Comments of the Western Power Trading Forum on Possible Amendments to the Cap and Trade Program
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Introduction

The Western Power Trading Forum[1] (WPTF) welcomes the opportunity to provide input to the California Air Resources Board (CARB) on its consideration of possible amendments to the Cap and Trade program necessary for California's compliance with the Clean Power Plan (CPP). Our comments below address the following issues relating to amendment of the cap and trade program discussed in the Staff White Paper and February 24th Workshop:

- Development of a Trading-Ready State Plan
- Compliance periods after 2020
- Backstop Design
- The CPP glide path

WPTF does not provide specific comments on potential changes to the treatment of electricity imports, but reiterates our earlier comment that the implications of the California Independent System Operator (CAISO) Energy Imbalance Market's expansion and transformation of the CAISO to a regional organization also merit careful consideration. We look forward to discussing these issues once Staff provides information regarding their ongoing consultations with CAISO staff on these matters.

CARB Should Aim to Develop a "Trading-Ready" CPP Compliance Plan

As WPTF has have previously stated, linked allowance trading programs throughout the west and nationally would have significant advantages in terms of delivering long-term emission reductions and ensuring a common and consistent carbon price signal for generator dispatch and investment. Linked programs eliminates the potential for emissions leakage in the electricity sector across state lines and thus the need to account for electricity imports. Further, linkage of western states programs would align with and support efforts to improve the efficiency of the electric grid through regionalization of the CAISO.

WPTF is concerned that Staff does not intend to pursue a trading-ready state compliance plan at this point, nor to make changes to the cap and trade program that would enable the state plan to be considered trading-ready. Rather, additional changes to the cap and trade program design to make the program trading-ready, specifically changes to address the "allowance import/export adjustment" would be considered only at such a time that CARB engages in formal discussion to link the California program to another state CPP allowance trading program.

Staff's approach would mean that if and when CARB considers linking with other states, CARB would need to formally revise the cap and trade regulation, not only to approve use of allowances for other states, but also more substantive changes to account for allowance transfers with other

[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 the WCI member states and provinces, as well as other markets across the United States.

states. California's revised state plan would then need to be submitted to EPA for consideration and approval. The time required for these procedural requirements suggest that linkage to other state CPP programs could not occur until the second CPP compliance period (2025) at the earliest.

Rather than unnecessarily delaying opportunities to link with other CPP state allowance trading programs, WPTF urges CARB to make modifications to the cap and trade program now that would enable California's CPP state plan to be considered trading-ready by EPA upon approval. Such modifications and trading-ready status would not prejudice a decision on whether to link with other states -- this decision would occur though formal consideration of linkage as per SB1018 -- but it would reduce or eliminate the need for substantive revision and approval of the plan by EPA in the event that such linkage is pursued. Approval of linkage to some or all CPP trading-ready states might require resubmission and approval of program to EPA, but this approval process would likely be simpler and faster than an approval process for substantive program changes that would be needed if California does not design the program as trading-ready from the start.

The additional changes for the cap and trade program to make the program trading-ready and additional requirements for the state plan submission are modest relative to those already necessitated by a multi-sector trading program under a state measures approach:

- *Demonstration in state plan submission that the state's mass-based goal will be achieved considering the emission allowance links with other programs*[2] ARB and the California Energy Agencies are already undertaking modeling necessary to demonstrate that California's state measures approach will achieve the states CPP goals. The only additional piece necessary is consideration of allowance prices and potential transfers with other states. Given that California allowance prices post 2020 are likely to be significantly higher than those in other CPP states in the absence of linking, the risk that California will be a net exporter of allowances is extremely low. Thus, demonstration that California will be able to achieve its CPP goals with linkage should be straightforward.
- *Inclusion of the allowance import/export adjustment in the backstop trigger and in CPP performance period reports*[3] Adoption of a state measure approach in and of itself requires inclusion of a backstop standards for Electric Generating Units (EGUs) and corresponding triggers in the cap and trade program, plus submission of state performance period reports that demonstrate that aggregate emissions of EGUs have achieved the state mass goal. To be trading-ready, the backstop trigger and performance period reports would additionally need only to include a net import/export adjustment to aggregate EGU emissions. This would require a simple arithmetic step to add a single variable (the import/export adjustment). In the event that California does not approve any linkage to other CPP programs, the value of this variable would be zero.
- *Potential modification of CITSS* The CPP requires that states that adopt an allowance trading program use an EPA-approved or EPA-operated allowance tracking system. While it is likely that CITSS already meets EPA standards for security, interoperability, etc., some modifications may be necessary to enable implementation of the backstop. Specifically, if the backstop were triggered, CITTS (and market participants) would need to distinguish between the backstop allowances, other California-issued allowances, and allowances

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[2] CPP preamble page 64893

[3] CPP Section 60.5740 (a)(2)(ii)(H)

issued by the linked Canadian provinces[4]. These modifications would also support making the program trading-ready, because allowances issued by the linked Canadian provinces would not be eligible for use by entities in an electricity-only CPP allowance trading state.

