California Council for Environmental and Economic Balance
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March 16, 2018

The Honorable Chair & Board Members
California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Possible Revisions to the Cap-and-Trade Regulation: Preliminary Discussion Draft

Dear Chair Nichols and Board Members:

On behalf of the members of the California Council for Environmental and Economic Balance ("CCEEB"), we submit the enclosed comments on the Preliminary Discussion Draft ("PDD") to the Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanism. CCEEB is a non-profit and non-partisan coalition of business, labor, and public leaders that advances balanced policies for a strong economy and a healthy environment. Many of our members are regulated under climate change programs at the Air Resources Board ("ARB"), and CCEEB has been an active stakeholder throughout ARB's implementation of AB 32 and SB 32.

Support for California's Cap-and-Trade Program

CCEEB strongly supported the legislative extension of California's successful Cap-and-Trade Program and broadly supports the 2017 Climate Change Scoping Plan Update, which incorporates the Cap-and-Trade Program as a key measure for reaching California's long-term climate goals.

ARB, with robust public input and strong collaboration with stakeholders, has spent the last decade developing an environmentally effective and economically efficient Cap-and-Trade Program. CCEEB believes, and ARB analysis supports, that a Cap-and-Trade Program as the centerpiece of the Scoping Plan remains the best approach to achieve the 2030 target set by Executive Order B-30-15 and codified by SB 32. AB 398 affirmed the legislative commitment to Cap-and-Trade and desire to contain the costs of California's climate programs.

Covered entities have complied with emission reduction goals and the program is on track to meet its goals through 2020. It has done so by directing the most efficient reductions among "capped" entities, while providing an important funding mechanism for GHG reductions that either cannot be directly regulated, or through advanced development and deployment of new, lower-carbon technologies and systems.

Additionally, Cap-and-Trade has successfully facilitated linkages and partnerships to other jurisdictions and serves as a groundbreaking model program on an issue that requires global action. California has formal linkage agreements with the Provinces of Québec and Ontario and partnership agreements with Acre, Aguascalientes, Baja California, Beijing, Chiapas, Chongqing, British Columbia, Guangdong, Jalisco, Jiangsu, Shenzhen, Sichuan, Inner Mongolia, Osaka, Zhenjiang, Chile, France, India, Israel, Japan, Malaysia, Mexico, Kingdom of the Netherlands, Peru, Scotland, and South Korea. While the preponderance of GHG reductions from California's climate policies occur within California, these agreements help prompt much needed international action, which is needed now more than ever as United States federal climate programs are under attack. To mitigate GHG emissions and reduce the effects of climate change, it is imperative that California's strong policies be exported to other states, jurisdictions, and national governments. Without such cooperation, California's economic investments will not produce the hoped for environmental dividends.

The Visible Hand - Manipulating Prices
CCEEB disagrees with stakeholders who are proposing to constrain the market through major manipulation of the liquidity and flexibility provided by a market-based mechanism. Artificially constraining the market to drive the market price toward the ceiling price is counter to the cost-effectiveness and cost-containing purposes of mitigating emissions through the codification of the Cap-and-Trade Program. These stakeholders are arguing to adopt a highly restricted market, through removal of unsold surplus allowances, cap adjustments, and changes to banking or holding limits that will drive prices to a predictable ceiling tax, very similar to legislation that was introduced and not advanced in favor of a more cost-effective and more widely accepted Cap-and-Trade Program.

