



October 22, 2018

VIA EMAIL

Ms. Rajinder Sahota
Manager
Climate Change Program Operation Section
California Air Resources Board
1001 I Street
Sacramento, CA 95814

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Re: Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation

Dear Ms. Sahota:

On behalf of the Western States Petroleum Association (“WSPA”),¹ I submit the following comments on the California Air Resource Board’s (“CARB” or the “Board”) “Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanism” dated September 4, 2018 (the “**Proposal**”). The Proposal sets forth proposed amendments to CARB’s cap-and-trade regulation at title 17, California Code of Regulations, sections 95801 *et seq.* (the “**Regulation**,” “**Cap-and-Trade Program**,” or the “**Program**”) and is intended to implement the requirements of AB 398.

WSPA believes that several elements of CARB’s Proposal are not supported by the record and do not comply with California law. In WSPA’s view, adoption of the Proposal without the changes requested herein would be arbitrary and capricious and render the Cap-and-Trade Program legally vulnerable.

As set forth in greater detail below, WSPA’s primary concerns relate to CARB’s proposed price ceiling (including both the level of the initial price ceiling and the proposed annual 5% escalator). This proposal is flawed in many respects, including the following:

1. The proposed price ceiling is not based on a reasonable interpretation of AB 398 and AB 32 nor on a reasoned analysis of the relevant statutory factors. The Initial Statement of Reasons (“**ISOR**”) offers only a cursory review of the

¹ WSPA is a non-profit trade association which represents 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.

relevant statutory factors under AB 398, and its interpretation, balancing, and application of those factors is arbitrary and unsupported by reasoned analysis. Among other issues, the ISOR fails to consider the economic impacts of the proposed price ceiling at approximately \$100 (in 2018 dollars)² in 2030 on consumers and on the viability of the Cap-and-Trade Program. In addition, CARB has not justified the use of a 5% annual escalator and the application of such escalator to the price ceiling is, accordingly, arbitrary and capricious.

2. CARB's selection of a 2021 ceiling of \$61 and its application of the 5% escalator results in a 2030 price ceiling of approximately \$100 in 2018 dollars. This is dramatically (roughly 66%) higher than the \$60.39 value from the Social Cost of Carbon that CARB identifies as its benchmark. CARB offers no rationale for setting the 2030 price ceiling at a level so far in excess of its benchmark 2030 estimate of the social cost of carbon. Under AB 398, the social cost of carbon should be considered a reasonable upper bound for the price ceiling, as expenditures in excess of the social cost of carbon would impose higher costs than the benefits, and thus would be irrational.
3. The price ceiling is intended to ensure that the economic impacts of the Cap-and-Trade Program on California do not exceed an acceptable maximum level, as well as to prevent economic and environmental leakage. AB 398 expressly requires CARB to consider such leakage in setting the price ceiling. But while the Proposal makes cursory mention of this factor, it is supported by no analysis and fails to recognize that the proposed price ceiling is set far too high to prevent such leakage. The result is a program that could cause serious harm to California consumers and businesses while failing to achieve the State's greenhouse gas ("GHG") reduction targets because of emissions leakage.
4. There is no empirical or theoretical basis for CARB's notion that businesses make or have made GHG reduction investment decisions based on a *delta* between the floor price and the current or projected tier 3 Allowance Price Containment Reserve ("APCR") price. To the contrary, a large cross section of businesses regulated by the Cap-and-Trade Program assume that a California Governor will suspend and a California Legislature will terminate the Cap-and-Trade Program if allowance prices come anywhere close to the current or projected tier 3 APCR prices.
5. AB 32 requires CARB to consult with other states, the federal government, and other nations to, among other things, facilitate the development of integrated and cost-effective (*i.e.*, linked) regional, national, and international GHG reduction programs. CARB's proposed price ceiling is inconsistent with other existing carbon pricing schemes in the United States, North

² Please see discussion below of 2018 versus 2021 dollars.

America, and globally and will present a potentially insurmountable obstacle to linkage.

