



## California Council for Environmental and Economic Balance

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October 22, 2018

Rajinder Sahota  
Assistant Division Chief, Industrial  
Strategies Division  
Air Resources Board  
1001 I Street  
Sacramento, CA 95814

Jason Gray  
Branch Chief, Cap-and-Trade Program  
Air Resources Board  
1001 I Street  
Sacramento, CA 95814

RE: Comments on the Proposed Changes to the Regulation for the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Ms. Sahota and Mr. Gray:

On behalf of the members of the California Council for Environmental and Economic Balance (CCEEB), we appreciate this opportunity to comment on the proposed regulatory changes and, specifically, the key elements of AB 398 (E. Garcia, Chapter 135, Statutes 2017) which authorized and extended California's Cap-and-Trade program to 2030. 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 existing 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.

We believe there is a great opportunity for California to lead global efforts on climate change with Cap-and-Trade as the centerpiece of the State's program. California's program on climate change goes beyond simple commitments and as such, the benefits and consequences must be carefully considered to avoid loss of productivity or undue costs to the public. An efficient and cost-effective program will deliver emission reductions at a cost that is tenable for the public without creating political pressure on the State's other funding priorities outside of climate change.

CCEEB supports AB 398 as it maintains the environmental integrity of SB 32, while re-emphasizing cost-effectiveness in California's climate change program by prioritizing cost containment, market stability, environmental and economic leakage caused by foreseeable and increased production costs and regulatory impediments. These impediments lead to a loss or shift in production to other jurisdictions without air quality or climate change policies, and least cost principles. The price ceiling, price containment points and market size designed in AB 398 work together to reduce volatility and provide time for regulatory review while protecting jobs and consumers. A well-designed Cap-and-Trade should incentivize the lowest cost emission reductions, thereby resulting in emission reductions while preserving a facility's economic contribution at the same time.

CCEEB is concerned the proposed mechanisms that set the price ceiling and price containment points are inconsistent with the intent of AB 398 and by extension, the support given by a broad-based business-labor coalition and bipartisan group of legislators in 2017.

During the AB 398 negotiations in 2017, a bipartisan coalition of legislators determined a series of principles necessary for the reauthorization of Cap-and-Trade. This bipartisan caucus continues to emphasize these principles and recently submitted this letter to ARB:

STATE CAPITOL  
P.O. BOX 942849  
SACRAMENTO, CA 95894-0115

## California Legislature

June 14, 2018

Mary D. Nichols  
Chair, California Air Resources Board  
1001 I Street  
Sacramento, California 95814

RE: Assembly Bill 398 Cap-and-Trade Program Implementation

Dear Chairwoman Nichols:

We write as a bipartisan coalition of legislators who together participated in negotiations and voted for Assembly Bill 398. We understand the California Air Resources Board (CARB) staff and leadership are debating and interpreting AB 398, and how the post 2020 Cap-and-Trade program is going to be implemented. We join together again to ask that CARB be mindful of the critical need to set a price ceiling that respects and supports the environmental goals of Cap-and-Trade and, simultaneously, contains costs for California consumers and businesses who comply with the state greenhouse gas (GHG) reduction goals.

In AB 398, we directed CARB to establish a price ceiling for carbon and we provided a framework for developing the price for carbon emissions that included:

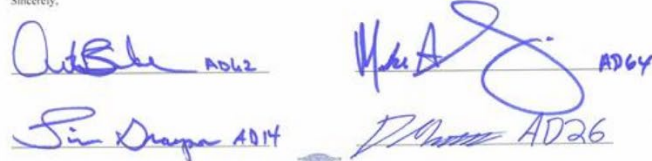
- The critical need to avoid adverse impacts on resident households, businesses, and the state's economy;
- The 2020 tier prices of the allowance price containment reserve;
- The full social cost associated with emitting a metric ton of GHG;
- The auction reserve price;
- The potential for environmental and economic leakage;
- And the cost per metric ton of GHG reductions to achieve the goals established in AB 32 and SB 32.

As you are considering the regulations to implement AB 398, we want to reiterate how critically important it is to avoid adverse impacts on resident households, businesses, and the state's economy and to consider the potential environmental and economic leakage that could occur.

