Appendix

WSPA Comments on Cap & Trade Cost Containment, Post-2020 Cap Setting, and Emissions Allocation

Cost Containment Issues

Price Cap

ARB is considering implementing changes to the pricing and structure of the Allowance Price Containment Reserve (APCR) recommended by the Emissions Market Assessment Committee (EMAC). However, the EMAC favored a maximum price at which it would sell unlimited additional allowances to avoid possible price spikes and economic dislocation.[1] EMAC noted that "It is far better to have a transparent and credible process for limiting allowance prices established in advance than relying upon ad-hoc emergency measures during periods of stress."[2]

The EMAC identified the price cap mechanism as the optimal approach to address potential allowance supply imbalances. WSPA strongly recommends that ARB work with market experts and other program stakeholders to establish a reasonable price cap designed to maintain market stability.

Industry Assistance for the Third Compliance Period

As the Cap continues to decline and opportunities for emission reductions become increasingly scarce and expensive, there is a greater need for industry assistance to insulate in-state regulated parties from economic advantages that would otherwise be enjoyed by their out of state competitors. The need for industry assistance in California diminishes only as other jurisdictions implement similar programs that level the playing field among competitors. As ARB is aware, the response from other jurisdictions has been slow and very limited in scope. California industries remain competitively disadvantaged by costs imposed not only under Cap & Trade, but by other "complementary measures" such as the Low Carbon Fuel Standard. ARB's proposed linkage with the Canadian Province of Ontario will provide little if any discernable relief for globally traded commodities such as transportation fuels.

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[1] *Price Containment in the California Cap & Trade Market*, Emissions Market Assessment Committee, November 14, 2013

[2] *Price Ceiling in the Greenhouse Gas Emissions Cap-and-Trade Market*, Severin Borenstein, James Bushnell and Frank A. Wolak, Emissions Market Assessment Committee, November 8, 2013.

Absent an immediate groundswell of action by other jurisdictions, the reductions in industry assistance scheduled for the third compliance period will guarantee trade exposure for in-state regulated entities and will likely lead to emissions leakage. WSPA recommends that ARB extend the industry assistance factor of 100% of sector benchmark through the third compliance period and into the post-2020 compliance periods when the competitive disadvantage would be even more pronounced.

Offsets Policy for the Third Compliance Period and Beyond

WSPA disagrees that the current limits on offsets should be retained. The under-utilization of offsets to date is not a predictor of the need for offsets in the future, particularly in light of the fact that the allowance market will become increasingly constrained as the cap declines.

As some stakeholders have testified during recent ARB workshops, the current offset regulation and ARB's interpretations and implementation add complexity and create systemic bottlenecks that limit the viability of offsets. These issues include: 1) the inflexible 8% quantitative use limit, 2) geographic restrictions including ARB's interpretation that emission reductions outside of California are only eligible for credit if they would be considered "additional" within California, 3) ARB's approach to investigation and invalidation of offsets, and 4) amendments to existing protocols imposing new restrictions on offsets projects. All of these features serve to constrain the pool of available offsets and their value in the marketplace.

We agree with ARB that the offsets process would benefit from greater predictability and that actions should be taken to compress the timeframe for issuing offset credits. ARB should retain a third party to work with Cap & Trade regulated entities, offset project developers and market experts to identify impediments to offset credit generation and use. The results of this review should inform offset policy changes for the third compliance period and post-2020 program design.

As part of this process, ARB should explore a range of options already identified by various market experts and compliance entities[3], including but not limited to:

- **Increase the 8% quantitative use limit**, both for the third compliance period and for any post-2020 program. The 8% limit ignores the fact that GHG emission reductions yield the same climate benefits regardless of where they occur. It also discourages market interest in offsets, which in turn discourages offset project development and further limits the volume of allowances available in the market. In addition, ARB has predicted a steeper rate of decline in GHG emissions between 2020 and 2030 relative to the pre-

[3] See in particular the *Joint Utilities Group Cost Containment Proposals* presented during the Air Resources Board Cost Containment Workshop on June 25, 2013.

2020 timeframe[4] which would amplify the need for more effective cost-containment measures. To address these challenges, we propose that ARB double the offset quantitative use limit from 8% to 16%.

- **Additionality concern for linked jurisdictions.** ARB has often observed that the vast majority of California emission sources are already controlled, or are forecast for future control, and opportunities for in-state offsets are very limited. This challenge would not be alleviated with linkage to other jurisdictions because emissions in those jurisdictions would only be eligible for credit if they would be considered "additional" under the California program. Additionality standards in California should not be applied to potential offset projects in these other jurisdictions.

- **Allow compliance entities to carry forward any unused portion of the applicable quantitative use limit** through 2030 and to trade or sell the option for unused offsets to other regulated entities.

- **Redistribute unused offset "capacity" to compliance entities.** For example, if usage for the prior compliance period was only 7%, ARB could allow up to 9% in the next compliance period. This approach could be implemented on an aggregate or individual compliance entity basis.