Based on the foregoing, WSPA urges CARB to: (1) conduct an appropriate economic analysis of reasonable alternative price ceiling designs and how these affect each of the factors identified in AB 398; (2) eliminate the 5% escalator, which is arbitrary and capricious and lacks economic or policy justification; and (3) select a price ceiling equal to or lower than a defensible 2030 estimate of the social cost of carbon, at a 3% discount rate.

In addition, WSPA supports CARB's proposed determination that no changes to the Regulation are needed to address concerns regarding "overallocation" of allowances and strongly oppose the contrary view. There is no policy justification for such a change, and as discussed below CARB lacks legal authority to make such a change in any event. Accordingly, WSPA urges the Board to continue to reject any calls for a change in approach.

We note at the outset that, unless otherwise noted, these comments refer to 2018 dollars in order to maintain consistency with the approach used by CARB in the ISOR and thus avoid confusion. However, because the proposed regulation itself uses 2021 dollars, any dollar figures in these comments should be translated to 2021 dollars for purposes of comment on the proposed regulation. WSPA objects to CARB's use of a different year in the ISOR than in the proposed regulation, which reduces transparency, causes confusion, and is contrary to the plain English requirement that state agencies explain their changes clearly.

I. CARB'S PROPOSED PRICE CEILING IS NOT BASED ON REASONED ANALYSIS AND IS INCONSISTENT WITH AB 398 AND AB 32

A. AB 398 and AB 32's Text and Purpose

California Health and Safety Code Section 38562(c)(2), as enacted by AB 398, provides that in establishing a price ceiling applicable from January 1, 2021, through December 31, 2030, inclusive, CARB "shall consider, using the best available science, all of the following:

- (I) The need to avoid adverse impacts on resident households, businesses, and the state's economy.
- (II) The 2020 tier prices of the allowance price containment reserve.
- (III) The full social cost associated with emitting a metric ton of greenhouse gases.
- (IV) The auction reserve price.
- (V) The potential for environmental and economic leakage.
- (VI) The cost per metric ton of greenhouse gas emissions reductions to achieve the statewide emissions targets established in Section 38550 [*i.e.*, the 2020 target] and 38566 [*i.e.*, the 2030 target]."

In addition to the statute's specific directive with regard to use of "best available science," Section 38562(e) directs CARB to "rely upon the best available economic and

scientific information and its assessment of existing and projected technological capabilities when adopting the regulations required by this section.”

Further, AB 32 requires that CARB develop regulations that are *cost effective*, *facilitate linkage* with other market-based GHG reduction programs, *minimize leakage*, and *minimize adverse impacts on consumers*. Specifically, AB 32 requires CARB to adopt “[GHG] emission limits and emission reduction measures by regulation to achieve . . . cost-effective reductions in [GHG] emissions in furtherance of achieving the [2020 target].”³ The statute reiterates the requirement that GHG reductions be achieved in a cost-effective manner ten separate times, including in reference to the adoption of rules and regulations, approval of the scoping plan, and the adoption of the Program.⁴ AB 32 also directs CARB to consult with other states, the federal government, and other nations “to facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs.”⁵ The statute expressly requires CARB to “minimize leakage” when adopting regulations under the relevant part (including the instant rulemaking).⁶ Section 38501 as amended by AB 398, directs CARB to extend the cap-and-trade regime under Section 38562 in a manner that “minimizes any adverse impacts on state consumers.”⁷

Finally, as with any rulemaking, CARB must “adequately consid[e]r all relevant factors, and . . . demonstrat[e] a rational connection between those factors, the choice made, and the purposes of the enabling statute.” *American Coatings Ass’n, Inc. v. South Coast Air Quality Dist.*, 54 Cal. 4th 446, 461 (2012).

B. CARB’s Proposal Is Not Based On a Reasonable Interpretation or Application of The Statutes

In seeking to justify its proposed ceiling, CARB offers some limited discussion of each of six statutory factors set forth above. However, the Board does not provide a transparent or reasonable interpretation of the factors individually or of how they should be balanced and applied in determining the price ceiling (including both the level of the ceiling and whether or to what extent the ceiling should increase beyond the rate of inflation).