Cost Concerns
The decision to codify Cap-and-Trade last year centered around cost-effectiveness and flexibility to protect California's economy, compliance entities, and citizens from undue costs of mitigating greenhouse gases. The nexus of cost of allowances to fuel, natural gas, and electricity rates, led the Legislature and Administration to defer the discussions of the price ceiling to the ARB. There are many other policies that extend beyond the scope of ARB and the California Environmental Protection Agency ("CalEPA") and require the public to carry the cost burden. For example, in addition to passing AB 398, the Legislature passed SB 1 that increased the excise tax on gasoline and diesel to address transportation infrastructure needs. While there was widespread support and a demonstrable need for SB 1 and the projects it promises to deliver, the public is very divided on this $0.12 increase on gasoline and $0.20 increase on diesel, both pegged to future inflation adjustments. CCEEB urges staff and the Board to consider the combined cost of LCFS compliance, costs for California-specific fuel formulations and the very real possibility for national increases to federal fuel excise taxes between now and 2030, before enacting changes that unnecessarily modify components of the Cap-and-Trade Program to further raise allowance prices that will also affect fuel, natural gas, and electricity prices. There are other public needs that place a great deal of pressure on the cost of fuel and the public is very cognizant of these costs as they result in direct impacts on household finances.

CCEEB's initial calculation based on ARB's PDD yield a potential 2030 ceiling price of $202 per ton of CO_2e. This could add an additional $2 per gallon to the cost of transportation fuel. Given the 2018 election debates, pending Senatorial recall, and a repeal proposition on the ballot for a $0.12-$0.20 increase, CCEEB believes that sending the public a signal of increases substantially greater than the SB 1 excise tax increase could undercut faith and confidence in California's climate programs.

Surplus Allowances and Overallocation
CCEEB does not believe the current program is overallocated. This concept originated from detractors of Cap-and-Trade. The concern of overallocation was a part of the initial discussions in 2009 and the reason California's Cap-and-Trade Program includes design features like output-based benchmarks for industrial processes, as well as banking and holding limits. Early compliance and overperformance especially in the context of the increasing slope of the cap for the post-2020 goals, should not be a concern. The more aggressive 2030 goal will naturally tighten the market without regulatory intervention.

The retirement of surplus allowances will overly constrict the market. CCEEB will reject any proposal to unnecessarily retire surplus allowances from early compliance, as it would have substantial unintended financial and program consequences. Given the auction results after passage of AB 398, measures to tighten the market are premature and will result in substantial increases in costs for Californians as the market naturally tightens on its own during the 2021-2030 timeframe.

Industry Assistance
Industry assistance for trade-exposed companies is a simple method of protection to avoid both environmental and economic leakage. California businesses are trade exposed unless their competitors are in a linked jurisdiction. AB 398 extended industrial assistance from the 2nd compliance period to the post-2020 program. While some will argue that this gives the ARB authority to drop assistance factors for the 3rd compliance period, CCEEB believes this logic does not follow the AB 398 negotiations and public debate. Furthermore, it is unnecessary and creates temporary disruption to the market without environmental benefits. ARB and stakeholders have a responsibility to ensure that the market is stable year to year and not artificially disrupted.

In the absence of broad-based linkage, national, or international programs comparable to what exists in California, CCEEB supports the ARB recommendation to maintain industrial assistance factors as mandated in AB 398.

Establishing a Ceiling Price
For setting a ceiling price ARB is required to consider:

- The need to avoid adverse impacts on resident households, businesses, and the state's economy.
- The 2020 tier prices of the allowance price containment reserve.
- The full social cost associated with emitting a metric ton of greenhouse gases.
- The auction reserve price.
- The potential for environmental and economic leakage.
- The cost per metric ton of greenhouse gas emissions reductions to achieve the statewide emissions targets established in Health and Safety Code Sections 38550 and 38566.

These are co-equal considerations and will require substantial balance throughout the discussion this year. CCEEB believes that the ceiling price range proposed by ARB is too high to ensure allowance prices do not rise to politically unacceptable levels and frustrates the Legislature's intent of creating a meaningful price ceiling.

Price Tiers
CCEEB believes price tiers were intended to be further spread out than proposed. While any suggestion is arbitrary setting them at 1/3rd and 2/3rd of the difference between the price ceiling and the price floor will allow enough time for the IEMAC to constitute, analyze, and make recommendations on action or no action depending on the course of the market.

