

December 16, 2016

California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments of Shell Energy on 2030 Target Scoping Plan Discussion Draft

To: Air Resources Board:

Pursuant to the instructions accompanying the ARB's December 2, 2016 "2030 Target Scoping Plan Discussion Draft," Shell Energy North America (US), L.P. ("Shell Energy") provides preliminary comments on two issues raised in the Discussion Draft: First, the ARB should continue a market-based cap and trade program. Second, the ARB should maintain the existing regulations permitting "offset credits" to be used to meet a covered entity's compliance obligation.

In support of its position on these matters, Shell Energy states the following:

I.

A MARKET-BASED CAP AND TRADE PROGRAM SHOULD CONTINUE BEYOND 2020

Shell Energy supports continuation of the cap and trade program beyond 2020. A cap and trade program provides a structured market through which a value is attached to GHG compliance. Obligated entities, as well as opt-in covered entities and voluntarily associated entities, may use verifiable compliance instruments in addition to measurable GHG emission reductions to achieve GHG emission reduction targets. The combination of on-site GHG emission reductions and compliance instruments allows obligated entities to meet GHG emission reduction goals while managing the costs of compliance.

The Discussion Draft notes that "[t]he Cap-and-Trade Program is a key element of California's GHG reduction strategy." Draft at p. 45. The Draft continues: "The Cap-and-Trade Regulation . . . creates a powerful economic incentive for major investment in cleaner, more efficient technologies." *Id.* Significantly, the Draft notes that the cap and trade program "applies to emissions that cover about 80 percent of the State's GHG emissions." *Id.* The Discussion Draft properly concludes that "continuing progress to [the State's] long-term [GHG emission reduction] goal requires California to maintain and build upon existing programs, scale up

deployment of clean technology, and provide more low-carbon options to accelerate GHG emission reductions, especially after 2020.” Discussion Draft at p. 7. “Building upon existing programs” includes continuation of the cap and trade program.

Continuation of the cap and trade program will be an integral part of achieving the State’s GHG emission reduction goals, with the greatest chance for encouraging economic growth and job creation. The Discussion Draft states: “California’s strategic vision for achieving at least a 40 percent reduction in GHG emissions by 2030 is based on the principle that economic prosperity and environmental sustainability can be achieved together.” Draft at p. 24. The Discussion Draft properly notes that “[p]olicies to address GHG emission reductions must continue to balance the State’s economic well-being versus progress towards achieving the statewide limits.” Draft at p. 43. The cap and trade program achieves the balance required under AB 32 and subsequent legislation.

The Environmental Justice Advisory Committee (“EJ Committee”) urges that the “benefits from Scoping Plan implementation must be accessible to Environmental Justice (EJ) communities.” Discussion Draft, Appendix “D” at p. 2. Continuation of the cap and trade program achieves this objective. The Discussion Draft notes that “funds collected through the Cap-and-Trade Program in the Greenhouse Gas Reduction Fund (GGRF) can contribute to residents in disadvantaged communities having equitable access to clean technology, clean energy options, transit options, and infrastructure improvements that reduce GHGs and improve quality of life.” Draft at p. 12.

The Discussion Draft emphasizes that the cap and trade program is responsive to the needs of disadvantaged communities. The Draft states: “It is critical that environmental justice communities share in the benefits of the cleaner economy that California is building. This includes environmental and economic benefits.” Draft at p. 26. The Draft points out that “low-income customers that are enrolled in the California Alternate Rates for Energy (CARE) Program or the Family Electric Rate Assistance (FERA) Program are also eligible to receive a rebate under the California Climate Credit, or a credit on residential and small business energy bills resulting from the sale of allowances received by investor-owned utilities as part of the Cap-and-Trade Program.” *Id.* The Draft continues: “SB 1018 ... and other implementing legislation requires that Cap-and-Trade auction monies deposited into the GGRF be used to further the purposes of AB 32, while also fostering job creation by promoting in-State GHG emissions reduction projects carried out by California workers and businesses.” Draft at pp. 26-27.

Notwithstanding the community benefits provided through the cap and trade program, the EJ Committee urges the ARB to abandon the cap and trade program and instead pursue more facility-specific GHG emission reduction measures (“prescriptive facility level regulations”) to achieve potential local air quality co-benefits. Discussion Draft at p. 46. The EJ Committee’s proposal, if adopted, would not result in greater or more focused GHG emission reductions in disadvantaged communities. Moreover, elimination of the cap and trade program would foster

uncertainty and impose additional energy costs on businesses and consumers, which would most adversely affect disadvantaged communities.

