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IETA COMMENTS ON CALIFORNIA AIR RESOURCES BOARD'S CAP-AND-TRADE REGULATION AMENDMENTS WORKSHOP

The **International Emissions Trading Association** (IETA) welcomes the opportunity to provide comments on California Air Resource Board (ARB)'s ***Cap-and-Trade Regulation Amendments Workshop***, held on 21 October 2016.

California is entering a critical phase in its global climate action leadership. As the leading voice for the world's international business community on climate markets and finance, IETA is a staunch supporter of California's strong commitment to Cap-and-Trade and tangible environmental market links with other jurisdictions. **IETA therefore commends ARB's continued support of Cap-and-Trade as a vital, cost-effective cornerstone tool in California's climate policy architecture.** We regard market solutions as the best means to: drive climate action and investment across key sectors of the economy; meet climate targets cost-effectively; and accelerate low-carbon transformative economic and societal changes.

KEY TAKEAWAYS AND RECOMMENDATIONS

A selection of IETA's key observations and recommendations to ARB are summarized below.

1. **Reducing greenhouse gas (GHG) emissions and improving local air quality are two distinct and separate issues.** While cross-over impacts exist, their respective objectives should be assessed and regulated independently, as to avoid inefficiencies and confusion.

2. **California's 2030 and 2050 emission reduction targets are significant and will lead to significant GHG reductions across multiple sectors.** The current Cap-and-Trade program's alignment of cap levels with these targets is a prudent policy position that will catalyze direct GHG emission reductions across the State. This extremely important market-based tool will ensure measurable environmental outcomes and certainty that reduction targets are achieved. Cap-and-trade will achieve this goal in the most cost-effective manner, while also driving clean finance and investment across the state.

3. **California's leadership on climate mitigation is unmatched. The State's actions are driving climate partnerships and adoption of climate policy – particularly carbon market action – beyond California's borders (e.g. Asia, Canada etc.). Stifling the market or constraining critical cost-containment program elements, such as lowering offset usage limits post-2020, will be a regression in this climate leadership.** ARB should also consider the impacts that program reforms will have on current and potential partner jurisdictions. Taking radical steps to reduce compliance flexibility or prevent future linkages will undermine California's reputation at this pivotal juncture in both regional and international climate fora.

4. **Offsets are an integral aspect of California's long-term strategy to mitigate climate risks.** Carbon is a global pollutant and climate impacts to California are not jurisdictionally constrained to in-state reductions. California's offset program drives **real additional reductions** both within and beyond state borders. Offsets also encourage climate action, clean investment and technology deployment across non-covered sectors – many of which are located in disadvantaged communities.

STRUCTURE OF DETAILED COMMENTS

IETA's comments on proposed Cap-and-Trade regulation amendments, along with broader workshop-related observations, are structured around the following categories:

1. Potential Design Changes;
2. Role of Offset Credits;
3. AB197 Interpretation; and
4. Treatment of Unsold Allowances.

1. POTENTIAL DESIGN CHANGES

California's Cap-and-Trade program will drive GHG emission reductions by covered entities over the mid to long-term. Such reductions are driven by the stringency of 2030 and 2050 reduction targets.

Any additional modifications to Cap-and-Trade program design, like retiring unsold allowances, could lead to significant price spikes post-2020; an uneconomic climate solution that could increase program costs and negatively impact the competitiveness of California industry.

Worse yet, the adoption of prescriptive command and control GHG emissions reduction regulation – measures in lieu of Cap-and-Trade – could result in even higher cost implications to the consumer and broader economy. Under this scenario, California emissions intensive, trade-exposed (EITE) industries facing international competition could easily be driven out of the state, leading to carbon leakage and counterproductive results. For other sectors, significant cost increases would be borne by the California consumer, with real potential for broad political backlash across a swath of California constituencies, including stakeholders in disadvantaged communities.

2. ROLE OF OFFSET CREDITS

IETA strongly opposes the reduction of the offset usage limit in California's Cap-and-Trade program post-2020. The reduction of offsets usage will ultimately translate into higher compliance costs for California businesses and impair the State's ability to meet its targets for 2030 and 2050. Direct reductions will be driven by the aggressive emissions reduction trajectory of 2030 and 2050 Cap-and-Trade program caps.

