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Mr. Jason Gray
Cap-and-Trade Program, Branch Chief
California Air Resources Board
Sacramento, CA

Re: 2018 Amendments to California's GHG Cap-and-Trade Regulation

Dear Mr Gray:

These comments are submitted on behalf of the Center for Biological Diversity regarding the Preliminary Discussion Draft of Potential Changes to the Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms and the associated public workshop held on March 2, 2018. I appreciate the information that was shared at that workshop, and I appreciate this opportunity to provide some input on the changes being considered by ARB in the coming months.

The need for steep reductions in greenhouse gas emissions in order to avoid the worst impacts of climate change is becoming clearer every year, and indicates that California and the world must utilize all available options to reduce greenhouse gas emissions in the near term. In that context, the Center for Biological Diversity finds California's cap-and-trade program frustrating, as that market mechanism tends to postpone potentially greater reductions in favor of smaller and less expensive options in the near term, and can divert attention and resources from other urgently needed and cost-effective GHG reduction activities. However, given that ARB has chosen to place a great emphasis on cap-and-trade as a mechanism for achieving California's greenhouse gas reduction goals, it is very important that the program be as ambitious and well-designed as possible. It is in that context that we offer these comments.

This comment letter focuses on a few issues among the potential changes to the cap-and-trade rule that are of particular interest to the Center for Biological Diversity. 1) We recommend that allowances banked through 2020 sunset after 2020 in order to avoid postponing or precluding new, on-site reductions in the 2021-2030 period. 2) We recommend that the Industry Assistance Factors decline for the 2018-2020 period as proposed under the current rule and the Industry Assistance Factor for petroleum refining be set at 0% over that period, in order to increase the amount of reductions achieved in that sector. 3) The primary information relevant to the determination of the "direct environmental benefits" of an offset project is the location of that

project with respect to the boundaries of the state and its waters; we recommend that the determination of which project types reduce or avoid emissions of air pollutants or water pollutants be done at the program level. 4) We recommend that the Environmental Analysis assess the impacts of surplus credits, the benefits of lower Industry Assistance Factors for the 2018-2020 period, and the emissions associated with the combustion of exported petroleum products. These issues are discussed in turn below.

1. Allowances banked through 2020 should sunset after 2020 in order to avoid postponing or precluding new, on-site reductions in the 2021-2030 period.

California's cap-and-trade program is projected to generate between 190 and 300 million surplus allowances through 2020, with each allowance representing a ton of CO_2-equivalent GHG emissions. Since the cap-and-trade program went into effect in 2013, emissions from facilities subject to the cap have consistently been lower than the projected business-as-usual baseline, which has allowed covered polluters to acquire excess allowances at relatively low prices, as well as free allowances, that they have been able to trade and bank for future use.

At the same time, the price of offset credits has also stayed low, in part because the price of offset credits is dictated largely by the price of allowances, which have been readily available at low prices. This has allowed for the purchase of offset credits at low prices to use at a later date when the price of allowances may rise, and contributes to the current surplus of credits.

The expected surplus of allowances by 2020 is potentially comparable to the 294 MMT in reductions that ARB estimates must be achieved under cap-and-trade between 2021 and 2030. As a result, the reductions required under cap-and-trade through 2030 could feasibly be met in large part with the excess carbon credits leftover from the pre-2020 period, if those credits are allowed to carry forward for use in 2020-2030.

If GHG emissions have been lower than business-as-usual projections as a result of general economic factors and larger market forces (i.e., non-carbon market) or because the business-as-usual projection is too high for any reason, and cannot be attributed to climate policies, then the excess allowances are not the result of real reductions in the covered sectors. In that case, surplus allowances that are the accident of larger market trends would be treated the same as reductions attributed to climate policies, and would undermine future real reductions.

We heard at the March 2 workshop that ARB is looking at this issue and accepting comments on what analyses they might run to determine the extent to which the surplus allowances are due to real reductions rather than a result of inaccurate business-as-usual projections. We support that exercise but it is also critical to determine the extent to which the existing surplus of allowances and credits can serve to postpone new, on-site reductions in the years after 2020. Because there is a significant probability that the surplus of banked allowances will postpone new, on-site reductions, then the cap-and-trade regulation should contain options for retiring and/or devaluing pre-2021 allowances in private accounts after 2020.

2. The Industry Assistance Factors should decline for the 2018-2020 period as proposed under the current rule and the Industry Assistance Factor for petroleum refining should be

set at 0% over that period, in order to increase the amount of reductions achieved in that sector.