The cap and trade program and facility-specific emission requirements are not mutually exclusive. GHG emissions, as a global climate issue, are distinct from local air pollutants (such as particulate matter); management of GHG emissions and management of air pollutants require separate regulatory tools. While there are some cross-over impacts, the ARB has found these impacts to be de minimis. Furthermore, while a facility may emit both GHGs and other pollutants, the overlapping emissions from a facility are not optimally addressed by the same regulatory approach for all types of emissions. If local air pollutants continue to be problematic in certain geographic areas, the appropriate response is to strengthen local regulatory measures and programs that address those pollutants, rather than drive up the cost of compliance through abandonment of the cap and trade program.¹

California has a legislative commitment to invest 10 percent of cap and trade auction proceeds directly into projects in disadvantaged communities, including a broader goal of 25 percent of auction revenue invested in projects that provide benefits to these communities. These investments must deliver economic, environmental and public health benefits. In 2015 alone, \$2.6 billion was raised in auction revenue – which provided over \$200 million to be invested directly in disadvantaged communities. The ARB provides a clear breakdown of these investments and outcomes in its annual report on auction proceeds. Communities (councils) can play an increased role in the allocation of funds into projects that deliver local and regional benefits.²

In this connection, the Discussion Draft states that “local governments are essential partners in achieving California’s goals to reduce GHG emissions.” Discussion Draft at p. 102. The Discussion Draft continues: “Local air pollution control and air quality management districts (air districts) have a key role to play in reducing regional and local sources of GHG emissions. Because many actions to reduce air pollutants also reduce GHG emissions, many air

¹ The Discussion Draft properly notes: “Many of the actions for addressing criteria pollutants and toxic air contaminants in the industrial sector are through California’s local air pollution control and air quality management district (air district) stationary source permitting requirements to ensure progress towards achieving State and national ambient air quality standards. And many of the actions, such as use of Best Available Control Technology, have resulted in some co-benefits in the form of GHG reductions. The State must continue to strengthen its existing criteria and toxic air pollutant programs and relationships with local air districts to ensure all Californians have healthy, clean air. This is especially true in disadvantaged communities.” Draft at p. 44. The Discussion Draft also states: “Requirements for direct GHG reductions at refineries will further support air quality co-benefits in neighborhoods, including in disadvantaged communities historically located adjacent to these large stationary sources, as well as efforts with local air districts to tighten emission limits on a broad spectrum of industrial sources.” Discussion Draft at p. 12. The cap and trade program complements local air quality regulations. These programs can and should operate in tandem.

² The ARB can coordinate further with disadvantaged communities. For example, the ARB can facilitate training to identify and develop locally relevant offset generation opportunities. The ARB also can work with communities to direct the use of allowance auction revenues into projects that facilitate local GHG reductions.

districts are actively integrating climate protection into air quality programs.” *Id.* The Discussion Draft makes it clear that distinct and complementary roles apply for the cap and trade program and local air quality districts. Disadvantaged communities benefit under both Statewide programs and local regulatory programs.

Carbon policy should be designed to achieve GHG reductions in an efficient and least cost manner to minimize the impacts of CO₂ costs on households and businesses. CO₂ costs are additive to the costs of electricity and transportation fuels; economic studies suggest these increased costs are ultimately passed through to customers. In 2015, transportation fuel and electricity costs amounted to just over 10 percent of the average family household expenditure in California. The need for electricity and transportation fuel is relatively fixed for most households. A regulatory structure that imposes added transportation fuel and electricity costs on consumers would have the greatest cost impact on disadvantaged communities. California’s cap and trade system provides industry with the least cost path to GHG reductions, which minimizes the costs of GHG reductions to consumers.

The State can do more to promote direct GHG emission reductions in communities that are home to industrial facilities, however. For example, the State can promote deployment of carbon capture and sequestration (“CCS”) by enacting risk-based permitting and regulatory processes that encourage use of this safe and proven method for reducing emissions. Furthermore, the State can and should signal its confidence in the permanence of CCS to provide certainty to project developers. If CCS regulations do not unnecessarily burden CCS project proponents with time-consuming and costly requirements – and if local communities are willing to support CCS projects – California will be able to achieve greater in-State emissions reductions at lower cost and sooner than otherwise would be possible.

Finally, the EJ Committee recommends that the ARB replace the cap and trade program with a “carbon tax” or a “fee and dividend” system. Discussion Draft, Appendix D at p. 4. The Discussion Draft responds to this recommendation with a good discussion of why a carbon tax would achieve neither the desired GHG emission reductions nor economic growth. The Draft states as follows: “Achieving the 2030 GHG target by using a carbon tax will require setting the right price—a difficult task to do. A set carbon tax may not actually represent the actual cost of abatement for the covered sectors, as the needed GHG reductions may occur at a cost higher than necessary or may not occur at all as there is no limit on emissions and the carbon tax value may not be sufficient to motivate the necessary GHG reductions.” Draft at p. 97.

