.

5. IN-STATE DIRECT ENVIRONMENTAL BENEFITS

With AB 398, the legislature did not restrict one-half of offset usage to projects within California. Instead, the bill says that one-half of offsets used must have in-state direct environmental benefits ("DEBS"). Had the legislature been more restrictive, AB 398 might have brought lawsuits based on the Commerce Clause, which would drain agency resources and negatively impact the market.

Evidence from climate science shows that the atmosphere is a global sink and that GHG emissions anywhere in the world have direct impacts on California. While IETA continues to maintain that isolating California's program with the DEBS provision is counterproductive to broad climate action, we support CARB's initial framework, as described on page 17 of the Discussion Draft. CARB's framework would protect tribal initiatives that rely on offset projects as economic resources; a significant step in its continuing efforts to support disadvantaged communities.

To simplify compliance and reduce administrative burden, IETA recommends that offset projects whose address is physically located within the state of California should automatically earn designation as a DEBS project, both for past and future ARBOC issuances. Projects that are not geographically located within the state, but that provide clear reduction or avoidance of any pollutant that could have an adverse impact on the air or waters of the state, should not be arbitrarily labeled as failing to provide DEBS. Offset projects in neighboring states, for example, likely benefit California air quality and watersheds, which do not strictly stop at state lines.

Further, AB 398 says that DEBS includes "the reduction or avoidance of ***any pollutant*** [emphasis added] that could have an adverse impact on waters of the state." Greenhouse gas emissions are pollutants, as the Supreme Court found in Massachusetts v. EPA (2007). Further, there is robust evidence that these pollutants, wherever they occur, cause climate change and adverse effects on the state's waters.[2,3,4] Therefore, according to AB 398 language, avoiding or reducing emissions anywhere provides DEBS.

Offsets provide numerous benefits and co-benefits to California and beyond. For sectors with more dispersed emissions which are not covered by the cap (e.g. agriculture) offsets provide an incentive to invest in GHG reductions projects. For Californian consumers, they provide a lower-cost alternative to meet the state's reduction goals. This cost perspective will be especially important in the future, when allowance prices will be higher. Finally, offsets provide a tangible way for people around the country – from the White Mountain Apache Tribe in Arizona to Wisconsin dairy farmers – to engage with California on climate action while seeing for themselves that we can grow the economy in a climate-friendly manner.

6. ADDITIONAL OFFSET PROTOCOLS & REGULATION AMENDMENTS

CARB has six approved offset protocols, with the last one (Rice Cultivation) approved in 2015. There are several new protocols that would meet CARB's rigorous review process. IETA believes that this process should begin as soon as possible. While the Compliance Offsets Protocol Task Force has not yet been convened, CARB staff could review new protocols already published by voluntary offset programs, as were many of CARB's existing compliance protocols initially.

Because the decrease in the offset usage limit could result in higher compliance costs, IETA also encourages CARB to consider additional amendments to the regulation's offsets provisions within this or subsequent proceedings, including narrowing the scope of grounds for invalidation, and shortening the invalidation period such that all ARBOCs are CCO3s without a second verification.

[2] Central Valley Board – Climate Change Work Plan December 2017, pp. 9-17
[3] The Effect of Climate Change on Water Resources and Programs, U.S. EPA, pp. 9 – 19.
[4] Using Future Climate Projections to Support Water Resources Decision Making in California. pp. 45-46.

7. ASSISTANCE FACTORS

IETA supports teh proposal to extend the 100% industry assistance factor, as proposed on page 30 of the Discussion Draft. For compliance entities, this approach is important and consistent with the imperative of Callifornia's cap and traede program to minimize environmental and economic leakage.

In Conclusion

We appreciate this opportunity to comment on CARB's proposed amendments' Discussion Paper and Cost-Containment Concept Note. While moving forward with cap and trade amendments and stakeholder engagement in 2018, IETA looks forward to closely engaging with Staff. If you have questions about IETA's comments, contact Katie Sullivan, Managing Director, at sullivan@ieta.org.

Sincerely,

Dirk Forrister

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IETA President and CEO