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

Re: San Diego Gas & Electric Comments on the September 4, 2018 Cap-and-Trade Regulation Amendments – 45-Day language

Dear Ms. Sahota:

These comments are respectfully submitted on behalf of the San Diego Gas & Electric Company (SDG&E), which currently delivers roughly 45% renewable energy to its customers and is a proud partner of the State in working to achieve California's ambitious clean energy and climate goals. SDG&E continues to support a well-designed Cap-and-Trade Program and appreciates this opportunity to comment on the California Air Resources Board's (CARB) *Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation*. The amendments aim to bring the Program into compliance with Assembly Bill (AB) 398 (Stats. 2017, Ch. 135), which extended the Cap-and-Trade Program through 2030. SDG&E provides comments below on the following topics in the 45-day language:

1) Reasonable Floor Prices for a Stable and Exportable Cap-And-Trade Program;
2) Setting the Price Ceiling in Accordance with Statute;
3) The Reserve Tiers (Price Containment Points);
4) Offset Credits and Direct Environmental Benefits;
5) Allowance Allocation and Post-2020 Cap-Setting;
6) Eligible Uses of Allowance Proceeds;
7) Equitable Treatment for Natural Gas Allowance Allocation; and
8) Energy Imbalance Market (EIM) Secondary Emissions.

1. Reasonable Floor Prices for a Stable and Exportable Cap-and-Trade Program

In October 2018, the United Nations Intergovernmental Panel on Climate Change (IPCC) released a Special Report[1] on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas (GHG) emission pathways, with an eye toward strengthening global efforts to combat climate change.[2] The findings of this report have spurred new pressure to increase pricing in the Cap-and-Trade program under the theory that price increases would incentivize additional emissions reductions from compliance entities. While this could work for the state, California's contribution to GHG emissions is relatively low; approximately 1% of all global GHG emissions come from California. Even if the state were to cut its emissions in half, the impact on global warming and global climate change would still be negligible.

The path to meaningful global reductions in GHG emissions is exporting the Cap-and-Trade Program to other jurisdictions. Thus, the program needs to be attractive to other governments and stakeholders, which can be accomplished by ensuring a stable and sustainable program by maintaining a reasonable Cap-and-Trade auction floor price. Drastic increases in the price of Cap-and-Trade allowances due to an unreasonable, elevated floor price would have destabilizing political and economic effects on the Program, including market uncertainty and economic leakage. Maintaining the annual price floor, with an increase of 5% plus the consumer price index (CPI), is a stable and sustainable strategy that will support the long-term viability and exportability to other markets of the California Cap-and-Trade Program.

2. Setting the Price Ceiling in Accordance with Statute

AB 398 SEC. 4. Section 38562 (c)(2)(A) requires CARB to establish a price ceiling, prescribing certain considerations to be incorporated into the process. SDG&E appreciates the difficulty in determining an appropriate ceiling price and urges CARB to consider the following criteria as laid out in AB 398:

- Avoiding adverse impacts on resident households, businesses, and the state's economy.
- The 2020 tier prices of the Allowance Price Containment Reserve (APCR).
- The full social cost of emitting a metric ton of GHGs (the Social Cost of Carbon).

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[1] United National Intergovernmental Panel on Climate Change. Special Report – Global Warming of 1.5°C. 8 October 2018: http://www.ipcc.ch/report/sr15/

[2] The report details the environmental and human benefits of keeping global warming to 1.5°C, versus exceeding 1.5°C and then gradually stabilizing at 1.5°C, especially if the peak is high (e.g., 2°C). The modeled differences in regional climate characteristics between the current level of global warming and 1.5°C, and between 1.5°C and 2°C, are robust, including increases in mean land and ocean temperatures, hot extremes, heavy precipitation in some regions, and drought in others. These changes will impact biodiversity, ecosystems, sea level rise, human health and security, food security, water supply, and economic growth. Adaption is also expected to be more challenging for some human and environmental systems at 2°C of warming than at 1.5°C. Global net anthropogenic emissions of CO_2 would need to decline roughly 45% below 2010 levels by 2030, and reach "net zero" emissions around 2050, to limit global warming to 1.5°C. Any remaining emissions would have to be balanced by removing CO_2 from the air. According to the report, current nationally-stated mitigation commitments under the Paris climate agreement are not sufficient to limit global warming to 1.5°C.

