Comments of the Western Power Trading Forum to the California Air Resources Board on Potential Changes to the Cap and Trade Regulation in response to AB398

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Clare Breidenich

WPTF GHG Committee Director

Email: cbreidenich@aciem.us

The Western Power Trading Forum[1] (WPTF) welcomes the opportunity to provide input to the California Air Resources Board (CARB) on issued discussed during the March 2nd workshop. Our comments below address use of auction proceeds by electric utilities, cost-containment, offsets and potential changes to the treatment of greenhouse gas emissions (GHG) in the Energy Imbalance Market (EIM).

Allowance Allocation for Electric Utilities

CARB staff have proposed changes to clarify the allowable use of allowance proceeds for electric utilities. The draft Preliminary Discussion Draft (PDD) proposes that allowance revenue could be used for purchase or construction of renewable energy or energy storage products, and funding for energy efficiency or fuel-switching programs, provided that these investments demonstrate GHG reductions, for non-volumetric rate-payer relief, and for administrative costs of managing allowance allocation and use of auction revenue. As the use of allowance proceeds by investor-owned utilities is limited to non-volumetric rate relief for retail customers and is overseen by the California Public Utilities Commission, WPTF understands the proposed changes would apply to Publicly-Owned Utilities (POUs) only.

WPTF supports limiting the use of auction proceeds for non-volumetric rate relief and for administrative costs of managing allowance allocation and use of revenue. We also support a prohibition on the use of auction proceeds to purchase allowances. With respect to the use of funding for investments and programs to reduce GHG emissions, we are concerned that allowing use of auction proceeds for these activities would be less transparent and therefore more challenging for CARB to monitor. WPTF beliefs that the ability of the POUs to use auction proceeds for customer rate relief would allow mitigation of the rate impacts of GHG-reducing investments on its customers and that additional flexibility to use auction revenue to defray the costs of GHG investments is not needed.

Cost Containment

At the March 2nd workshop and in background documents, Staff provided initial thinking on implementation of the AB398 requirements for modification of the price containment reserve and establishment of a hard price ceiling. This included discussion of division of allowances to populate the two price tiers and provide an initial supply at the ceiling, as well as a potential price range for setting the ceiling. What was notably absent was discussion of mechanisms to achieve additional emission reductions in the event that the price ceiling is ever breached.

We believe that consideration and determination of the appropriate price for setting the price ceiling requires clear understanding of what would happen if the cap is breached. Options that

[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 80 members participating in power markets within California and elsewhere across the United States.

have been previously proposed[2], such as the ability to convert future vintage allowances at a fee, could reduce allowance prices in the immediate period, but may result in higher allowance prices later. Alternatively, the cost implications of purchase and retirement of allowances from other programs, such as the Regional Greenhouse Gas Initiative or the European Emission Trading Program, would differ greatly depending on whether such purchases are funded by CARB or by market participants.

Without a full picture of the vision for the price ceiling, WPTF is unable to provide specific comments on the appropriateness of the price range CARB is considering or the specific proposals for distribution of allowances across the tiers. Our initial thinking is that CARB should maximize the quantity of allowances that are available in the two price tiers below the ceiling, to reduce the likelihood that the ceiling is ever triggered. We also consider it appropriate that any allowances purchased at the price ceiling be required to be used for immediate compliance by the purchasing entity. It is not clear that such a restriction should also apply to restrictions at lower reserve tiers.

WPTF supports the proposal to reduce the frequency of when reserve sales are offered and to tie these sales to compliance events. However, we do not believe that the question of frequency is appropriate for the price ceiling, as ideally breach of the price ceiling will never occur. Staff should instead focus on identifying the particular conditions that would trigger price ceiling sales. These conditions would need to show sustained prices at or near the price ceiling for a pre-determined period, as evidenced by a series of auctions. Staff should also consider whether the price ceiling could be triggered at any point in a compliance period, or only as the three-year compliance deadline nears.

WPTF would welcome further discussion on these topics.

Overallocation

Some stakeholders have expressed concern that the unused supply of allowances from the pre-2020 program indicates that the program caps have been set too loosely, and advocate for reduction of program caps post 2020, or limits on use of banked allowances in the post-2020 period. At the workshop, staff expressed a view that the fact that GHG emissions are lower than the caps demonstrates that the program is a success and does not necessarily indicate an oversupply.

WPTF agrees with staff's assessment that the program is not over allocated. We oppose any tightening of caps or limits on banking.

Offsets

With respect to AB398 direction on limitation on the use of offsets and a requirement that 50% of offsets used must achieve "direct environmental benefits" in the state, staff indicate that

[2] https://www.arb.ca.gov/cc/capandtrade/simulationgroup/msg_final_v25.pdf

they do not propose to further define direct environmental benefits but rather will use the exact language of the legislation in revising the regulation. WPTF supports this approach.

Further, staff laid out a general framework to evaluate offset projects to determine whether this criterion is met. This framework would also allow staff to evaluate projects retroactively to check whether credits already issued, but not yet used, meet the direct environmental benefits criterion. WPTF urges CARB to develop these procedures as soon as possible, so that covered entities will know the status of any offset credits they are holding well in advance of the 2022 compliance deadline, when the new criterion and offset limits will go into effect.

GHG Emissions in the EIM

Lastly, WPTF would like to address the latest proposal by the California Independent System Operator (CAISO) to address the GHG accounting problem in the Energy Imbalance Market (EIM). In response to concerns that the so-called two-pass approach would be susceptible to potential bid manipulation, the CAISO has abandoned that approach. Instead, they propose an approach whereby 1) only incremental dispatch of energy over base schedules would be eligible to be deemed delivered to California and 2) all external resources, including zero emission resources, would be required to submit a minimum GHG bid adder.

WPTF could tentatively support the first part of the proposal but is strongly opposed to the second. Limiting the output of an EIM resources that can be deemed delivered to California may be workable, but we believe that additional consideration is needed as to how this would work in a day-ahead market. With respect to the second part of the CAISO proposal – a minimum GHG bid adder, WPTF has continually expressed concerns that the negative consequences of a hurdle approach on the market outweigh the potential emission reduction benefits. Although the CAISO does not characterize its recent proposal as a hurdle, it would operate as such for zero emission resources. It would make external, zero-emission resources less economically competitive not only to California thermal resources, but also to external thermal resources.

Given that CARB has already implemented an interim solution to address emissions associated with secondary dispatch under the cap and trade program, we do not believe that is urgent to adopt changes to the EIM now. Instead, CARB should continue to work with CAISO and stakeholders to find a solution that would be viable if the EIM expands and as other western states adopt carbon pricing. The CAISO’s latest proposal is not that solution.