For these reason, WPTF urges CARB to build the architecture necessary to make the state plan trading-ready upon approval by EPA into the cap and trade program now.

Compliance Periods

Staff propose setting the post 2020 compliance periods to end in 2024, 2027, 2029 and thereafter every two years to align with the CPP. WPTF supports this proposal. We note that potential expansion of the carbon market via linkage to other CPP programs would more than compensate for any loss of compliance flexibility caused by going from three to two-year compliance periods.

Backstop design

Staff have proposed a design for the program backstop that would kick-in in the event that aggregate EGU emissions exceed the CPP glide path. As we understand the proposal, CARB would set-aside a quantity of allowances from within the broad program cap. In the event that the backstop is triggered, EGUs would be required to purchase allowances from this pool to cover any emissions in excess of CPP goals. The quantity of allowances to be purchased by each EGU would be proportional to that entity's share of aggregate EGU emissions.

WPTF is concerned that the backstop design proposal does not conform with EPA requirements because it would not guarantee achievement of CPP emission targets. Rather, the proposed backstop would act as a price mechanism – it would increase the costs to EGUs by requiring them to purchase additional allowances, but it would not actually limit and decrease the quantity of allowances available to EGUs. It would therefore not guarantee achievement of the CPP emission goals.

The CPP is clear that the backstop must consist of emission standards for EGUs and that emission standards must be set at such a level to meet the state's emission goals and make up for any emission performance shortfall that occurs prior to triggering of the backstop[5]. Under a multi-sector trading program, the only backstop design that would meet these requirements would be to sever the electricity sector from other covered sectors. This would in effect result in two separate cap and trade programs – one for EGUs that could maintain any linkage with other CPP states and one for other sectors that would maintain linkages to the Canadian provinces.

We recognize that such an outcome would be extremely disruptive to the program and the carbon market, but do not believe that the CPP provides any flexibility on design. Although it is extremely unlikely that the backstop would ever be triggered, CARB should do everything in its power to ensure that it never occurs. A key step in this regard would be to establish CPP performance period targets in state plan at the maximum level allowed by EPA, i.e. at the level of California's interim and final CPP goals plus the new source complement. Setting the performance period targets at these levels will minimize the risk of the backstop ever being triggered.

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[4] See also comments on the backstop provisions below

[5] CPP Section 60.5740(3)

WPTF recommends that CARB incorporate the following provisions into the cap and trade regulation for the backstop.

- *Backstop targets:* The regulation should establish separate emission targets for EGUs in aggregate and all other covered sectors collectively for the years 2022 and beyond. These targets would have no effect until and unless the backstop is triggered.
    - EGU targets: The aggregate EGU targets should be set at a level that is consistent with state GHG goals and projected electricity sector emissions under a high-growth scenario.
    - Non-EGU targets: The regulation would also establish emission targets for all other non-EGU covered sectors collectively.
- *Target adjustments for excess emissions*. The regulation would include provisions to adjust the EGU targets if the backstop is triggered by excess emissions. These provisions should account for any import/export adjustments.
    - Excess emissions = Total EGU emissions over CPP performance period + net allowance import/export adjustment[6] - CPP performance period target
    - Adjusted EGU target for year = EGU target for year – (excess emissions/years remaining until 2030[7]).
- *Allowance distribution and use*: If the backstop is triggered, program rules for allocation and retirement of allowances for compliance must distinguish between allowances issued under the EGU target and allowances issued under multi-sector targets.
    - EGUs must retire California EGU allowances or allowances issued from other linked CPP program for compliance. Use of offsets, allowances banked prior to the backstop, Price Containment Reserve allowances or California non-EGU allowances would be prohibited.
    - Covered entities in non-EGU sectors would be prohibited from using EGU allowances and CPP allowances from other program for compliance, but could use all other compliance instruments, including offsets and allowances from linked Canadian provinces.

Glide path

Staff have proposed using the CPP's 2030 emission target as the emission target for all performance periods under the CPP (i.e. a flat emission glide path) using the final performance period limit for all years. WPTF opposes this proposal because it unnecessarily increases the risk, albeit slightly, of triggering the program backstop. Instead, WPTF recommends that CARB set the interim and final targets at the levels set by EPA with the new source complement. Since EGUs emission levels will determined by California's state goals and policies, rather than the CPP, such an approach would not undermine environmental integrity in any way.

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[6] The net import/export adjustment value would be zero if California does not approve linkage to other CPP states

[7] This adjustment enables EGUs to make up any excess over the remaining years of the CPP performance periods, rather than in a single year.