July 5, 2017

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

Re: Gas Utility Group (GUG) Comments on the June 2018 Cap-and-Trade Workshop

Dear Ms. Sahota:

These comments are respectfully submitted on behalf of investor-owned, natural-gas distribution utilities (IOUs): Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), San Diego Gas & Electric (SDG&E), Southwest Gas Corporation, and publicly-owned natural gas distribution utilities (POUs) serving the Cities of Long Beach, Palo Alto and Vernon. All of the above utilities are referred to collectively as the Gas Utility Group (GUG) or Utilities. The GUG appreciates this opportunity to comment on the California Air Resources Board's (CARB) June 21, 2018 workshop (Workshop) which continued the informal stakeholder discussion on potential changes to the Post-2020 Cap-and-Trade Regulation.

The GUG provides comments on the following topics: 1) Equitable treatment for natural gas allowance allocation 2) Setting the price ceiling in accordance with statute; 3) The reserve tiers; 4) Offset credits and direct environmental benefits; 5) Allowance allocation and post-2020 cap-setting; and 6) Eligible uses of allowance proceeds. The comments below address each of these topics:

1. Equitable Treatment for Natural Gas Allowance Allocation

Allowance allocation for natural gas utilities continues to be an important issue for the GUG. Maintaining the current rate of decline for the post-2020 Cap Adjustment Factors (CAFs) is critical to the protection of utility customers and to providing equitable treatment between the natural gas and electric sectors.

Currently, the electric utility sector is recognized for early action and the additional cost burdens of complementary policies such as the Renewable Portfolio Standard and energy efficiency measures. The GUG acknowledges that this is appropriate and necessary given the required investments and costs associated with reducing greenhouse gas (GHG) emissions in California's electric sector. Accounting for these costs holistically through allowance allocation is an efficient way to balance the dual goals of protecting utility customers from rate shock and meeting the state's climate objectives.

The natural gas sector is making significant and material steps towards decarbonizing the pipeline, which also requires substantial investment. The following activities highlight some of the decarbonization efforts currently underway:

- SoCalGas and PG&E have both filed Advice Letters[1,2] with the California Public Utilities Commission (CPUC) in support of a Voluntary Renewable Natural Gas (RNG) Procurement Pilot that seeks to purchase RNG to meet the compressed natural gas (CNG) vehicle fuel demand from utility-owned CNG fueling stations. PG&E has received approval of their Advice Letter which is effective as of June 18, 2018.
- The City of Palo Alto approved a Carbon Neutral Natural Gas Plan[3], which sets in motion a strategy to achieve carbon neutrality for the gas supply portfolio. All Palo Alto gas customers pay a 4 cent-per-therm surcharge in addition to any Cap-and-Trade compliance charges.
- In January 2014, the CPUC approved SoCalGas' application to offer a Biogas Conditioning/Upgrading Services Tariff in response to customer inquiries and requests[4].

[1] SoCalGas Advice Letter #5295: https://www.socalgas.com/regulatory/tariffs/tm2/pdf/5295.pdf
[2] PG&E Advice Letter 3961-G: https://www.pge.com/tariffs/assets/pdf/adviceletter/GAS_3961-G.pdf
[3] City of Palo Alto Carbon Neutral Natural Gas Portfolio Plan: https://www.cityofpaloalto.org/civicax/filebank/documents/54160
[4] SoCalGas Biogas Conditioning/Upgrading Services. Schedule No. GO-BCUS: https://www.socalgas.com/regulatory/tariffs/tm2/pdf/GO-BCUS.pdf

This service is designed to meet the current and future needs of biogas producers seeking to upgrade their biogas for beneficial uses such as pipeline injection, onsite power generation, or compressed natural gas vehicle refueling stations.