The Draft also addresses the potential for “leakage” that would arise as a result of a carbon tax. The Draft states: “There is no easy design feature to address trade exposure and to protect against emissions leakage as required under AB 32. One potential strategy to prohibit emissions leakage may be to exempt trade exposed sectors from the carbon tax, but that will shift the burden to the sectors still subject to the tax and may pick ‘winners’ across sectors as some industries may face a carbon cost and others may not.” *Id.*

For the reasons stated above, a market-based cap and trade structure is preferable to a top-down structure or a “tax” that imposes costs without regard to creating workable incentives for GHG reductions and compliance. Abandonment of the cap and trade program would result in uncertainty with delivery of GHG emission reductions. Imposition of a “tax” would increase the potential for “leakage” as compared to a market-based cap and trade program. “Leakage” would be both economic (i.e., a loss of employment and significant societal costs) as well as environmental (by shifting emissions to jurisdictions with lower standards than those in California).

A cap and trade program should be maintained beyond 2020. Cap and trade is a model for similar GHG reduction programs throughout the world, and will produce accelerated benefits as the GHG emission reduction targets progress. The Discussion Draft states that “[b]y extending the existing Cap-and-Trade Program post-2020, the State preserves its current linkages and supports future linkages.” Draft at p. 91. In this connection, Shell Energy supports linkage with Ontario’s cap and trade program in 2018.

Moreover, the Discussion Draft notes that cap and trade allowance revenues will “continue to be deposited into the GGRF to support projects that fulfill the goals of AB 32.” *Id.* The Draft provides that “[i]nvestment of these proceeds furthers the goals of AB 32 by reducing GHG emissions, providing net GHG sequestration, providing co-benefits, investing in disadvantaged communities and low-income communities, and supporting the long-term, transformative efforts needed to improve public and environmental health and develop a clean energy economy.” Draft at p. 91.³

II.

THE USE OF OFFSET CREDITS FOR COMPLIANCE SHOULD BE MAINTAINED

The permissible use of offset credits for compliance should continue. The ARB has developed detailed regulations addressing the eligibility of offset projects for compliance, approval of offset protocols, and independent verification of GHG emission reductions from offset projects. The ARB has linked California with other jurisdictions to encourage the development of offset projects to meet covered entities’ increasing compliance obligations over time. California’s worldwide leadership on climate change mitigation should not be derailed through a reduction or prohibition on the use of “offsets” for GHG compliance.

³ In direct response to concerns raised by the EJ Committee, the Draft states: “These investments support programs and projects that deliver major economic, environmental, and public health benefits for Californians, including meaningful benefits to the most disadvantaged communities. Investments are providing a multitude of benefits to disadvantaged communities including increased affordable housing opportunities, reduced transit and transportation costs, access to cleaner vehicles, improved mobility options and air quality, job creation, energy and water savings, and greener and more vibrant communities.” *Id.*

Experience has shown that offsets provide near-term opportunities for cost-effective, verifiable GHG reductions that deliver long-term, sustained emissions reductions. Offset projects result in compelling environmental benefits in rural, urban and disadvantaged communities. Benefits include GHG emission reductions, water conservation and improved water quality. For example, forest carbon offsets preserve biodiversity and enhance water quality. Livestock projects reduce odors and provide jobs. Benefits include economic opportunities and preservation of natural systems. Offsets also encourage advanced technology development and deployment, and investment in “clean” and “green” projects in non-covered sectors.

The permissive use of offsets also mitigates the price impact of GHG emission reduction measures. Without the use of GHG cost control mechanisms such as offsets, the price of transportation fuels and electricity would rise. As noted above, the rise in transportation costs and home energy prices would disproportionately impact lower income households, which typically spend a higher percentage of income on energy, transportation fuel and carbon intensive goods without any incremental environmental benefit.

The EJ Committee proposes to eliminate the use of offsets for compliance. Discussion Draft, Appendix “D” at p. 5. Shell Energy strongly disagrees. The ability to use offsets for compliance stabilizes the costs of the cap and trade program. Reduction or elimination of the use of offsets would translate into higher compliance costs for California businesses. Higher compliance costs could threaten the competitive viability of some energy-intensive businesses, leading to stranding of investment and leakage of jobs and emissions out of State. While this could help the State achieve its GHG emission reduction targets for 2030 and 2050, it would not necessarily contribute to a reduction in global emissions.

