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November 4, 2016

Rajinder Sahota
Chief, Climate Change Program Evaluation Branch
California Air Resources Board
1001 I Street – P.O. Box 2815
Sacramento, CA 95812

Re: SoCalGas Comments on the October 2016 Cap-and-Trade Regulation Amendments Workshop

Dear Ms. Sahota:

On behalf of the Southern California Gas Company (SoCalGas), we respectfully submit the following comments in response to the California Air Resources Board's (ARB) Proposed Amendments to the Cap-and-Trade Regulations presented at the October 21, 2016 Workshop (Workshop). Our comments address four issues: 1) Post-2020 Cap Adjustment Factors, 2) Post-2020 Allowance Consignment requirements, 3) Allowance Price Containment Reserve, and 4) Offset Credit Usage Limits.

## I. POST-2020 CAP ADJUSTMENT FACTORS

**Support a Continuation of Current Cap Adjustments Factors for Allowance Allocation –** SoCalGas strongly supports a continuation of the rate of decline under current regulations (approx. 1.86% factor decline per year) for Post-2020 cap adjustment factors (CAFs). The proposed CAFs, as presented on slide 47 of the Staff presentation, would nearly double the annual rate of decline from current CAFs for "Standard" sectors (1.86% to 3.4%). As illustrated in Figure 1 below, the direct allocation allowance gap widens with each year. By 2030, Standard sectors would receive only 50% under the proposed changes compared to 67% of direct allocation allowances that should occur under existing regulations. This change would result in significant costs to ratepayers as we discuss in the next paragraph.

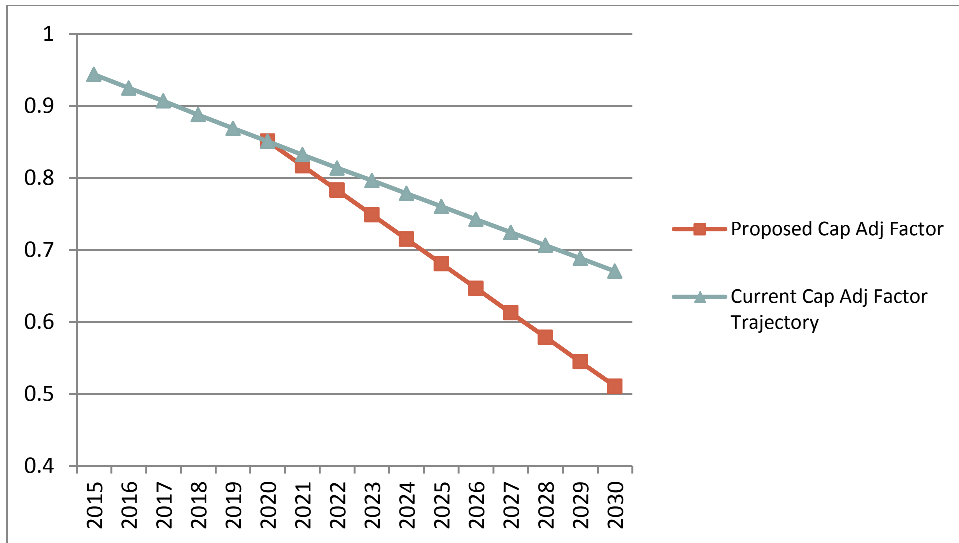


**Figure 1 Cap Adjustment Factors: Current Decline Rate vs. Proposed Decline Rate**

We direct Staff's attention to the fact that reductions in direct allocation allowances will increase the cost pass-through while simultaneously decreasing the amount of consignable allowances that are used to mitigate costs for impacted customers through issuance of Climate Credits. As shown in Table 1, the proposed CAFs are estimated to generate lower Climate Credit value than that of the current regulations, when compliance costs are at their highest. This mismatch between credits and costs will result in rate impacts to utility customers that can be avoided by maintaining current regulations. A gradual step-down in emission caps coupled with the gradual increase (five percent per year) in consignment requirements is a more prudent approach to safely introduce a price signal while ensuring consignment revenue for distribution of Climate Credits to eligible natural gas utility ratepayers.

**Table 1 Year 2030 Estimated Annual Residential Climate Credit and Compliance Cost for SoCalGas[1]**

| CAF and Consignment Scenario | Climate Credit | Compliance Cost |
|---|---|---|
| Current Regulations[2] | $63 | $59 |
| Proposed Changes[3] | $48 | $59 |

[1] All values are shown in real 2016 dollars; consignment values assume a low allowance price scenario, derived from the auction floor price in 2016 escalated by 5% a year and adjusted 2% a year for inflation.
[2] Current Regulations - using the 5% consignment rate in the current regulation with current cap adjustment factors.
[3] Proposed Changes include 100% consignment in 2021 and post-2020 cap adjustment factors for "Standard" sectors presented in slide 47 of the Staff Presentation at the Workshop.