- Per SB 1383, the CPUC's dairy pilot biomethane solicitation program is also underway and will approve at least five dairy biomethane projects for pipeline interconnection to investor-owned utilities in California by the end of 2018.[5]
- Many GUG members are actively engaged in pursuing the creation of a state-wide program that would foster cost-effective procurement of RNG in California.[6]

As the natural gas sector seeks to decarbonize, RNG will play an important role in achieving the State's climate goals by providing a lower-emission, beneficial use for Short-Lived Climate Pollutants (SLCPs) that are currently being released directly into the atmosphere as methane, or flared. An increasingly decarbonized gas supply can:

- Enable near-term GHG reduction of medium and heavy-duty transportation while also improving air quality and supporting successful implementation of the Low Carbon Fuel Standard,
- Provide cleaner fuel for ongoing thermal electric generation which supports integration of renewable resources and grid reliability, and
- Provide cleaner fuel for customer end-uses, especially in difficult to electrify industrial applications.

But these efforts do not come without a cost. Increasing the rate of decline for the Post-2020 CAFs and thereby, reducing the natural gas allowance allocation, only exacerbates the accumulating costs to ratepayers and stifles decarbonization efforts. In light of the activities mentioned above and future efforts to help decarbonize the natural gas system, the GUG believes it would be appropriate to maintain the current CAF rate of decline into the post-2020 period for the natural gas sector in order to protect customers, as noted in Board Resolution 17-21.

2. Setting the Price Ceiling in Accordance with Statute

The GUG appreciates the difficulty in determining an appropriate ceiling price. We urge CARB to use the following criteria as laid out in the AB 398 legislation, as required by law:

- To avoid adverse impacts on resident households, businesses, and the state's economy.
- To consider the 2020 tier prices of the Allowance Price Containment Reserve (APCR).

[5] As directed by SB 1383, CPUC instituted R.17-06-015 to implement the dairy biomethane pilot: http://www.cpuc.ca.gov/renewable_natural_gas/

[6] SB 1440 (Hueso). Energy: biomethane: biomethane procurement program: https://www.socalgas.com/regulatory/tariffs/tm2/pdf/GO-BCUS.pdf

- To consider the Social Cost of Carbon (SCC).
- To consider the auction reserve price.
- To minimize economic and environmental leakage.
- To consider the cost per metric ton of greenhouse gas emissions reduction to achieve the statewide emissions targets established in Sections 38550 and 38566.

We recommend that ARB stay focused on the above considerations of the statute and not drift into other pricing related objectives and considerations such as internal corporate carbon pricing. Furthermore, the GUG feels that it is important to use a relevant and defensible price ceiling to protect from threatening the long-term viability and support for the Cap-and-Trade Program within the Western Climate Initiative (WCI) and other jurisdictions with which it might link in the future. To accomplish these objectives and maintain consistency with the current program design, we support a 2030 price ceiling range of $60-$80 per metric ton (in 2015 dollars), which is greater than the SCC used in the 2030 Scoping Plan.

3. Reserve Tiers (Price Containment Points)

The GUG agrees with stakeholder comments that the Reserve Tier (RT) prices should be low enough to help protect customers before prices reach the ceiling and provide early signals to compliance entities and to give the Independent Emissions Market Advisory Committee time to evaluate and recommend possible program corrections, if needed. Effective cost containment is necessary to avoid rapidly escalating allowance prices and to help balance supply and demand in the market over time.

In previous comments, GUG members have advocated for setting the RT prices at one-third and two-thirds of the price ceiling. An additional consideration, and as suggested at the Workshop, is to set the RT prices so that they are bound to the annual floor price. This approach has two additional benefits: 1) the floor prices already account for inflation and have a built-in escalation rate and 2) there is a better grasp and broader consensus on the existing floor prices than the price ceiling, which has seen considerable divergence in stakeholder preferences. We maintain that the RTs would be more effective if spaced somewhat evenly between the floor price and ceiling price, rather than being clustered together near the ceiling. If the RTs are placed too close together or too close to the ceiling price, we fear they would be ineffective and fail to act as a brake on short-term price spikes as intended by the authors of AB 398. The risk is that policy makers might intervene and suspend the program due to price spikes, whereas a more gradual price trajectory provides opportunities to evaluate and refine the program, which would help mitigate potential risk to households, businesses and the viability of the program.