- The auction reserve price.
- Minimizing economic and environmental leakage.
- The cost per metric ton of GHG emissions reduction to achieve the statewide emissions targets established in statute.

Furthermore, SDG&E 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 price ceiling structures presented by the Joint Utilities Group (JUG).

AB 398 SEC. 4. Section 38562 (c)(2)(A)(ii)(II) states that *"If the allowances from the allowance price containment reserve are exhausted, the state board shall offer covered entities additional metric tons at the price ceiling if needed for compliance."* These instruments are called the "price ceiling units" in the 45-day proposed regulation. It is unfortunate that these units, which are necessarily above the state's emissions cap share the same price as allowances that are under the cap. Bifurcating the allowances from the price containment units, setting a lower "price ceiling" for allowances under the cap and a higher "price ceiling" for the price ceiling units may help to achieve the lower prices mandated in AB 398, while still maintaining a higher price that would act as a signal to invest in clean technologies via a somewhat higher price ceiling from price ceiling units.

Another potential way to partially bifurcate allowances under the cap from the price ceiling units would be to direct more allowances to the second reserve tier as opposed to the price ceiling tier.

3. Reserve Tiers (Price Containment Points)

AB 398 SEC. 4. Section 38562 (c)(2)(B) directs CARB to establish below the price ceiling two price containment points, or reserve tiers, at which covered entities may purchase non-tradable allowances. The reserve tiers shall be established using two-thirds, divided equally, of the allowances in the APCR as of December 31, 2017. SDG&E agrees with stakeholder comments that reserve tier prices should be low enough to help protect customers before prices reach the ceiling and provide early signals to compliance entities. Their placement should also give the Independent Emissions Market Advisory Committee established by AB 398 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.

4. Offset Credits and Direct Environmental Benefits

SDG&E supports the 45-day language on direct environmental benefits to California of offset credits. AB 398 SEC. 4. Section 38562 (c)(2)(E) established new offset credit limits, beginning with 4% of a covered entity's compliance obligation, for the period January 1, 2021 to

December 31, 2025, with no more than half of those credits coming from projects that do not provide direct environmental benefits to the state. That limit increases to 6% for the period January 1, 2026 to December 31, 2030, also with half required to provide direct environmental benefits to California. The current CARB language accepts that all projects located in California meet direct environmental benefits standards for both past and future offset credits. The 45-day language also allows for out-of-state offset projects to meet the standards by demonstrating that they provide environmental benefit to California.

SDG&E is appreciative of the continued support for Cap-and-Trade offsets as they provide real, additional, quantifiable, and verifiable GHG emission reductions. Offset 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.

5. Allowance Allocation and Post-2020 Cap-Setting

AB 398 SEC. 4. Section 38562 (c)(2)(D) directs CARB to "*evaluate and address concerns related to overallocation in the state board's determination of the number of available allowances for years 2021 to 2030"*. SDG&E is supportive of the proposed regulation's stance on what some stakeholders refer to as "overallocation" or "oversupply." SDG&E agrees with CARB that the fact that covered emissions have been lower than the annual caps does not represent a failure, but rather a success of the Cap-and-Trade Program. The state is on track to achieve the 2020 emissions target early. SDG&E agrees 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 penalize covered entities for early action in reducing GHG emissions and incent covered entities to only do the minimum going forward.

Available analyses, such as the report from the University of California Energy Institute,[3] 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 they 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. SDG&E believes the current mechanism to address periods of low demand by transferring unsold allowances to the APCR after 24 months is an adequate safeguard.

[3] 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.