Moreover, the Discussion Draft notes that “relocation of production out of California would . . . reduce the availability of associated jobs and may impact a local tax base, which supports local services such as mass transportation and social services, among others. Jobs and taxes are needed to support California residents, especially those that live in vulnerable communities.” Draft at p. 44.⁴

⁴ In support of its proposal to eliminate the use of offsets (and to eliminate the cap and trade program), the EJ Committee suggests that because large emitters use offsets as part of their compliance strategy, they do so at the expense of reducing emissions locally. See Discussion Draft at p. 46 and Appendix D, at p. 5. This false conclusion assumes an either/or scenario that is not based on reality. It is impossible for facilities to use offsets exclusively to meet their compliance obligation. Because a facility is limited to using offsets up to 8 percent of its compliance obligation, the decreasing availability of allowances over time will lead to measurable GHG emission reductions from these covered industries, mostly within California. With large emitting facilities representing the vast majority of total emissions, it is inescapable that these facilities will have to make direct, local reductions as the availability of allowances declines. Local GHG emission reduction will occur as the program is currently designed, even with the use of offsets. In this connection, AB 197 requires the ARB to consider the “social costs of the emissions of greenhouse gases.” AB 197’s mandate to “protect the State’s most impacted and disadvantaged communities” relies on mitigating these communities’ exposure to climate risk. Reducing offset usage would run counter to AB 197’s express focus, as offsets represent real emission reductions.

California is the leader in the worldwide movement to reduce carbon emissions. California's offset program stimulates national and international action on GHG emission reduction projects. The offset program is an example of California's leadership on climate change mitigation. This important tool of carbon diplomacy encourages natural resource owners by paying them for long-term commitments to protect their natural endowment.

In this connection, the offset program serves as the single largest price signal globally for changed/improved forest management. Both fossil fuel use reduction and tropical forest conservation are likely needed to avoid global warming of 2 degrees centigrade, which is the goal of the Paris Climate Accord. Because most of the carbon on the surface of the earth is located in tropical forests, offsets for this sector must necessarily be outside of California to address carbon sequestration by nature in a significant way.

The loss of tropical forests potentially contributes to drought in California. The Discussion Draft notes that "[a] growing body of scientific evidence ... shows that healthy tropical forests are central to solving climate change as tropical forests exchange large amounts of water and energy with the atmosphere (effecting atmospheric rivers), controlling regional and global climate ... Deforestation and climate change have the capacity to alter rainfall regimes, water availability, and surface-atmosphere flux of water and energy of tropical forests." Draft at p. 16. The Draft continues: "Preserving the tropical forests will help meet the aggressive emissions reduction targets that are necessary to avoid catastrophic climate change and may help to preserve California's historical rainfall patterns." Draft at pp. 16-17.

Continuation of the offset program will enable California to continue to participate actively in the global effort to reduce GHG emissions. The Draft accurately states: "Linkage with a state-of-the-art, jurisdictional sector-based offset program can provide significant benefits to California's Cap-and-Trade Program by assuring an adequate supply of high-quality compliance offsets to keep the cost of compliance within reasonable bounds, up to the quantitative usage limit for sector-based offsets. Linkage would also support California's broad climate goals, as well as global biodiversity and tropical forest communities." Draft at p. 109.

By contrast, pursuing high cost policies that constrain (or prohibit) the use of offsets in the cap and trade program would isolate California from potential sub-regional, national and international partners if these other jurisdictions are not willing to adopt measures that create additional economic pressures and impede sustainable economic growth. Offset developers are concerned that rules limiting offset usage would decrease the market for (and the value of) developed offset projects, as well as offset projects under development. Reducing the ability to use offsets would reduce the capacity of the program to activate a network of partners in the fight against climate change.

Consequently, rather than limit or exclude the permissive use of offsets for compliance, the ARB should develop a schedule to increase the permissive use of offsets for GHG compliance over time. The ARB should raise the offset usage limitation to 16 percent by 2030,

and to 20 percent by 2050. The ARB should adopt additional offset protocols for projects viable in California. The ARB also should recognize national and international offset programs (e.g., EU, Western Climate Initiative Partners), and approve linkage with Ontario's offset program in 2018. Finally, the ARB should remove the restriction on carrying over unused portions of an entity's offset limit into subsequent compliance periods. California should consider means through which its offset program can increase investment in land use and land use change for positive climate impacts rather than reduce permissible offset usage.

Reducing or eliminating the permissible use of offsets to meet a covered entity's compliance obligation would result in an increased cost burden that would reduce the competitiveness of a covered entity in its applicable market. Any reduction in the permissive use of offsets may have unintended consequences that could ultimately increase emissions if entities are not able to meet their obligations economically. By contrast, continuation and expansion of the use of offsets will mitigate the cost of GHG emission reduction compliance and reduce the burden on consumers. In addition, offset projects have ancillary benefits (e.g., reforestation) that further increase their value in an effective cap and trade program.

As obligated entities' compliance obligations increase in 2020 and beyond, these entities must be able to rely upon offsets, in addition to other compliance instruments and measurable GHG emission reductions, to meet the State's GHG compliance obligation. Covered entities must be permitted to manage the increasing cost of compliance with a portfolio of market-based compliance instruments.

III.

CONCLUSION

Please do not hesitate to contact the undersigned with any questions you may have regarding the foregoing comments.

Sincerely,



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Attorneys for Shell Energy North America (US), L.P.