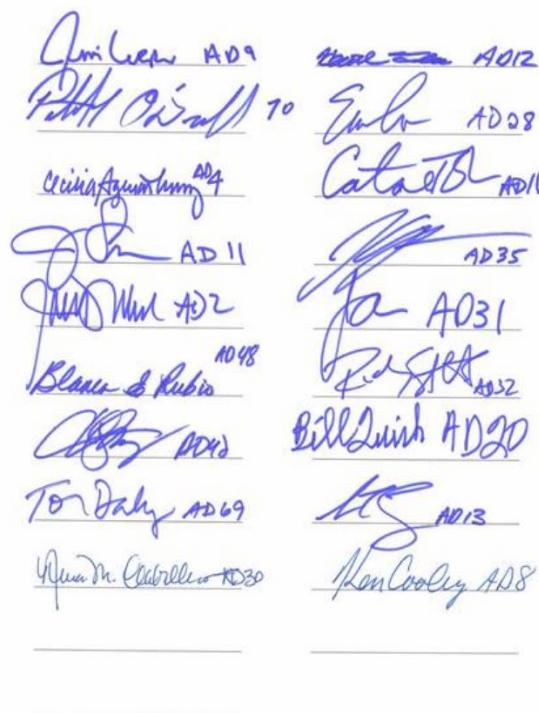
We support Cap-and-Trade, and want to see California continue to be a global environmental and economic leader. If we are going to prove to the rest of the world that our policies work, we must have a smart and sensible approach that supports a strong and growing middle class, helps Californians get ahead, and strikes the right balance of cost and environmental integrity to reach our goals. A sensible price ceiling and overall pricing system that fully incorporates the above factors, is key to that success. We believe failure to set an appropriate ceiling and price mechanism will not only undermine our environmental leadership and success, but also could cause the legislature to reconsider what next steps CARB can and should be authorized to take.

Thank you for considering our request, if you have any questions please do not hesitate to contact our offices.

Sincerely,


  
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CCEEB supports the message and principles promoted by these legislators. Their voices and votes were critical to achieving the 2/3rds support necessary for reauthorization and moreover, provided a bipartisan path for climate change policies. Their trust to, “strike the right balance of costs and environmental integrity...” should be reinforced with a price ceiling that reflects the negotiations had during the 2017 legislative session.

CCEEB urges the ARB to:

- Maintain 100 percent Industry Assistance Factors for the 3<sup>rd</sup> Compliance Period
- Only increase the ceiling price annually by CPI
- Fix the Price Containment Points at 1/3<sup>rd</sup> and 2/3<sup>rd</sup> between the price floor and price ceiling
- Maintain the proposed definition of Direct Environmental Benefits



## **Cost Concerns**

The decision to codify Cap-and-Trade beyond 2020 last year centered around cost-effectiveness and the flexibility to protect California's economy, compliance entities, and citizens from undue costs to reduce greenhouse gas emissions. The potential cost of allowances for fuel, natural gas, and electricity led the Legislature and Administration to defer the discussions of the price ceiling and the price containment points to the ARB's regulatory process. The ARB's assessment indicates that the costs of climate change policies are passed to the consumers of transportation fuels, natural gas, and electricity. Additionally, based on the Bureau of Labor Statistics, real wages, adjusted for inflation, have grown less than 2 percent since the first auction in 2013<sup>1</sup>, much slower than the proposed Cap-and-Trade program prices escalate (5 percent plus CPI). With wage growth and the public's capacity to pay in mind, the proposed regulations will lead to consumers paying an increasingly large proportion of their income annually on fuels, energy, and goods manufactured in California subject to the regulation. The 5 percent floor price escalator has increased energy costs since the program's origin in 2013. Assuming continued stagnant trends in real wages and inflation, the costs of energy in California will rapidly outpace the public's ability to pay these costs.

CCEEB urges staff and the Board to consider the household impacts of modifying components of Cap-and-Trade to raise allowance prices in tandem with the policies enacted outside of ARB's scope of authority. There are many other political and policy priorities that extend beyond the scope of the ARB and the California Environmental Protection Agency (CalEPA) that require the public to carry the cost burden, such as Medi-Cal, public pensions, infrastructure, public safety, education, and countless other underfunded or unfunded needs.