Offsets are "real" emissions reductions, as required by AB 32 and the existing cap-and-trade regulation. Reducing the limit on offsets usage reduces flexibility for regulated entities to find the most cost-effective mechanisms to meet emission reduction targets. This results in higher costs to ratepayers and consumers, which would disproportionately impact lower income families, who typically are required to spend a higher percentage of their income on energy, transportation fuel and carbon intensive goods.

Offsets reduce GHG emissions while providing important co-benefits, including across California's disadvantaged communities. Some examples include:

- **Yurok Tribe Sustainable Forest Offsets Project**: Improved Forest Management project at the mouth of the Klamath River in California. Revenue generated through offset sales enables the Tribe to improve wildlife habitat and forest health, conserve wildlife habitat, expand forestry employment, preserve culture and acquire land in their ancestral territory. Improved forest health provides additional benefits, such as preventing wildfires, which in turn reduces criteria pollutant emissions leading to better air quality and health outcomes in the state.

- **Usal Redwood Forest Carbon Project**: One of the largest Improved Forest Management carbon projects in the country encompasses more than 49,000 acres of productive redwood/Douglas-fir forest located on the North Coast of California. Extensive restoration has been conducted while sustainably managing the project to ensure carbon storage and fish and wildlife habitat maintenance for the long-term benefit of the region's citizens.

- **Pacific Rim Dairy Digester**: This 15,000 cow dairy in California's Central Valley installed a digester and 1 MW electric generating engine in late 2014. The installation of a digester has a number of localized environmental benefits. It eliminates ammonia emissions, which causes respiratory problems, and improves ground water and soil quality. Digesters significantly reduce pathogens associated with manure, preventing salmonella, E. coli and other dangerous pathogens that can contaminate local watersheds in disadvantaged communities.

Before making any regulatory changes on offset usage limits post-2020, IETA urges ARB to conduct a thorough and transparent cost and environmental (GHG) impact analysis of this design modification. As part of this analysis, IETA encourages ARB to examine and showcase future scenarios where offset usage limits are also increased from the current 8%. In fact, we believe that increased offset usage limits post-2020 will not only be desirable but likely critical to ensure program resilience, political acceptability, cost-effectiveness and overall environmental integrity and assurance that 2030+ targets are achieved.

3. AB197 INTERPRETATION

AB 197 mandates that ARB consider the "social costs of the emissions of greenhouse gases." Fortunately, the U.S. Government's "social cost of carbon" table of figures provides a working reference point[1]. The social cost of carbon incorporates climate impacts and only climate impacts. Impacts from other air pollutants are excluded. ARB would be not only justified, but accurate, in interpreting social cost as limited to climate impact.

IETA's believes that AB 197's requirement to "protect the state's most impacted and disadvantaged communities" necessitates reducing these communities' exposure to the worst impacts of a changing climate. Among these are extreme weather events, heat, and drought – real and rising threats to all of us, but with disproportionately greater impact to those in society's most vulnerable communities.

4. TREATMENT OF UNSOLD ALLOWANCES

IETA has previously cautioned ARB that the current program design for reoffering of unsold allowances into the market could quickly lead to scenarios where market participants will not be given another opportunity to purchase allowances before they are either transferred into the APCR or, in the currently contemplated amendment, permanently retired. **This type of program design feature can easily create short-term market pricing spikes.**

The current perceived legal and policy risk of California's Cap-and-Trade program provides a disincentive to market participants to hedge compliance obligations in advance of regulatory deadlines. This **short-term dampening on auction participation will effectively be dealt with under the program's current self-regulating mechanism for periods when allowance demand is low. Therefore, further adjustment is unnecessary.**

[1] *US Environmental Protection Agency, Social Cost of Carbon,* https://www.epa.gov/climatechange/social-cost-carbon

CONCLUSION

IETA appreciates the opportunity to help inform California's proposed Cap-and-Trade regulation amendments and future market. If you have questions or require more information, please contact Katie Sullivan, IETA's Director of the Americas and Climate Finance, Katie Sullivan (sullivan@ieta.org).

Sincerely,

Dirk Forrister
IETA President and CEO