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**SOUTHWEST GAS CORPORATION**



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October 27, 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 Comments on the October 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 Air Resources Board’s (“ARB”) October 12, 2017 workshop on next steps for the Post-2020 Cap-and-Trade Regulation (Workshop).

The natural gas distribution utilities represented by the GUG supported the recent passage of the 2016 Cap-and-Trade Amendments and Assembly Bill 398 (Chapter 135, Statutes of 2017). The 2016 amendments made important adjustments to the Cap-and-Trade Program (Program), which is a critical backstop in the state's strategy to achieve the deep emission reductions needed by 2030. AB 398 and the topics identified in Board Resolution 17-21 offer another opportunity to further refine this successful Program and ensure it continues to be effective post-2020 while striking the appropriate balance between incentivizing greenhouse gas (GHG) reductions and protecting Californians from excessive costs.

As ARB looks to set the scope for the next set of amendments to the Cap-and-Trade Program, the GUG urges ARB to include the topic of allowance allocation to natural gas distribution utilities, as directed in Board Resolution 17-21. As noted in the resolution, the GUG believes that more work needs to be done to protect customers as the state pursues strategies to decarbonize the natural gas system, which is critical to meeting the state's long term climate goals and is reinforced by the Short-Lived Climate Pollutant Plan.

In addition to promoting further discussion on natural gas allocation, the GUG would also like to provide comments on key elements from AB 398 that will be addressed in the next set of amendments that will affect the flexibility and effectiveness of the Program for all compliance entities. These comments are addressed by topic below:

### **Price Ceiling**

The GUG supported the establishment of a price ceiling in AB 398 because it provides certainty that helps compliance entities make practical, long-term investments in emissions-reduction technologies. A price ceiling will also ensure that allowance prices do not exceed a level that would result in a pause or end to the Program, which would jeopardize California's ability to achieve its emissions reductions goal. The GUG looks forward to discussion with ARB and other stakeholders on an appropriate level for the price ceiling in the upcoming rulemaking process.

### **Banking and Holding Limits**

AB 398 directs ARB to establish allowance banking rules that discourage speculation, avoid financial windfalls, and consider the impact on complying entities and volatility in the market. Current banking rules permit covered entities to use current vintage allowances for future compliance needs. Banking serves a critical function to the program, in that it allows compliance entities to adequately plan and to avoid potential price volatility and market disruption. Banking should be maintained through the program extension in support of the reasons cited above, and for market continuity. In addition, it is important to have consistent market rules across linked jurisdictions and ensure equitable access to all participants.

## **Overallocation**

AB 398 directs ARB to “evaluate and address concerns related to overallocation...” Despite some parties’ concern that the Program is “overallocated” due to banking from the pre-2021 period to post-2021 period, such is not the case. The Cap-and-Trade Program is not overallocated through 2030 considering the State’s ambitious emission reduction goals.

Available analyses such as the report from the University of California Energy Institute<sup>1</sup>, 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 restricts supply, accelerating the date that allowance prices will increase. While cumulative in-state emissions will be lower, compliance costs will be higher. And at higher prices, economic leakage, emissions leakage, and greater negative impacts to households are likely to occur.

## **Price Containment Points**

In addition to a price ceiling, the GUG supports the establishment of two lower Price Containment Points (“PCPs”) as directed by AB 398. These “PCPs” provide an important opportunity to help contain costs which could rise very quickly in the post-2020 period once allowance demand exceeds supply.

The cost containment points would be most effective if spaced evenly between the floor price and ceiling price, rather than being clustered together near the ceiling. This would provide an earlier first opportunity to balance out demand and blunt the potential for large price swings, helping maintain Program affordability. In order for the PCPs to be effective they must have sufficient volume. In the Workshop, Staff requested feedback on where the Allowance Price Containment Reserve (APCR) allowances and unsold allowances should be placed. One possible way to help achieve adequate volumes in the PCPs is to transfer APCR allowances and unsold allowances into the PCP reserves. The GUG will continue to explore other possibilities as well.

## **Offset Usage Limits**

AB 398 directs ARB to establish limits for the use of offset credits for compliance. Between 2021 and 2025 the limit is four percent; between 2026 and 2030 the limit is six percent. In both periods, no more than half of the total usage limit may be sourced from projects that do not provide a direct environmental benefit in the state.

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, these emission reductions 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.

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<sup>1</sup> 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

When determining an appropriate definition of “direct environmental benefits in the state,” the GUG recommends ARB think broadly and holistically. Projects that are not geographically located within the state but that provide clear reductions or avoidance of pollutants that could have an adverse impact on the air or waters of the state should be determined to have direct environmental benefits to California. Offset projects in Washington and Oregon, for example, likely have very clear benefits to California watershed and forests.

The GUG generally supports how Staff described the half in-state requirements at the Workshop, where the minimum in-state offset requirement and the allowed out-of-state percentage should be implemented as two distinct buckets; and the requirement applies to the total usage limit and not the quantity of offsets surrendered by the compliance entity. The GUG also supports ARB’s application of the offset limits to the emissions year, as opposed to the compliance year. For example the offset limit for the 2020 emissions year would be eight percent of a compliance entity’s total obligation, even though the surrender of those offsets may be in calendar year 2021.

### **Environmental Integrity at the Price Ceiling**

AB 398 directs ARB to maintain environmental integrity by using the proceeds from sales of price ceiling allowances to procure equivalent metric ton reductions outside of the Program to make up the sale of additional allowances. The GUG recommends that a broad range of projects and emissions reductions that meet the criteria of additional, verifiable and quantifiable, should be eligible for procurement by ARB in the event allowances sold at the auction exceed the cap.

The upcoming rulemaking should also consider which entities may buy at the price ceiling and the amount that qualifying entities may buy at the price ceiling. It will also be important to discuss strategies to ensure an adequate supply of additional emissions reductions is available in the price ceiling reserve.

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 you 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,



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