Fuel, natural gas and electricity costs are further compounded by California-specific policies like the Renewable Portfolio Standard and the Low Carbon Fuel Standard. Staff and the ARB must pause to consider the impact on California households and design a program that can be absorbed amidst a growing demand of spending obligations.

The proposed nominal 2030 ceiling price of approximately \$120 per ton of CO<sub>2</sub>e could potentially add over \$1 per gallon to the cost of transportation fuel based on estimates provided by the LAO<sup>2</sup>. CCEEB firmly believes the ceiling price sends a signal to the public and if it is too high or collides with others public cost pressures, it undermines support for California's Cap-and-Trade program. California's gasoline prices are currently \$0.86 higher than other high-population, progressive states like New York and \$1.22 more expensive than economic competitors like Texas<sup>3</sup>. With California poised as the leader in Cap-and-Trade, adopting such a high price ceiling could substantially inhibit the growing world-wide interest in establishing market-based programs to meet the Paris Agreement's Nationally Determined Contributions.

## **Protect California Jobs – Industry Assistance Factors (IAF)**

CCEEB agrees with the ARB's decision to maintain the industry assistance factors across the 3<sup>rd</sup> compliance period (CP3), required and imperative because;

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<sup>1</sup> <https://www.bls.gov/opub/ted/2018/real-average-hourly-earnings-up-0-point-2-percent-from-august-2017-to-august-2018.htm>

<sup>2</sup> Legislative Analyst Office's 2016 report

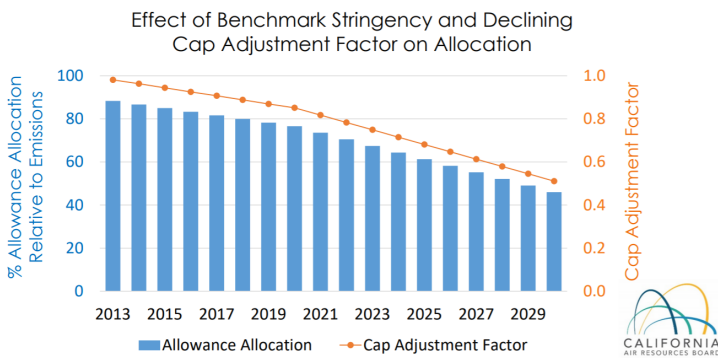
<sup>3</sup> <https://www.gasbuddy.com/USA>



- Providing a just transition – removal of industrial assistance for CP3 will shock the market and there is not enough time for compliance entities to plan for this change;
- Unnecessarily removing IAF that was negotiated as part of AB 398 is punitive;
- Trade protection is a part of most national, regional, and sub-regional programs;
- Carbon mitigation policies are not wide spread with major industrial competitors;
- Ease Transition into low carbon economy requires a steady and consistent price signal;
- CA’s program covers more sectors than most and as such is undertaking a greater task;
- Trade exposed by all competitors not under an equally stringent program.

Industry assistance for trade-exposed companies is a simple method of protection to avoid losing the jobs, economic benefits, and environmental benefits of operations within California. Avoiding environmental and economic leakage by supporting a just transition for compliance entities into a low-carbon economy is crucial, as facilities in California must comply with the most rigorous environmental standards from criteria pollutants, air toxics, greenhouse gases, and water quality while competing in increasingly global commerce. California businesses are trade exposed to any competitor that is not subject to a carbon price or is subject to a less stringent carbon policy. AB 398 set the industrial assistance factors in years 2021 to 2030 to that already existing for the 2015-2017 compliance period with this understanding, and Board Resolution 17-21 instructed staff to propose additional regulatory amendments to minimize emission leakage during CP3 in 2018-2020. The cap decline results in fewer allowances being distributed to covered entities year-on-year as the program progresses. As ARB’s workshop presentation<sup>4</sup> shows, industries in California will increasingly be competitively disadvantaged as they must cover both the 10 percent “haircut,” which was an initial removal of industry assistance allowances, and because of the steep decline factor of the cap escalating down from 3 percent to 6 percent by the end of the 2030 period.