In addition, the GUG believes that for the RTs to be effective they must have sufficient volume. We commented on this topic in previous Workshops and will summarize here. We suggest transferring APCR allowances and unsold allowances into the RT reserves. Therefore, the GUG recommends that the 52.4 MMT that CARB planned to add to the post-2020 Reserve be placed

in the RTs. Placing these allowances in the RTs would increase their effectiveness in mitigating rising allowance prices and help ease the transition to higher prices. Reserving them for the price ceiling does not help to reduce adverse impacts on residential households, businesses and the state's economy nor to minimize economic and environmental leakage . Additional ways to bolster the RTs would contribute to the stability of the program, reduce the possibility of reaching the price ceiling and protect Californians from intolerable increases in carbon costs.

4. Offset Credits and Direct Environmental Benefits

The GUG continues to support offset projects that provide real, additional, quantifiable, and verifiable GHG emission reductions. These projects can provide reductions from uncapped sectors like agriculture and forestry, and in some cases, can be achieved at lower cost than other GHG emission reductions, reducing the overall cost of the Cap-and-Trade Program and thereby its economic impact on California consumers.

While AB 398 reduced the overall usage limits of offset credits for compliance entities from the current level of 8% to 4% between 2021 and 2025 and 6% between 2026 and 2030, we urge CARB to take a less restrictive view of the geographic source of offsets. The GUG continues to recommend that all projects located in California should automatically meet "Direct Environmental Benefits" standards for both past and future offset credits, and out-of-state offset projects can meet the standards by demonstrating they provide environmental benefit to California.

In the June 21 workshop, CARB stated that they believe "DEBs are in addition to GHG reductions or removals that [the] Program credits."[7] This position is concerning because it discounts the science-based environmental benefits from reducing GHGs to mitigate climate change, which is the basis of the offset program. This further limitation could stifle the offset market when it already faces additional post-2020 restrictions to California-based offsets and the reduced offset usage limits. ARB should consider legislative intent and stakeholder input in the context of established science and program design. It will be important to the viability of offset credits as an effective compliance vehicle to define DEBs in a sensible way that is not overly restrictive to the burgeoning offset market nor too burdensome to enforce. For example, the DEBs requirement should not be applied retroactively to projects that have already received issuance as it would be very difficult to implement, incurring significant costs to CARB and project owners while also disrupting the offset market.

[7] California Air Resources Board. "Potential Amendments to the Cap-and-Trade Regulation", Slide 26. June 20, 2018

5. Allowance Allocation and Post-2020 Cap-Setting

Certain stakeholders are concerned with the fact that covered emissions have been lower than the annual caps in the Regulation, referring to this as "overallocation" or "oversupply." The GUG does not view this as a failure, but as a success of the Cap-and-Trade program. The state is on track to achieve the 2020 emissions target early. We agree with Staff's thinking on this issue in that the program is working as intended and that any modifications warrant more thoughtful and in-depth evaluation. We also share Staff's concerns that making the market more stringent would only penalize covered entities for early action in reducing greenhouse gases and incent covered entities to only do the minimum going forward.

Available analyses, such as the report from the University of California Energy Institute,[8] generally project that allowance demand will exceed supply sometime before 2030, even when including the purchase of previously banked allowances. When this occurs, prices will increase, and could increase dramatically. Permanent removal of allowances from the market will restrict supply and accelerate potential allowance price spikes. While cumulative in-state emissions will be lower, this allowance supply reduction will necessarily cause compliance costs to be higher, and at higher prices, economic leakage, emissions leakage, and greater negative impacts to households are likely to occur. The GUG believes the current mechanism to address periods of low demand by transferring unsold allowances to the APCR after 24 months is an adequate safeguard.