1. CARB Offers No Explanation or Reasoned Justification for Its Balancing of the Statutory Factors

CARB is required to consider all six statutory factors under AB 398 in setting the price ceiling. Because the factors point in different directions, it is clear that the Legislature intended the Board to balance and optimize among them in setting the price ceiling. To identify a

³ Cal. Health & Safety Code § 38562(a).

⁴ *Id.* §§ 38560, 38561(a), 38562(c).

⁵ *Id.* § 38564.

⁶ *Id.* § 38562(b)(8).

⁷ *Id.* § 38501(i).

reasonable price ceiling, CARB must (1) clearly explain the Board's interpretation of each factor and its comparative weight and directional influence in setting the level of the price ceiling, (2) use the factors to identify a reasonable set of alternative ceilings (including both the level and whether and what level of escalation to apply), and (3) analyze and compare the impacts of these alternative designs on each of the factors and the balancing of the factors.

CARB provides no discussion of how the six statutory factors should be integrated or balanced. Rather, as explained below, it identifies a proposed price ceiling and then makes cursory and in many cases either arbitrary or otherwise unreasonable observations about the proposed price in relation to each of the factors independently. This is not a reasonable construction or application of the statute, and WSPA asks that CARB revisit its proposed approach. As set forth below, under a reasonable interpretation of the statutory factors, the "auction reserve price" establishes a logical "lower bound," whereas the social cost of carbon establishes a logical "upper bound" of the range where CARB can potentially set the price ceiling in compliance with AB 398. Between these two bounding points, AB 398 requires CARB to consider the impacts of the other factors – including the economic impacts of the ceiling on California households and businesses and the potential for leakage, both of which would counsel in favor of setting the price ceiling toward the lower end of the potential range.

2. Social Cost of Carbon

The social cost of carbon is appropriately considered as a reasonable upper bound for the price ceiling. The U.S. Government's Interagency Working Group on the Social Cost of Carbon ("IWG") defined the social cost of carbon as "an estimate of the monetized damages associated with an incremental increase in carbon emissions in a given year."⁸ Imposition of economic costs in excess of the social cost of carbon would be irrational, as this would impose social costs in excess of the benefits of mitigation. As explained in a recent analysis by Dr. Todd Schatzki of the Analysis Group and Dr. Robert Stavins of Harvard University: "Setting the Price Ceiling above the social cost of carbon creates incentives for covered sources to undertake abatement of GHG emissions that is more costly than the damages these emissions create."⁹ Accordingly, CARB should set the price ceiling at a level at or below a reasonable estimate of the social cost of carbon.

In considering this factor, the ISOR (at pages 35-39) focuses on estimates of the social cost of carbon made by IWG. CARB does not endorse or justify the selection of any specific estimate of the social cost of carbon. The ISOR focuses, however, on the IWG's estimate of the

⁸ U.S. Gov't, Interagency Working Group on Social Cost of Carbon, Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12866 at 1 (Feb. 2010).

⁹ Exhibit 1, Todd Schatzki and Robert Stavins, Key Issues Facing California's GHG Cap-and-Trade System for 2021-2030 at ES-1 (July 2018), http://www.analysisgroup.com/uploadedfiles/content/insights/publishing/ca_ghg_cap_and_trade_price_provisions.pdf.