Distribution of Allowances to New Post-2020 Reserve and Price Ceiling
ARB set allowance budgets for the post-2020 program in the 2017 amendment process, when the Program's offset usage limit was still 8%. The Legislature lowered the offset usage limit from 8% to 4% in 2021-25 and from 8% to 6% for 2026-30. In both these timeframes, the offset usage limit will get more restrictive, which is the opposite of the initial adjustment in 2010-11 to the offset usage limit from 4% to 8% to account for the removal of allowances to fill the APCR. ARB should not exacerbate the impact of AB 398's reduction of the offset usage limit by further removing allowances from the post-2020 market.

A price ceiling and the ARB's new authority to backstop the ceiling with real, permanent, quantifiable, verifiable, enforceable, and additional reductions removes the need for stockpiling allowances. ARB should refrain from placing at the ceiling either the 52.4M that was taken from 2021-2030 budget years and from taking an additional 23M from later budget years. Removing allowances prior to understanding the true challenges from the much steeper cap decline is premature at best. The threat of doing so creates instability which is exactly what AB 398 was designed to avoid. The history of the program and the last 4 years show that the future is unpredictable. ARB should not make assumptions about the direction of emissions, industry or consumer needs and demand that would penalize early actors for their reductions.

CCEEB recommends that these allowances be placed in the post-2020 Reserve price tiers as it would increase their effectiveness in mitigating rising allowance prices for a period of time sufficient to allow compliance entities to adjust to higher prices, and for ARB and stakeholders to evaluate the performance of the program. CCEEB does not support putting these allowances into the price ceiling as they would be unnecessary since unlimited price ceiling instruments to meet compliance needs will be made available at the ceiling price.

Additionally, the volume of allowances sent to the individual price tiers should exceed the minimum volume of allowances established in AB 398. This will help ensure the price of allowances does not move through a tier too quickly.

Direct Environmental Benefits
CCEEB recommends that ARB interpret "Direct Environmental Benefits" ("DEBS") broadly so as not to exclude projects that are not geographically within California but provide reductions or avoidance of ANY pollutant that could have an adverse impact on the air or waters of the state.

ARB should also consider ways to recognize the direct environmental benefits that projects such as Ozone Depleting Substances ("ODS") destruction provide. Some of these projects collect ODS in California, but destroy them in states with appropriate destruction facilities. These projects yield significant DEBS by reducing a harmful pollutant, clearly meeting the spirit of this provision.

Banking and Holding Limits
CCEEB supports banking as we support Cap-and-Trade. Without banking, Cap-and-Trade becomes something much closer to a carbon tax. Banking allows for investment and helps avoid volatility in the market.

Current banking rules, allow use of pre-2021 compliance instruments, including offset credits procured under existing protocols post-2021, should be maintained to support market continuity, allow compliance entities to adequately plan for their compliance obligations, maintain investment in high quality offset projects, and avoid potential price volatility and market disruption. As such, compliance instruments should not have expiration dates, and those in private accounts post-2020 should not be de-valued.

ARB should consider whether changes to the holding limit are necessary now that Cap-and-Trade extends beyond 2020. The extension of Cap-and-Trade creates the opportunity to evaluate whether or not the existing holding limit supports the additional program period. CCEEB would appreciate consideration for increasing an entity's holding limit as we believe this will help reduce market volatility as the cap declines.

Conclusion
In closing, CCEEB appreciates the opportunity to comment on the PDD. We appreciate the timeline for adoption as it is aligned with the timing for truing up. CCEEB will continue to work on more detailed and sourced comments to follow-up with staff and the board on proposals within the PDD. We believe there is a great opportunity for California to lead global efforts on climate change with Cap-and-Trade as the centerpiece of State programs. An efficient and cost-effective program will deliver emission reductions at a cost that is tenable for the public without creating undue political pressure on the State's funding priorities outside of climate change.

Thank you for your consideration of our comments. We look forward to discussing them or answering any questions you may have at your convenience. Please contact me or Jackson R. Gualco, Kendra Daijogo or Mikhael Skvarla, CCEEB's governmental relations representatives at The Gualco Group, Inc. at (916) 441-1392 should you have any questions or comments.

Sincerely,

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President

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