■ By 2030, most industrial sectors will receive <50% of allowances needed to cover compliance obligations

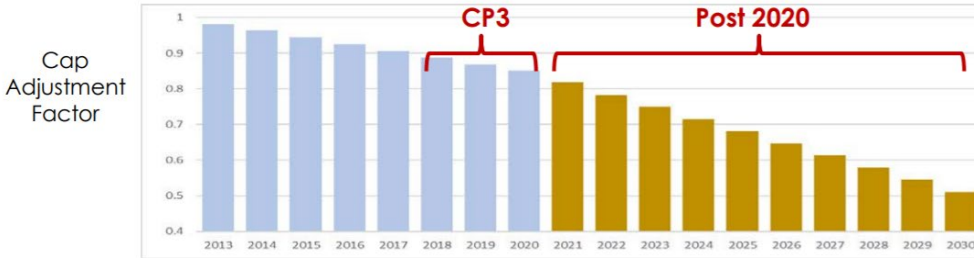


The AB 398 intent and public debate that took place prior to its passage recognized the vulnerability of California industry in a global marketplace with competitors not subject to a carbon price. Furthermore, it creates an unnecessary disruption to the market without environmental benefits. The ARB and stakeholders have a responsibility to ensure that the market is stable

year-to-year and not unnecessarily disrupted. The current IAFs for CP3 and through 2030 represent a smooth and steady decline that bridge the initial program with AB 398 and the increased stringency required to achieve the SB 32 goal.

<sup>4</sup> [https://www.arb.ca.gov/cc/capandtrade/meetings/20180426/ct\\_workshop\\_4-26-18.pdf](https://www.arb.ca.gov/cc/capandtrade/meetings/20180426/ct_workshop_4-26-18.pdf)

- Allowance budget and CAF decline faster in 2021 – 2030
  - 2013 - 2020: About 2% per year (15% cumulative)
  - 2021 - 2030: About 4% per year (36% cumulative)



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 during the 3<sup>rd</sup> compliance period.

**“Overallocation” Allowances**

AB 398 requires the ARB to review whether the program is overallocated. CCEEB believes the current program is appropriately allocated. The concern of overallocation was a part of the initial discussions in 2009 and the reason California’s Cap-and-Trade Program includes a robust emissions reporting, verification, and statewide inventory and design features like the 24-month provision for transferring unsold allowances to the Allowance Price Containment Reserve (APCR), output-based benchmarks for industrial processes, the auction reserve price, as well as the declining banking and holding limit which restricts the number of allowances an entity can hold as a function of the annual budget. From 2021 to 2030 the holding limit will decrease nearly twice as fast as the first ten years of the program. Additionally, entities with the largest compliance obligation have the same holding limit as those with the smallest. This ensures the scales are not tilted in favor of firms with a larger compliance obligation. Early compliance that resulted in 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. At the very least it is premature for ARB to make changes in a market that is just recovering from instability due to political and legal issues. The ARB must revisit the program by statute in 2025.

Some stakeholders have discussed the need to retire allowances from past auctions, which would only serve to constrict the market and send the wrong signal to market participants. CCEEB strongly encourages the ARB to reject any proposal to retire allowances from early compliance periods, 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 due to its increasing stringency during the 2021-2030 timeframe.

California’s Cap-and-Trade allocations are based on actual inventoried emissions unlike the first compliance periods of the EU ETS. The initial allocations under the EU ETS took place prior to the EU member states development of a strong GHG inventory, therefore, the first phases of the



EU ETS relied on capacity-based benchmarks as opposed to California's output-based benchmarks. Adjusting the caps for the EU ETS was a result of limited information during the benchmarking phase, thus the suggestions that adjusting allocations based on the European precedent are should be dismissed by the ARB.

### **Establishing a Ceiling Price**

The six criteria in AB 398 to guide the establishment of price ceiling values are co-equal considerations and will require substantial balance throughout the discussion this year. CCEEB believes the ceiling price 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.