2030 value of the social cost of carbon – at a 3% discount rate – of \$60.29 in 2018 dollars. CARB states:

Staff believes that a price ceiling below the 2030 value of \$60.39 would fail to recognize both [the social cost of carbon] and would also omit consideration of additional significant physical, ecological, and economic impacts of GHG emissions. Staff believes, however, that while new research indicates the [social cost of carbon] may be much higher, even closer to \$220, setting a price ceiling based on this research would be excessive relative to prices needed to achieve the 2030 target, and may be so high that it may lead to leakage and adverse impacts to the economy and households. Staff is proposing a price ceiling of \$61 in 2021 (real 2018 dollars), which would escalate over time. This value captures the [social cost of carbon] as established by the IWG, but recognizes that value does not represent the full social cost of carbon.¹⁰

This analysis is flawed in several respects. Most important, CARB's application of the 5% escalator results in a *2030 price ceiling of more than \$99 in 2018 dollars*. This is dramatically (roughly 66%) higher than the \$60.39 value from the IWG 2030 estimate (at 3%) that CARB identifies as its benchmark. CARB offers no rationale for setting a 2030 price ceiling at a level so far in excess of its benchmark 2030 estimate of the social cost of carbon. As discussed above, the social cost of carbon should be considered a reasonable upper bound for the price ceiling, as expenditures in excess of the social cost of carbon would impose higher costs than the benefits achieved and would thus be irrational.

Second, CARB offers no record basis to substantiate its conclusory statement that the actual 2030 social cost of carbon is much higher than its \$60.39 benchmark and certainly not that it could be as high as \$220. Recent analysis by Dr. Todd Schatzki of the Analysis Group and Dr. Robert Stavins of Harvard University shows that the central tendency of the 2030 estimates in the IWG's work is \$79 in 2030 dollars (roughly equivalent to \$61 in 2018 dollars).¹¹ This is similar to CARB's proposed IWG-derived benchmark of \$60.39 and significantly lower than CARB's proposed 2030 price ceiling. Moreover, recent work by Dr. Steven Rose of the Electric Power Research Institute (attached at Exhibits 2 and 3) recommends application of conservative minimum standards for transparency, scientific basis and justification, and plausibility of assumptions and modeling structure to the models and data underpinning the IWG estimates. Dr. Rose concludes that application of these criteria would result in an average estimate of the 2030 value of the social cost of carbon – using a 3% discount rate – of \$35 in 2007 dollars. The \$35

¹⁰ ISOR at 38-39.

¹¹ Ex. 1 at 7.

value for 2030 is consistent with the \$30 for 2020 value reflected in the exhibits.¹² Dr. Rose's 2030 value of \$35 in 2007 dollars equates to approximately \$42.61 in 2018 dollars.¹³

WSPA urges CARB to consider Dr. Rose's recommended values in identifying the 2030 social cost of carbon and to use the estimated social cost of carbon in 2030 as an upper bound for the price ceiling. Whatever value CARB elects to use in considering this statutory factor, it must defend the validity of the relevant estimate and the basis for CARB's selection of that estimate. It has not done so in the ISOR.

3. Auction Reserve Price

The most reasonable reading of AB 398's reference to the "auction reserve price" is that it is intended to establish a logical lower bound for a potential price ceiling. Indeed, if CARB were to set a price ceiling below the reserve price, the program would become unworkable, which clearly would be contrary to AB 398.

With regard to this factor (discussed at page 39 of the ISOR), CARB indicates that it has proposed to retain the 5% escalator currently in the auction reserve price and concludes that carrying forward an increasing gap between the auction reserve price and the price ceiling is appropriate for several reasons. First, the "extension of the existing structure where the Auction Reserve Price and price ceiling values do not converge . . . maintains the price signal to ensure the lowest [sic] reductions are targeted, while allowing for price discovery across a consistent range for all periods of the Program across all covered sectors. Narrowing the range for potential allowance prices over time results in the Program operating more like a carbon tax and it limits abatement potential." Further, CARB argues that this approach allows maintenance of a fixed distance between the new post-2020 cost containment points ("speed bumps") at a fixed distance from one another, rather than converging into the price ceiling.

As discussed Section I.A.5 below, there is no clear rationale for maintaining a specific "window" or delta between the floor and the ceiling. Further, CARB's Proposal does not maintain constant separation between the proposed price floor and ceiling; because of the 5% escalator, the ceiling increases at a greater rate in absolute (inflation-adjusted) terms than does the floor. To the extent CARB is concerned that too low a price ceiling will cause the ceiling to be triggered and make the program function like a carbon tax, this bears no relationship to the

¹² Exhibit 2, Steven Rose, Understanding, Improving and Using the Social Cost of Carbon at 33 (September 19, 2018).