## II. ALLOWANCE CONSIGNMENT REQUIREMENTS

**Support Current Consignment Level Increases of 5% per year** – SoCalGas urges ARB to maintain the current 5% annual increase in required allowance consignment levels for natural gas suppliers. At the Workshop, Staff proposed the most aggressive of three options presented at a previous March 29 Workshop – 100% consignment starting in 2021. Our estimates indicate that moving to full consignment so quickly is a dramatic departure from current regulations and creates significant rate shock to our customers. Table 2 below provides the compliance cost comparison between two scenarios for year 2021, when the proposed consignment would first have its impacts: 1) a continuation of current consignment and CAF levels and 2) the proposed decreased CAFs and accelerated consignment. As shown below, the compliance cost per therm would nearly double to $0.09. This would result in the average annual compliance cost for residential, commercial and large commercial customers to increase by 65% or more from the rate impact of current regulations.

**Table 2 Sample Rate Impacts for Year 2021: Comparing Current Regulations and Proposed Changes[4]**

| | **Current Regulations[5]** | **Proposed Changes[6]** |
|---|---|---|
| Total Compliance Cost ($ Millions) | $215 | $356 |
| Compliance Cost per Therm | $0.05 | $0.09 |
| **Average Annual Compliance Cost Per Customer** | | |
| Residential | $23 | $38 (65% increase) |
| Commercial | $186 | $309 (66% increase) |
| Large Commercial | $3,882 | $6,430 (67% increase) |

[4] Ibid., 2.

[5] Ibid., 2.

[6] Ibid., 2.

Furthermore, any acceleration of consignment requirements overlooks the documented reasoning for a more gradual transition to a full price signal,[7] and is simply unsupported by any new information presented by staff. The original consignment level is an approach that remains sound today. The following points outline reasons why a continuation of 5% annual consignment increase is the most judicious approach:

1. The idea that full-price pass-through more closely aligns the natural gas utilities with the electric distribution utilities' allocations fails to recognize the fundamental difference in the assessment of compliance obligations between natural gas utilities and electric distribution utilities. The compliance obligation is allocated directly to the gas utility based on retail sales, compared to point-of-generation or import in the electric sector. While the State's natural gas suppliers and other RNG stakeholders are working to increase the number and volume of natural gas alternatives, such as renewable natural gas, supply is currently too low to replace conventional natural gas at any significant scale. This necessitates a longer transition period to full rate impact for consumers.

2. Staff presented the position that increased consignment will incentivize greenhouse gas reductions. We respectfully request that Staff provide evidence that supports their claim before implementing the most aggressive consignment option presented to stakeholders. Our cost analysis presented in this comment letter and in meetings with ARB Staff, on the contrary, demonstrates that the proposed CAFs and consignment changes will have very significant negative impacts on utility ratepayers. Furthermore, the literature suggests that price increases at the residential and small commercial level do little to decrease consumption behavior. [8,9] A report co-sponsored by the California Energy Commission and the California Environmental Protection Agency found that "there are fewer and less obvious opportunities for consumers to reduce their demand for natural gas in response to price as compared to electricity." [10] SoCalGas confirmed these findings during recent resource planning activities and in implementation of energy efficiency programs. Therefore, given the likelihood of severe impacts to ratepayers, SoCalGas urges that Staff suspend the proposed changes until further study justifies such changes.

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[7] See page 16 of the September 2013 Initial Statement of Reasons-Proposed Amendments to the California Cap on Greenhouse Gas emissions and Market-Based Compliance Mechanisms

[8] California Climate Change Center, *Price Impact on the Demand for Water and Energy in California Residences,* (CEC-500-2009-032-F) (2009).

[9] Bernstein, M.A., Griffin, J., *Regional Differences in the Price-Elasticity of Demand for Energy*, National Renewable Energy Laboratory, (Subcontract Report NREL/SR-620-39512) (2006).

[10] California Climate Change Center, supra at 5.

3. Changes to current consignment requirements introduce regulatory uncertainty around procurement activities for all market participants by suggesting that ARB staff may suddenly modify allocation frameworks. The current levels of consignment for natural gas suppliers were carefully negotiated and designed to provide a balanced transition to a full carbon price-signal, mitigate market risk, and manage costs for California's natural gas customers. Altering the rate of consignment, particularly by adopting the most aggressive option proposed, upsets this careful balance and fails to recognize the time needed to implement carbon reduction activities by both utilities and consumers.