The public's ability to bear and accept the costs is an important factor and is also one of the key criteria in AB 398. It is imperative that Cap-and-Trade be publicly and politically acceptable to backstop California's climate goals as the stringency and affordability becomes increasingly more difficult in the later years of the program.

The price ceiling currently proposed by ARB is not an effective cost containment mechanism. ARB should set the price ceiling in 2021 at \$60-80 (2021 dollars), adjusted annually on CPI, to account for inflation, in order adequately protect the State's economy, consumers and ratepayers against higher costs. In order to maintain public and political support the 2030 price ceiling should be between \$80-\$93 in 2030 dollars.

Other important criteria that need to be the focus of the policy discussion to date, include consideration of environmental and economic leakage. One metric for consideration is whether other jurisdictions are pursuing climate policy with the same stringency and pricing as California. A review of the world-wide climate policy stringency shows that only a few entities share the same level of stringency and even among those, the carbon pricing policies are lower in cost. There are many resources that provide world-wide pricing, including the World Bank that demonstrate the average carbon price today, where it exists, is below California's floor price at around \$10. These metrics point to the significant disadvantage for California entities facing high stringency and much higher prices throughout the program. It is a clear indicator that California should consider a lower price ceiling than what has been proposed by the ARB.

CCEEB agrees with Dr. Stavins' views on the inappropriateness of using cost of abatement as a primary factor for consideration of setting a price ceiling. Pricing above the social cost of carbon does not provide additional environmental benefit. As the social cost of carbon is an approximation, costs of compliance below this price are a result of the unique solutions compliance entities implement in order to reduce their costs within a Cap-and-Trade. The purpose of Cap-and-Trade programs is to allow flexibility on who makes reductions and how the reductions are made to ultimately incentivize the lowest cost reductions. Choosing a high cost abatement specifically targeting a specific sector is both presuming that this is required to meet the reductions and also that a one size fits all approach is appropriate policy for a Cap-and-Trade price ceiling. Moreover, ARB's own Scoping Plan is based on pathways which do not include use of the same abatement technology, carbon capture and storage until after 2030. It is therefore inappropriate to identify this abatement cost in a pre-2030 regulatory framework. Cap-



and-Trade is not designed to promote or focus on single abatement techniques but drive innovation and reductions through unique investment as different sectors are able to find and cost-effectively implement these reductions.

### **Eliminate Price Escalators**

The 2030 goal and subsequent allowance budgets are sufficiently stringent to drive pricing without the five percent escalator on the floor, price containment points and ceiling. By eliminating the five percent escalator, the price ceiling in 2030 will remain under \$100 (2030 dollars) and likely more politically palatable. As previously, indicated real wage growth has been stagnant over the course of California's climate change program and it is socially reasonable to mitigate the overall impacts to households. The environmental integrity of the Cap-and-Trade is the declining cap, not the allowance price so there is no need to design a program with prices as high as the proposed regulation.

### **Price Containment Points (PCPs)**

Price containment points were included in AB 398 to mitigate risk and to the extent possible reduce volatility. CCEEB believe equally spaced PCPs provide more stability and steadier markets than where the PCPs are placed in ARB's proposed regulation. Setting the price tiers at 1/3<sup>rd</sup> and 2/3<sup>rd</sup> of the difference between the price ceiling (assuming a reasonable price ceiling) and the price floor will maximize their effectiveness and allow enough time for the Independent Emissions Market Advisory Committee (IEMAC) to constitute, analyze, and make recommendations on any actions depending on the course of the market. By having a program with robust price containment points, the possibility of volatility associated with low supply in later compliance periods will be reduced.

### **Proposed removal of allowances from the 2026 to 2030 budget**

ARB's proposed regulation contemplates removing allowances from the 2026 to 2030 period and placing them into the second Tier as a response to the quantitative offset usage limit increasing from 4 percent to 6 percent in 2026. Doing this simply adds cost and uncertainty to compliance entities. ARB has always viewed offsets as a cost-effective means of delivering real emission reductions. Provided AB 398's requirement that 50 percent of the offsets used for compliance must meet the Direct Environmental Benefits (DEBS) definition, shifting allowances from the annual auction budget into the second price containment Tier does little but increase the cost of compliance. Because of uncertainty in the quantity of projects that will meet the DEBS definition, lack of information on the cost to implement a DEBS project, CCEEB feels constraining the annual allowance budget based on ARB rational starting in 2026 is hurried. Therefore, CCEEB recommends ARB keep the 22.7 million allowances in the 2026 to 2030 allowance budget.