¹³ We also note that the New York Independent System Operator (NYISO) is currently in the process of considering a "straw proposal" to incorporate the social cost of carbon into its wholesale electricity markets. In its recent draft report, NYISO used a 2030 value of \$69.32 in nominal dollars, implying a significantly lower value in 2018 dollars. See NYISO, Carbon Pricing Draft Recommendations, A Report Prepared for the Integrating Public Policy Task Force at 4 (Aug. 2, 2018), https://www.nyiso.com/public/webdocs/markets_operations/committees/bic_miwg_ipptf/meeting_materials/2018-08-27/Carbon%20Pricing%20Draft%20Recommendations%2020180802.pdf.

Auction Reserve Price per se; concern about loss of abatement under the program is misplaced, as discussed elsewhere in these comments. Finally, there are alternative approaches to design of the “speed bumps” that could avoid the convergence concern CARB identifies. And it is unclear, in any event, why this concern is raised in relation to the “auction reserve price” discussion.

Further, as discussed in Section I.D below, the auction reserve price incorporates a 5% escalator, but the rationale for including this escalator in the price floor does not apply to the setting of a price ceiling (and certainly CARB has failed to articulate why it would).

4. Adverse Impacts on Resident Households, Businesses, and the State’s Economy and Potential for Environmental and Economic Leakage

The “need to avoid adverse impacts on resident households, businesses, and the state’s economy” and the “potential for environmental and economic leakage” both militate in favor of a lower price ceiling. These factors accordingly provide grounds for deviating below the social cost of carbon and the 2020 tier prices. The objective of a price ceiling is to ensure that compliance costs – and the resulting impacts on households, businesses, and the State’s economy – do not exceed a predetermined limit. Other things being equal, the higher the price ceiling the more likely the environmental and economic leakage; as allowance prices and in-state economic impacts increase, economic activity and associated emissions will move out of state.¹⁴

CARB briefly considers the application of these two factors, in conjunction, to the price ceiling at pages 33-34 of the ISOR. It states that “in advance of widespread carbon pricing and deployment of GHG reducing technologies, California businesses may be more sensitive to potential emissions leakage,” and that “[t]his concern supports the selection of a price ceiling path below the single tier Reserve value in the early 2020s.” It goes on to state that “the price ceiling cannot be set to so low that covered entities’ primary compliance strategy is to make substantial and continued use of the price ceiling units”

This cursory analysis gives no consideration at all to the interpretation of “adverse impacts on resident households, businesses, and the state’s economy” or to how the proposed *price ceiling level and design* affects this factor. With regard to environmental and economic leakage, CARB correctly identifies that a higher initial cap would be more likely to result in leakage. But it does not provide any analysis of the 5% escalator or the overall proposed price ceilings may impact leakage – nor what role this factor plays in its selection of the proposed level and design in lieu of alternative options.

As discussed further in Section I.C below, CARB offers virtually no analysis of these factors in the ISOR or the Standardized Regulatory Impact Analysis (“SRIA”). It provides little to no discussion or analysis of the incremental economic impact of the proposed price ceiling on consumers, businesses, or the state’s economy, and no discussion of critically important issues such as gasoline prices. Nor does it conduct any analysis at all of the risk of economic and environmental leakage associated with its Proposal, nor does it comparatively analyze alternative

¹⁴ Ex. 1 at ES-2.

ceiling designs. In short, the Board has not adequately “considered” either of these two factors – and it certainly has not met its legal obligation to do so based on the “best available science” or the “best available economic and scientific information.”