ARB proposes to maintain Industry Assistance Factors of 100% for all industries through 2020, given that AB 398 mandates 100% Industry Assistance Factors beginning in 2021. The Center for Biological Diversity opposes this proposal, and recommends that the Industry Assistance Factors decline for the 2018-2020 period as proposed under the current rule. Adjusting the 2018-2020 Industry Assistance Factors upward for 2018-2020 is not required by AB 398, and the upward adjustment is inconsistent with previous CARB determinations that the Industry Assistance Factors should be decreased over this period. Furthermore, reducing the Industry Assistance Factors is an important way to increase transparency and facilitate higher levels of real reductions in the program.

In addition, we recommend an Industry Assistance Factor of 0% for petroleum refining for the 2018-2020 period. We single out refineries here because AB 398 purports to prohibit ARB from adopting any GHG regulation other than cap-and-trade for petroleum refineries and oil and gas production facilities through 2030. In addition, AB 398 purports to prohibit local air districts through 2030 from "adopting or implementing an emission reduction rule for carbon dioxide from stationary sources that are also subject to a specified market-based compliance mechanism." Thus, refineries present a special situation in which options for inducing GHG emission reductions are purportedly limited, making it necessary to optimize the reductions achieved through cap-and-trade. In the time since the current rule went into effect, the need for greater reductions from the cap-and-trade program as a whole, and from the oil refining sector in particular, have become more clear and urgent. A lower Industry Assistance Factor would raise the cost of emissions in the refinery sector for the next two years, providing an incentive for on-site reductions over that period, including equipment upgrades that would continue to provide real reductions in GHG emissions and co-pollutants on an ongoing basis after 2020.

3. The primary information relevant to the determination of the "direct environmental benefits" of an offset project is the location of that project with respect to the boundaries of the state and its waters; the determination of which project types reduce or avoid emissions of air pollutants or water pollutants must be done at the program level.

AB 398 specifies that after 2020 no more than one-half of offset credits may be sourced from projects that do not provide "direct environmental benefits in the state," and defines "direct environmental benefits in the state" as "the reduction or avoidance of emissions of any air pollutant in the state or the reduction or avoidance of any pollutant that could have an adverse impact on waters of the state."

It is clear from the text of AB 398 and its intent that "direct environmental benefits in the state" refers explicitly and solely to the reduction of air pollutants and water pollutants within the state. This intention is clearly stated in the AB 398 bill analysis that was prepared for the full Senate, which characterized this provision as simply: "Requires 50% of all offsets to be in California."

The Discussion Paper proposes that offset projects can meet the "legislative direction" of the requirements for providing direct environmental benefits in the state by "providing additional information." This proposal is vague and difficult to assess. AB 398 clearly requires an avoidance or reduction of air pollution in the state or the avoidance or reduction of a pollutant impacting the state's waters. Therefore, the primary information that offset projects must supply that would be relevant to the determination of its direct environmental benefits in the state is the location of that project with respect to the boundaries of the state and its waters. The determination of which project types reduce or avoid emissions of air pollutants or water pollutants must be done at the program level.

Furthermore, the fact alone that a project is located within California does not ensure that the offsets provide direct environmental benefits in the state. The Ozone Depleting Substances offset protocol is a prime example, as this offset protocol is based on the destruction of categories of chemicals that have been unlawful to produce or release since 1992 (plus halons in 1994 and CFCs in 1996). Therefore, these offsets would provide no direct environmental benefits in the state even if the destruction were to occur within California.

4. We recommend that the Environmental Analysis assess the impacts of surplus credits, the benefits of lower Industry Assistance Factors for the 2018-2020 period, and the emissions associated with the combustion of exported petroleum products.

As mentioned above, we recommend that the Environmental Analysis include an assessment of the potential reductions achieved through reducing the Industry Assistance Factors as previously scheduled under the existing rule for the 2018-2020 period, and a 0% Industry Assistance Factor for petroleum refining, with respect to the emissions from that sector over that period and subsequently through 2030.

A report by Communities for a Better Environment highlights the trend that exports of petroleum products such as engine fuels and petroleum coke have increased from California refineries in recent years even as demand for those products within California declines. This trend is driven in part by the cap-and-trade program, which increases costs on the combustion of fuels used in California but fails to account for the emissions associated with the combustion of those fuels exported out of California. We recommend that the Environmental Analysis include an assessment of the GHG emissions from the combustion of exported fuels and petroleum coke by sectors and entities under the cap.

We also recommend that the Environmental Analysis include an assessment of the impacts of sunsetting allowances banked before 2020, with its implications for new, on-site reductions, and associated reductions in co-pollutants, in the years after 2020.

Thank you for your consideration of these comments. Please contact me if you have any questions.

Sincerely,

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