### **Banking, Cap Adjustments, and Holding Limits**

CCEEB supports banking as an integral component of Cap-and-Trade. Without banking, Cap-and-Trade becomes something more akin to a carbon tax. Banking has allowed for investment, while lowering the costs of achieving the state's greenhouse gas reduction goals. Additionally, it helps reduce volatility in the market.



Current banking rules that 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.

CCEEB is concerned that allowances they purchased in good faith under a linked, verified program could be arbitrarily and abruptly confiscated or cancelled by ARB. We hope and believe that this is not the intent of the amendment to §95942. It is our understanding that ARB can and may choose to hold back allowances that would otherwise be auctioned by the state, but in no circumstances should allowances be confiscated from regulated parties due to the decision of an approved GHG ETS to revoke, repeal or rescind its program.

CCEEB suggests adding this language to §95942 of the regulations:

- (i) *If an approved External GHG ETS has taken an official act to revoke, repeal, or indefinitely suspend its ETS program or one of the linkage findings made pursuant to Government Code section 12894(f) is no longer supported, the Executive Officer may suspend, revoke, or repeal the approved linkage. In taking such action, the Executive Officer may limit transfers in or out of holding accounts pursuant to sections 95921 or 96011, modify auction notices pursuant to section 95912, and modify holding limits pursuant to section 95920, and cancel or issue additional allowances to ensure the environmental stringency of the California Cap-and-Trade Program is maintained as if there had not been a linkage approved with the External GHG ETS.*

ARB should also consider whether changes to the holding limit are necessary now that Cap-and-Trade extends beyond 2020. The reduction of the market due to an increased cap decline will further reduce the holding limit and reduce options to obligated parties. The extension of Cap-and-Trade creates the opportunity to evaluate whether 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.

### **Direct Environmental Benefits (DEBs)**

CCEEB supports ARB's definition of DEBs. We believe there is a need for a long-term and broad view. Unlike criteria pollutants and air toxics, a ton of GHG emitted in California, or not sequestered due to rain forest destruction in tropical locales, will have the same detrimental climate impact. Cap-and-Trade is intended to encourage an open market and provide for investment in climate projects such as reforestation that cannot otherwise be mandated by direct regulation. It is important to note that not all GHGs are emitted from industrial sources. Failure to sequester GHGs because of deforestation and other land use practices contribute significantly to the global increase in atmospheric GHGs. A properly designed Cap-and-Trade program permits investments in projects that can correct for these detrimental land use activities and preserve the world's vital carbon sinks.





## **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 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. The California legislature did not approve with a 2/3rds vote a narrowly priced cap-and-tax that these proposals propose. Those ideas did not have the support to receive a committee hearing. Those who fought to end the Cap-and-Trade program do not have the same interest in the success of the program as those who have compliance obligations and economic vitality of the State in mind.

A balanced regulation from the ARB should not incorporate or seek to balance ideas that were rejected by the legislature and not congruent with a successful Cap-and-Trade. High prices, manipulated supply, and a constrained market do not ensure the success of California's climate change programs.

## **Conclusion**

In closing, CCEEB appreciates the opportunity to comment. We believe there is a great opportunity for California to lead global efforts on climate change with a thoughtfully designed Cap-and-Trade as the centerpiece of the State's climate change 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 other funding priorities outside of climate change. California cannot afford to remove safeguards that were tightly negotiated by the Legislature and industry to appease stakeholders that opposed the marque super-majority approved legislation that explicitly chose Cap-and-Trade over other policy options.

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,

  
GERALD D. SECUNDY  
President

cc: Mr. Richard Corey  
Ms. Edie Chang  
Ms. Emily Wimberger  
Mr. Bill Quinn  
Ms. Janet Whittick  
Mr. Devin Richards  
The Gualco Group, Inc.