5. The 2020 Tier Prices of the Allowance Price Containment Reserve

AB 398’s reference to consideration of the “2020 tier prices” of the APCR refers to the three-tier APCR structure. This factor should be understood to reflect a benchmark for continuity with the pre-2021 program and a potential alternative upper bound for the price ceiling. The prices for the three tiers of the APCR in 2020 are (in 2018 dollars): \$59.82 for Tier 1, \$67.32 for Tier 2, and \$74.89 for Tier 3.¹⁵ The Legislature specifically directed CARB to consider the “2020 tier prices” (plural) – indicating that it was to consider *the three tiers* of APCR prices and the specific prices *in 2020*, rather than considering only the tier 3 price (singular), the “single-tier” price (singular) CARB established for 2021 and later under the current Regulation, or any *projection* of post-2020 APCR prices. Furthermore, the 2020 APCR tier 3 price is already well in excess of any reasonable estimate of the 2020 social cost of carbon, indicating that this price should not be the basis for selecting the price ceiling.

CARB discusses its interpretation of this factor at pages 34-35 of the ISOR. CARB’s discussion focuses on two points it deems relevant to setting the price ceiling:

- First, the amendments to the Regulation that were adopted in 2017 “provided a framework for the post-2020 period of the Regulation and extended the upper bound of price expectations. . . . To maintain continuity for entities’ assessments of the value of GHG reduction investments, staff set the proposed price ceiling at a level that roughly maintains the ‘window’ that would have been provided by the [post-2020] single Reserve tier above the Auction Reserve Price.” The ISOR then appears to suggest a rough equation of the delta between the 2015 floor price and tier 3 price, the delta between the 2021 floor price and projected single tier APCR price (under the current Regulation), and the delta between the 2025 floor price and proposed price ceiling.
- Second, “[m]aintaining continuity of expectations is also important because some covered entities have already taken early action to reduce GHGs. Setting the price ceiling at a level significantly below the third tier of the current Reserve and single tier post-2020 Reserve price would create a precedent of devaluing early action. Covered entities’ future expectations of the full range of potential allowance values, as well as their expected potential rate of return for their GHG reduction investments, would be undercut by anticipation of the potential for future regulatory revisions that might significantly decrease the price ceiling.”

¹⁵ Calculated based on 2018 APCR prices of \$54.26, \$61.06, and \$67.93, and adding the 5% annual increase provided for in the Regulations with no adjustment for CPI.

This interpretation and application of the “2020 tier prices” factor is inconsistent with the statute and irrational for several reasons.

First, the Legislature directed that CARB consider “[t]he 2020 tier prices.” As noted above, this suggests that CARB is to consider all three tiers of prices in 2020. CARB’s focus on tier 3 and its projection of post-2020 single tier prices is inconsistent with the statute.

Second, there is no empirical or theoretical basis for the notion that businesses make or have made GHG reduction investment decisions based on the *delta* between the floor price and the tier 3 APCR price.

Third, current allowance prices are comparatively low, CARB amended its Regulation to establish post-2020 single tier reserve prices very recently, and the Legislature enacted AB 398 (which calls for the establishment of an entirely new cost containment regime) almost immediately thereafter. Accordingly, there is no basis for the notion that businesses have made or are making GHG reduction investments based on expectations regarding the 2020 tier 3 APCR price, and certainly not based on projected single tier APCR prices for the post-2020 period. In fact, this assertion is absurd as the widespread consensus among members of industry is that, if allowance prices reach levels anywhere close to the tier 3 of the APCR, the resulting impacts on energy prices, including the price of a gallon of gasoline, will result in widespread voter revolt, which will inevitably prompt the Governor to suspend and the Legislature to terminate the Cap-and-Trade Program. These events will not only adversely impact the environment and California’s leadership position in setting environmental policies globally, but it will frustrate industry’s long-term investments in the Cap-and-Trade Program.

Finally, while CARB’s proposed price ceiling *starts* below the 2020 tier 3 price, it significantly exceeds CARB’s projected post-2021 single tier APCR prices from 2028 onward – including by roughly \$10 in 2030. This is inconsistent with CARB’s purported rationale of maintaining continuity of expectations with regard to the upper range of prices and with regard to the delta between the reserve price and the price ceiling.