- **Remove or reduce geographic use restrictions**, including allowing use of offsets approved by other jurisdictions (both linked and non-linked). The current limitations in section 95972(c) sacrifice valuable opportunities to reduce GHG emissions in jurisdictions that lack established GHG emission control programs.

Allowance Price Containment Reserve

ARB has already accumulated a substantial amount of allowances in the Allowance Price Containment Reserve (APCR) and should not add to it unless an analysis is completed showing that the existing APCR is inadequate. WSPA supports modifications to the APCR that would reduce the number of allowances diverted from the market to the APCR and/or return unused allowances to the market for use in future compliance periods. There is a limit to the number of allowances required to contain costs under the APCR mechanism. By diverting allowances to an ever growing APCR, ARB is creating a state-owned bank which increases allowance scarcity

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[4] See: Air Resources Board staff presentation: *2030 Target Scoping Plan*, October 1, 2015, slide 10.

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and the likelihood of higher allowance costs. ARB is also artificially lowering the cap. None of these actions are authorized by AB 32.

Unsold reserve allowances should be placed back into the market after the compliance deadline corresponding to the vintage year of the allowances. For example, VY2018 reserve allowances would be returned to market after the 2018 compliance deadline has passed. This approach would create additional cost containment benefits without impacting the market during the applicable vintage year.

WSPA opposes the retirement of any allowances available under the cap that are not surrendered as compliance instruments.

WSPA offers the following recommendations to improve the cost containment functionality of the APCR starting in the third compliance period. All of these alternatives would need to be further evaluated to understand potential impacts on the market.

- **ARB should establish a process to decrease the flow of allowances into the APCR** if it is unused for several years**.** This could include returning some volume of unused allowances in the APCR back to the regular auction market at the end of each compliance period. This approach would reduce costs in an increasingly constrained market.

- **ARB should establish the appropriate volume of allowances needed in the APCR.** WSPA recommends that ARB conduct a separate study to evaluate the market status and trends and use study results to set an appropriate APCR quantity.

- **Index APCR price escalation to the rate of inflation only.** WSPA agrees with ARB's proposal to eliminate the 5% per year escalation and collapse the current price tiers. Both features are arbitrary. APCR pricing should be informed by actual market dynamics and market data.

- **Include a process to address depletion of the APCR**, to be triggered if the APCR falls below a predetermined volume. WSPA recommends that ARB consider alternatives to restocking the APCR, such as allowing regulated entities to purchase offsets above the prevailing quantitative use limit.

Additional Allowance Management Issues

Use of future vintages at a premium (ARB offered for discussion the idea of retiring one allowance for every 4 borrowed) must be evaluated for potential to cause a market shortage in the future. The potential for a future shortage could increase the possibility of market volatility in the future. This scenario highlights the need for a price cap.

If ARB were to obtain the legislative authority to extend the Cap & Trade program past 2020, we would support ARB's proposal to continue banking of allowances through 2030.

Post 2020 Cap Design

WSPA recommends that ARB design the cap for a back-end loaded emissions reduction schedule where the slope of the cap in the first few years is relatively shallow and then declines more rapidly toward the latter half of the 2020-2030 period. We believe this approach will be necessary to ensure adequate time to develop cost-effective technologies and projects to facilitate compliance in the post-2020 period.

If ARB seeks to expand the number of sources regulated under the Cap & Trade program, it must adjust the cap to accommodate the additional emissions from these sources without penalizing currently regulated sources.

Post-2020 Allowance Allocation

Allocation for Purchased/Obtained Electricity

ARB proposes that it would assume responsibility from the California Public Utilities Commission (CPUC) for direct allocation of allowances to industrial entities for purchased or obtained electricity. WSPA supports ARB's proposal. WSPA also supports equitable refund treatment for entities that obtain power from IOUs, POUs and third parties (the current CPUC allocation methodology does not address POUs or third parties in POU territory) which should be accomplished by realigning this function under ARB. We agree with ARB that almost all steam and electricity purchases and sales data will be reported using financial records and that verification of this data should not be overly burdensome.

While we agree with ARB that it is desirable to use verified MRR data as the source of data for benchmarking, benchmark stringency should remain consistent with the 2008-2010 baseline period.

WSPA has previously commented that consumers of transportation fuels deserve protections from climate program-related cost increases similar to those the state currently affords to electricity and natural gas customers. The transfer of responsibility for allocations related to electricity sales from the CPUC to ARB presents another opportunity to remedy the current inequity in consumer protections for energy cost increases. WSPA would welcome the opportunity to discuss with ARB potential mechanisms to achieve this end.

In addition, for the post-2020 natural gas supplier allocation, there should be no increase in the percentages already assigned through 2030, unless ARB first establishes a proportional allocation mechanism for transportation fuel suppliers.

