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Catherine H. Reheis-Boyd

President

November 3, 2017

Ms. Rajinder Sahota via e-mail at: rsahota@arb.ca.gov
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: WSPA Comments on ARB's 10-12-17 Workshop on AB398 Follow-up

Dear Ms. Sahota:

The Western States Petroleum Association (WSPA) is a non-profit trade association representing companies that explore for, produce, refine, transport, and market petroleum, petroleum products, natural gas and other energy supplies in California and four other western states.

WSPA appreciates this opportunity to provide comments on the Air Resources Board's (ARB) October 12th workshop which provided for discussion of the regulatory follow-up and implementation of AB398.

AB398 provides an extension of the state's cap-and-trade program through 2030 and includes cost-containment mechanisms which, if designed properly, will allow the state to reduce the overall cost of reducing California's greenhouse gas emissions.

In this letter, we will provide some of our preliminary feedback regarding the third compliance period industry assistance factor, the over allocation question, price containment points, offsets, unsold allowances, and banking.

Third Compliance Period Industry Assistance Factor
The state has historically emphasized the importance of creating a climate change program which provides a means of reducing the potential negative economic impacts of a carbon policy while at the same time ensures that the state can meet its environmental goals. To that end, AB32 gave specific direction to ARB to minimize leakage.

In order to guard against leakage, academics and economists have advised the state to consider, as part of the design of the cap-and-trade program, a system of allowance allocation that includes industry assistance. In recognition of this important component of the state's cap-and-trade program, the Board issued Board Resolution 17-21 at its July 2017 Board meeting in which it directed staff to "propose subsequent regulatory amendments to provide a quantity of allocation, for the purposes of minimizing emissions leakage, to industrial entities for 2018 through 2020 by using the same assistance factors in place for 2013 through 2017."

During the workshop on October 12, 2017, ARB staff discussed the extension of the previously adopted industry assistance factor, making the important point that doing so would not mean that entities are allocated all allowances they need to comply with the state's cap-and-trade program. ARB staff highlighted that by 2030, most industrial sectors will receive less than 50% of the allowances needed to cover their compliance obligations[1]. This clarification is important as there has been some misunderstanding of the facts on this point in the press. The point made by ARB staff should serve to set the record straight. WSPA supports the direction of the Board Resolution and requests that ARB staff put forward a proposal that enacts that direction as quickly as possible.

The Board's action is consistent in spirit with the Legislature's intent in AB 398 to contain costs and support California's jobs and industry. If this action is not taken, the state's economy could be subject to a one time unnecessary shock downwards.

Over Allocation Question
A few stakeholders have noted that today's current emissions levels are lower than what was forecasted as the anticipated level of capped emissions. The fact that California is exceeding its greenhouse gas emission reduction target should be celebrated. Nonetheless, some stakeholders have questioned why this might be. The Legislative Analyst's Office points out in their February 2017 report titled *The 2017-18 Budget: Cap-and-Trade* that slower than expected economic growth and the implementation of multiple complementary measures could be reducing emissions more than had been expected.

We would note that to the extent the stringency of certain programs increase – for example, the Low Carbon Fuel Standard – even more emission reductions will be forced to occur under complementary measures as opposed to the cap-and-trade program, thus driving up overall compliance costs. If ARB desires to have more emission reductions occur under the cap-and-trade program, it may want to consider, where feasible, reducing the stringency of complementary measures such as the LCFS. This could allow the state to meet its GHG emissions target at a lower cost to California consumers and its economy.

WSPA believes that the cap-and-trade program is operating as it was designed by ARB for the first part of the program (2012-2020). The future of the program will be structurally different in two ways: the annual reduction required will rise to 4-5% per year, and California plans to rely more heavily on cap-and-trade after 2020. There is also a substantial change economically for California due to the Great Recession which reduced CA productivity by 7% during the first half of the program, causing

[1] Because the compliance obligations associated with petroleum products constitutes more than 70% of the total obligation, members of the petroleum sectors will actually receive less than 15% of the allowances needed to cover their compliance obligations.

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
cathy@wspa.org ▪ www.wspa.org

reduced emissions. Under the policy and due to technological costs of meeting the higher emission reduction rate that will be introduced beginning in 2020, allowances will be in higher demand. Recovery from the Great Recession could also increase emissions as CA increases productivity. These structural changes will put substantial pressure on the allowance supply. If that supply is artificially constrained even further, it will simply increase costs of allowances and ultimately cause the cap-and-trade program to reach the price ceiling sooner. Therefore, changes should not be made to the allowance budgets that comprise the cap until the impacts of these substantial changes are understood. In the interim, we oppose the idea that the cap should be further reduced. The market has already made assumptions about allowance supplies in the coming years.

For the long-term health and sustainability of the cap-and-trade program, it is vital for the ARB to continue to send consistent signals to the market, especially as it relates to the cap and associated allowance budgets. Changing the cap and allowance budgets midstream would undermine certainty in the market.

Price Containment Points
AB398 directs ARB to establish two price containment points at levels below the price ceiling. As a guiding principle, the price containment points should provide true opportunity for cost containment and be set at a point to allow early enough warning to the market. This would avoid undue program costs and adverse economic impacts. We also recommend that ARB design the price containment points in a way that would minimize or avoid the need for last minute program changes.

Offsets
ARB accurately points out in their October 12th Workshop presentation that offsets fund reductions in uncapped sectors and serve as an important cost-containment mechanism by expanding opportunities for emission reductions. To maintain that function, it will be important for ARB to send consistent signals in order to avoid undermining the market. To that end, WSPA recommends that ARB consider grandfathering offset projects that are currently listed with an offset registry but not issued by the state of California. Not doing so would send a signal to potential developers that ARB may change its mind midstream, undermining potential future investments in these projects.

Unsold Allowances
During the past year, market conditions indicated some ambivalence about the longevity and sustainability of the state's cap-and-trade market, evidenced by low demand at earlier auctions. As a result of this temporary low demand, some allowances went unsold. Allowances that remain unsold for more than 24 months will be transferred to the APCR for sale at the APCR price tiers until December 31, 2020. Section 95911(f)(3)(C) of the regulation limits the number of unsold allowances re-designated to a subsequent auction to 25% of the total allowances for such auction, so the ability of the ARB to dispose of unsold allowances through auctions is somewhat limited. WSPA supports changing the current limit in order to maximize the ability of unsold allowances to re-enter the market. Doing so will improve credit supply and will reduce the potential for volatility in the market.

Furthermore, consistent with the direction and spirit of AB398, rather than re-populate the APCR, ARB should abandon the use of the APCR. The 52.4M allowances from vintage 2021-2030 which are currently scheduled to be added to the APCR should instead be redistributed evenly into the allowance budgets and auctioned.

Banking

Banking is an important design feature of a cap-and-trade program. Banking encourages early emission reductions and decreases potential market volatility. Current regulatory rules allow compliance entities to bank prior or current vintage allowances for use in any future compliance period. WSPA supports the continuation of this practice.

WSPA looks forward to working with ARB to address these issues. If you have any questions, please contact me at this office, or Tiffany Roberts of my staff at (916) 325-3088 or email troberts@wspa.org.

Thank you,

cc: Richard Corey – ARB
Edie Chang – ARB
Tiffany Roberts - WSPA