SoCalGas believes it is imperative for ARB to consider cost impacts from the Cap-and-Trade regulation in light of all future customer bill impacts for both natural gas and electricity, and to take into account the totality of utility bill increases that all Californians will be facing, especially low income households and small businesses. This is particularly important given that utility customers cannot currently distinguish between rate increases due to California's greenhouse gas programs and increases imposed by other regulatory changes.

## III. ALLOWANCE PRICE CONTAINMENT RESERVE

**Moving unsold allowances to the Allowance Price Containment Reserve (APCR) after 24 months is premature** – SoCalGas does not support Staff's proposal to move allowances that remain unsold for 24 months into the APCR. As proposed, this market intrusion could create pricing spikes in the short-term due to an artificial undersupply of allowances. Many have attributed the recent soft market to uncertainty about the future of the Cap-and-Trade program resulting from the legal challenges it faces and lack of legislation to extend the program beyond 2020. While these external influences on the market could temporarily cause market participants to hesitate and take stock, that does not justify a deliberate shifting of allowances into the APCR creating an artificial scarcity to inflate prices. Unsold allowances may be needed to meet short term demand with no ability to access volumes without purchasing the highly priced APCR allowances, leading to increased market pricing over short time periods. This condition would be exacerbated by the proposal to collapse the three reserve-price tiers into one. Indeed, the only beneficiary of such interference in the marketplace is the State who will be getting more for the allowances it sells, at the expense of California residents and businesses who will have to pay more for natural gas and electricity.

**Recommend Maintaining Three Price Tiers** – SoCalGas is concerned that collapsing the existing three reserve price tiers to one will increase the chances of extreme price spikes and price volatility in the linked California and Quebec Cap-and-Trade carbon market. The risk for this market behavior is heightened when combined with the proposal to remove surplus unsold allowances from the Auction Holding Account (AHA) and transferring them to the APCR. The result could be very costly for covered entities and damaging to utility ratepayers. The Carbon Market Compliance Association

completed an analysis that found as many as 250 million unsold allowances could be transferred from the AHA to the APCR by 2020. [11]

## IV. OFFSET CREDIT USAGE LIMITS

**Urge Against Decreasing the Offset Usage Limits** – Emission offset credits provide a critical cost containment function for the Cap-and-Trade program. Cost containment protects California's ratepayers and businesses, and supports the AB 32 objectives to cost-effectively reduce greenhouse gases. As acknowledged by ARB and other AB 32 stakeholders, California plays a leading role in developing frameworks and markets that achieve climate goals shared by jurisdictions globally to reduce greenhouse gas emissions. Therefore, ARB should strengthen rather than diminish the early-stage offset market by expanding the role of offsets in California's Cap-and-Trade program. SoCalGas supports actions that contribute to a robust offset market including increasing usage limits, improving and expanding offset protocols, and other actions that instill confidence in the offset market.

In conclusion, SoCalGas believes that the viability and health of the Cap-and-Trade program in post-2020 will be strengthened by considering and adopting our recommendations as outlined in this letter and summarized as follows:

1. We support a continuation of current cap adjustments factors for direct allowance allocations. The proposed alternative will result in significant costs for ratepayers while at the same time reducing the amount of consignment revenue for cost mitigation.

2. We urge ARB to maintain the current 5% annual increase in required allowance consignment levels for natural gas suppliers. Fundamental differences exist between how the natural gas and electricity utilities are treated under the Cap-and-Trade regulations and in the challenges they face to reduce emissions. Accelerated consignment fails to appreciate these differences and will have a severe impact on ratepayers.

3. SoCalGas cautions Staff to not move unsold allowances after 24 months into the APCR, as this will increase the likelihood of short-term price spikes. We also support the current 3-tier APCR structure that functions to reduce price volatility and mitigates price spikes.

4. Finally, SoCalGas supports strengthening the emission offset market, not weakening it by reducing the offset credit usage limits. We share the view that California should demonstrate leadership in all aspects of furthering climate goals, and the development of a robust offset market is a key component to reducing global greenhouse-gas emissions.

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[11] Carbon Market Compliance Association, "Notice of Public Hearing to Consider Amendments to the California Cap on Greenhouse Gas Emissions and Market-based Compliance Mechanisms Regulation" (Sept. 15, 2016).

Again, SoCalGas thanks you for this opportunity to comment on the October Cap-and-Trade Regulation Amendments Workshop and we look forward to additional dialogue as the amendments move forward. Please contact me if you have any questions or concerns about these comments.

Sincerely,

*Tim Carmichael*

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SoCalGas