On a similar topic, ARB sets annual emission budgets to steadily increase the price signal and constrain the amount of allowable emissions to meet the emissions target. Recently, there had been confusion amongst certain stakeholders as to how these caps are established. The GUG appreciates that Staff took time during the Workshop to walk through the steps of the methodology and clear the record of misunderstanding on this topic.

6. Eligible Uses of Allowance Proceeds

Staff proposed specific language in the second version of the Preliminary Discussion Draft that restricts electric and natural gas utilities from using allocated allowance proceeds for activities other than as described.

The GUG wishes to identify two main concerns with the proposed regulation text:

1. Eligible uses seem to exclude support for education and outreach activities, such as costs associated with outreach efforts related to distribution of the California Climate Credit. This applies to both the Electric Distribution Utility and the Natural Gas Supplier sections (§ 95892 and § 95893).

[8] Severin Borenstein, James Bushnell, and Frank Wolak, "California's Cap-and-Trade Market Through 2030: A Preliminary Supply/Demand Analysis" (July 2017) Working Paper 281.

2. As written, the amended text offers many more allowable cost categories for electric distribution utilities than is offered for natural gas suppliers. For example, allowable uses include "construction of eligible renewable energy resources," "support for renewable energy resources," "purchase of generation from eligible renewable energy resources," "switching from natural gas," and "infrastructure projects or other projects supporting active transportation, zero-emission vehicles, or public transportation" with nothing comparable in the Natural Gas Suppliers section. In the interest of equitable treatment and to drive the most cost-effective and innovative GHG reduction strategies, we encourage Staff to address this discrepancy.

To assist with remedying these concerns, the GUG makes the following suggested edits to the regulation text (edited sections are in red):

1) Revised section §95893(d)(3).

(B) Other GHG Emission Reduction Activities. Programs or activities other than energy efficiency, for which the natural gas supplier can demonstrate quantifiable GHG emission reductions per section 95893(d)(4), including funding projects or activities that reduce emissions of the natural gas pipeline, such as bringing renewable natural gas into the system.

(C) Education and Outreach. Programs or activities that educate the public on the indirect or direct reduction in GHG emission reductions or that relate to outreach on the California Climate Credit.

(~~C~~D) Non-Volumetric Return to Ratepayers. (no changes to this section)

(~~D~~E) Administrative Costs. Allocated allowance proceeds may be used for all costs related to the implementation of sections 95893(d)(3)(A)-(D).

2) Revised section § 95893(d)(4).

(4) Natural gas suppliers must demonstrate quantifiable GHG emissions reductions for each use of allocated allowance auction proceeds undertaken under sections 95893(d)(3)(A)-(B), as applicable, as described in section 95893(e)(4)(B).

The GUG can appreciate Staff's intention to clarify allowable uses of auction proceeds, although we believe that the currently proposed language could benefit from explicitly including education and outreach activities as allowable costs, and including additional activities that reduce GHG emissions such as bringing renewable natural gas into the natural gas system. Staff comments during the Workshop were indicative that they understand these issues but having the regulation text reflect their sentiment would help eliminate the ambiguity.

In conclusion, the GUG believes that the viability and health of the post-2020 Cap-and-Trade program can be strengthened by the appropriate application of the modifications directed by AB

398 and BR 17-21, including further consideration of natural gas allocation. Again, the GUG thanks CARB for this opportunity to comment on the Workshop, and we look forward to additional dialogue. Please contact the members of the GUG if you have any questions or concerns about these comments.

Sincerely,

Tim Carmichael

Tim Carmichael
Agency Relations Manager, Energy and Environmental Affairs
SoCalGas and SDG&E

Debra Gallo
Director, Public Affairs
Southwest Gas Corporation

Mark Krausse
Director
Pacific Gas and Electric

Tony Foster

Tony Foster
Business Operations Manager
City of Long Beach

Kelly Nguyen

Kelly Nguyen
General Manager
Vernon Public Utilities

Ed Shikada

Ed Shikada
General Manager of Utilities
City of Palo Alto