6. Cost Per Ton to Achieve the 2020 and 2030 Targets

The final factor – the “cost per metric ton of greenhouse gas emissions reductions to achieve the [2020 and 2030] statewide emissions targets” – is relevant insofar as it provides insight on likely allowance prices associated with meeting the cap, and the probability that a given price ceiling in a given year will or will not be triggered. It is important to remember, however, that AB 398 requires that if the ceiling is triggered, the revenues from sales of price ceiling allowances will be used to achieve ton-per-ton reductions outside of the cap, helping to ensure the overall environmental performance of the program. The objective of the price ceiling, moreover, is to ensure that program costs do not exceed an acceptable maximum level. It would be irrational, accordingly, to suggest that the price ceiling should be set above any possible cost per metric ton of abatement, ensuring that the ceiling could never be triggered. Rather, the ceiling must be set at a level reflecting an acceptable maximum level of costs in light of the six factors.

In discussing this factor (at pages 39-40 of the ISOR), CARB appears to identify the need to “stri[k]e a balance between being high enough to allow for a sufficient volume of reductions to occur to meet the 2020 and 2030 targets, and being low enough to meet the AB 398 objectives of minimizing leakage and minimizing adverse impacts to households, businesses, and the California economy.” CARB then states, however, that “[c]ost containment *cannot* interfere with the Cap-and-Trade Program’s ability to deliver the GHG reductions needed to achieve the statewide GHG reduction targets. . . . Staff believe the proposed price ceiling will improve the likelihood of meeting the 2030 target, while addressing concerns of cost containment through a variety of *other design features* in the Program, such as the two Reserve tiers, banking, and multi-year compliance periods.” (emphasis added)

This discussion reflects an unreasonable interpretation and application of this factor. First, under CARB’s reading of the statute, the price ceiling must be set high enough *never* to be triggered (thus avoiding any interference with achievement of the 2020 and 2030 targets) and cost containment concerns must be addressed through *other* design features of the overall cap-and-trade regime. This proposed approach would lead to the conclusion that CARB can and should set the price ceiling as high as possible to avoid triggering it, and that CARB’s consideration of other statutory factors in setting the price ceiling – such as adverse economic impacts – is largely irrelevant. That cannot be a permissible reading of the statute. Further, CARB’s consideration of this factor does not appear to be based on any actual analysis of the estimated cost per ton needed to achieve the 2020 and 2030 targets, or how this relates to CARB’s proposed price ceiling. CARB’s cursory reference to the 2017 Scoping Plan analysis of the likelihood that the existing program will achieve the required reductions does nothing to remedy this glaring gap in its analysis. In short, CARB’s interpretation and application of this factor is unreasonable and should be remedied through actual analysis of the cost per ton of achieving the 2020 and 2030 targets and how this may impact consideration of the price ceiling level and design.

C. CARB’s Proposal Is Not Based on A Reasonable Analysis of Options in Relation to the Statutory Factors

CARB must demonstrate that the ceiling it selects (including both the proposed level and any rate of increase) represents a reasonable balancing of the tradeoffs between the statutory factors. To do so, CARB must identify reasonable alternative approaches and analyze the comparative impacts of these approaches on the six statutory factors. Absent such an analysis, CARB’s selection of a ceiling price (and any rate of increase) would necessarily fail to “adequately consid[er] all relevant factors, and . . . demonstrat[e] a rational connection between those factors, the choice made, and the purposes of the enabling statute.” *American Coatings Ass’n, Inc. v. South Coast Air Quality Dist.*, 54 Cal. 4th 446, 461 (2012). Further, under the California Administrative Procedure Act, CARB is required to make a “*reasoned* estimate of all cost impacts of the rule on affected parties.” *W. States Petroleum Assn. v. Bd. of Equalization*, 57 Cal. 4th 401, 408–09 (2013). Reliance on “[m]ere speculative belief” or a demonstrably invalid analytical methodology fails to meet this requirement. *Id.* at 428.