Additional Allocation Issues:

- **Allocation for electricity sector.** ARB is not proposing changes in allocations for this sector and we do not object to the requirements in the existing regulation. However, electric utilities should be accountable for use of this revenue stream on cost-effective GHG reductions.

- **Allocation for natural gas.** ARB is proposing to increase the amount of consignment to auction, which in turn may increase costs to consumers. ARB should provide trade exposure protection for these costs consistent with its electricity EITE policy.

- **Legacy contracts.** ARB is not proposing changes to the current regulation related to legacy contracts. WSPA supports adding a requirement that legacy contract decisions must include consultation with both parties to improve transparency.

- **Methane Global Warming Factor.** ARB proposes to change this factor from 21 to 25 based on the global warming potentials in the IPCC's Fourth Assessment Report. WSPA asserts that the 100 year factors are the only appropriate factors for use in any California regulation. Further, we oppose this particular change unless commensurate changes are made for all other state-regulated GHGs, and those changes are tied to the baseline inventory and the 1990 emissions level to ensure consistent and transparent emissions accounting moving forward.

Additional Process Concerns

Proposal to Adopt a "Framework" Regulation

While we appreciate ARB's stated intention to hold workshops and share draft language in advance of noticing proposed 15-day changes, having a Board-approved "framework" regulation already in place which provides ARB staff the power to determine what areas will be changed and what will not, provides no stakeholder due process for changes that are in areas of concern to those stakeholders. Because the approval is of a general framework, the Board is actually approving a blank check. This regulatory process effectively eviscerates the ability of stakeholders to meaningfully evaluate or to participate in the rulemaking process. We believe that ARB must include stakeholders in the entire process fairly and without rushing to adopt a blank check. ARB has ample time to develop a complete proposal through an informal pre-rulemaking process and meet all of the procedural requirements of the APA well in advance of the October, 2017 timeframe for allowance allocation.

Standardized Regulatory Impact Assessment

WSPA is further concerned that ARB's Standardized Regulatory Impact Assessment (SRIA) Report, submitted to the Department of Finance on April 1, 2016 suggests ARB has already workshopped proposed Cap and Trade changes and potential alternatives.[5] These documents acknowledge and attempt to quantify additional costs across covered and non-covered entities. They also describe and analyze in general terms two alternatives to the "proposed regulations": facility-specific requirements and a carbon fee. In fact, ARB has only shared broad concepts for potential pre- and post-2020 program changes. *ARB has not provided sufficient definition of proposed changes or potential alternatives, much less draft regulatory language.* The SRIA document suggests that ARB has already largely determined the path forward for the Cap & Trade regulation, independent of meaningful stakeholder input on specific proposals.

Reliance on Advisory Committee Recommendations

ARB staff's statement that it will retain current offsets policies, rather than amend the regulation to enhance their utility, based on opposition from the Environmental Justice Advisory Committee (EJAC) implies that ARB is giving greater weight to EJAC recommendations than to those of other stakeholders. This bias was demonstrated most recently during ARB's April 28 workshop on sector-based offsets, during which ARB allowed EJAC members to preside over public discussion of this issue. The EJAC members used this platform to criticize the motivation and integrity of the regulated community as a prelude to public comments. ARB should recognize that this approach promotes greater conflict among stakeholders and discourages an open exchange of ideas. Staff should never delegate management of a public forum to any one stakeholder group. Moreover, if ARB intends to discount stakeholder input relative to advisory committee recommendations, then it should establish additional advisory committees to ensure that all stakeholder views are fully and fairly considered in the rulemaking process.

[5] Air Resources Board submittal to Department of Finance: Major Regulations Standardized Regulatory Impact Assessment (SRIA) Proposed Amendments to the Cap-and-Trade Regulation and SRIA summary, April 1, 2016.

Emphasis on Localized GHG Emission Reductions

WSPA objects to staff statements that ARB intends to retain existing offset limits to help maximize GHG emission reductions from individual facilities. This position is at odds with the principles of market mechanisms inherent in ARB's Cap & Trade program design and ARB's own findings that GHG emissions do not correlate to regional or local air quality impacts from criteria pollutants and air toxics. ARB acknowledged this point at the April 5 workshop, and is actively educating local air districts on the lack of environmental results from establishing sector or facility-specific GHG caps.[6] Statements such as these promote confusion about the intent of the program, and the very outcomes ARB seeks to avoid. ARB should ensure that all of its statements in workshops, hearings, other public and private venues and in supporting materials do not contradict the overall design of a market mechanism or ARB's own Cap & Trade program.

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[6] Letter from ARB Executive Officer Richard Corey to Bar Area AQMD Executive Officer Jack Broadbent, dated September 17, 2015, asserts that local GHG controls on refinery emissions "will have no effect on overall GHG emissions" and "would likely be compensated by emissions increases (also called emissions leakage) in other parts of the state."

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