6. Eligible Uses of Allowance Proceeds

The 45-day language updates to Section 95892 (e)(4)(B) of the Cap-and-Trade Regulation detail calculations to estimate the GHG emission reductions associated with the use of allowance proceeds. However, SB 92 (Stats. 2017, Ch. 26, Sec 83) directs utilities to allocate approximately $100,000,000 or 10% of annual allowance proceeds to the Multifamily Affordable Housing Solar Roofs Program (MASH). The utilities are mandated to make these funds available to the program and thus should not have to justify the use of the proceeds for this purpose, nor the GHG reductions associated with this utilization. Added requirements for GHG calculations could hamper our use of these proceeds for programs that require this additional justification.

Additionally, the draft regulations 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 of the Cap-and-Trade Regulation). While the benefits of education and outreach are not quantifiable, they are beneficial and should be allowed.

SDG&E 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 (RNG) into the natural gas system.

7. Equitable Treatment for Natural Gas Allowance Allocation

Allowance allocation for natural gas utilities continues to be an important issue for SDG&E, and we support the comments of the Southern California Gas Company and the Gas Utility Group on this issue. 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. SDG&E acknowledges that this is appropriate and necessary given the required investments and costs associated with reducing GHG emissions in California's electric sector. While natural gas utilities receive an allocation to ease customers' transition to higher natural gas costs and for prior energy efficiency efforts, the allocation and associated methodology for the gas sector does not go far enough to help reduce the cost burden of decarbonization, even though natural gas ratepayers are incurring these costs. 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.

Staff highlighted this discrepancy between electric utility and natural gas utility allocation methodology in the Initial Statement of Reasons (ISOR)[4]. SDG&E appreciates that Staff also acknowledged in the ISOR the need to revisit natural gas allocation if an RNG mandate or other changes to the natural gas sector occur. This is a timely acknowledgement given Senate Bill 1440 (Stats. 2018, Ch. 739), which requires the California Public Utilities Commission, in consultation with CARB, to consider adopting specific biomethane procurement targets or goals for California's gas corporations. 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 that are currently being released directly into the atmosphere as methane or flared. There are many environmental and economic benefits to employing a decarbonization strategy that includes RNG, and an increasingly decarbonized gas supply will also be critical in achieving the Governor's statewide goal of carbon neutrality by 2045 (Executive Order B-55-18). These efforts do not come without a cost, however, and our concern is protecting utility customers.

In light of current and future efforts to help decarbonize the natural gas system, SDG&E looks forward to working with CARB to recognize the costs of these decarbonization efforts through adjustment to the natural gas sector allocation in future Cap-and-Trade rulemakings, per Board Resolution 17-21.

8. Energy Imbalance Market (EIM) Secondary Emissions

SDG&E supports the JUG position on secondary emissions in the California Independent System Operator (CASIO) EIM. The JUG calls for a simple and transparent method for assessing individual compliance obligations and optionality in how a utility retires its compliance instruments. This includes support for the continuation of CARB's current method for ensuring the environmental integrity with regard to EIM outstanding emissions, for contrasting any EIM outstanding emissions against the GHG benefits of California's renewable energy exports in the EIM, and for determining compliance obligations based on an entity's annual EIM purchases, not their overall share of total retail sales among EIM participating utilities. Though out of scope for this rulemaking, SDG&E also supports the JUG suggestion that CARB consider allocating additional allowances to electric utilities to cover the costs of this new EIM compliance obligation, as well as updating the unspecified emissions factor, to help lessen the impact on customers.

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In conclusion, SDG&E 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 Board Resolution 17-21, including further consideration of natural gas allocation.

[4] California Air Resources Board. Staff Report: Initial Statement of Reasons. Sept. 4 2018, page 67: https://www.arb.ca.gov/regact/2018/capandtrade18/ct18isor.pdf

SDG&E again thanks CARB for this opportunity to comment on the 45-day language, and we look forward to additional dialogue. Please contact us if you have any questions or concerns about these comments.

Sincerely,

/s/ Tim Carmichael

Tim Carmichael
State Agency Relations Manager