CARB’s Proposal includes no reasoned analysis linked to the statutory factors it is required to consider in setting the price ceiling. As explained above, the narrative discussion of

the factors in the ISOR is cursory, incomplete and arbitrary, does not address alternative ceiling levels or designs, and does not analyze the comparative impacts of alternative designs on the statutory factors. Nor does the SRIA address this. The SRIA purports to analyze three alternatives: The proposed level (2021 level of \$61 + 5% escalator), Alternative 1 (2021 level of \$78.52 + ~12.5% escalator), and Alternative 2 (2021 level \$50 + maintain \$33.18 difference from floor price in each year; equivalent to approximately 1.9% escalator). There are several problems with this analysis, however, that render it uninformative with regard to how best to balance among the six statutory factors in selecting a price ceiling level and design.

First, the SRIA does *not* analyze the projected economic impacts of the Alternatives in relation to an analysis of available emission mitigation options and costs. Instead, CARB's analysis appears to assume that the pre-selected price ceiling is triggered in 2030 and that allowance values increase from 2020 to 2030 on a path consistent with triggering the ceiling in 2030. CARB's analysis appears to quantify the economic impacts that would result under such assumptions. But such an analysis is entirely divorced from any consideration of estimated abatement costs, how those would affect allowance values, and whether and when these alternative price ceilings would therefore be triggered. As a result, the SRIA provides no reasoned analysis with regard to how the economic impacts of these alternatives are likely to vary. Accordingly, they provide little or no insight in how best to balance or apply the statutory factors.

Second, even if the SRIA did provide a reasoned analysis of the economic impacts of the Alternatives considered (which it does not), it does not analyze or discuss the relationship between any such analysis and the six statutory factors. There is no discussion or analysis in either the SRIA or the ISOR's main text of how the "potential" economic impacts identified would affect the specific factors for consideration.

Third, there is not a reasonable relationship between the SRIA's (deficient) analysis and the policy option CARB has proposed. Based on the assumptions discussed above, CARB estimates that Alternative 1 (the high 2021 price ceiling + higher escalator) would result in \$13.8-27.9 billion more costs to industry than the proposed alternative, as well as related impacts to state GDP and employment.¹⁶ CARB estimates that Alternative 2 (the lower price ceiling + lower escalator) would result in \$5.1-19.2 billion *lower* costs to industry, as well as related decreases in the impacts to state GDP and employment.¹⁷ Other things being equal, therefore, the analysis (if valid) would indicate that Alternative 2 would be superior to CARB's Proposal –

¹⁶ These numbers are drawn from the June 2018 SRIA at pages 58-59. The September 4, 2018 updated SRIA does not report estimated costs relative to *the proposed amended regulation*, but reports (at page 75) the same estimated cost of Alternative 1 *relative to the current regulation*, as does the June 2018 version (\$28 billion).

¹⁷ These numbers are drawn from the June 2018 SRIA at page 64. The September 4, 2018 updated SRIA does not report estimated costs relative to *the proposed amended regulation*, but reports (at page 81) the same estimated cost of Alternative 1 *relative to the current regulation*, as does the June 2018 version (\$5 billion).

in that it would have lower “adverse impacts on resident households, businesses, and the state’s economy” and correspondingly lower “environmental and economic leakage.”

The final paragraph of the SRIA, however, states:

The price ceiling in Alternative 2 may be too low to incent the abatement technologies described in Table 22 to achieve the GHG reductions necessary to achieve the State’s 2030 reduction target. To achieve the 2030 GHG reduction target, the program may then have to rely on the metric ton for metric ton reductions CARB identifies to sell at the price ceiling and implement the types of measures included in Alternative 1 in the 2017 Scoping Plan to ensure the 2030 target is achieved. Therefore, Alternative 2 does not appear to be a viable alternative to the Amended Regulation.¹⁸

Table 22 presents ranges of estimated abatement costs for several technologies with applications in California’s industrial sectors (including carbon capture and sequestration, concentrated solar thermal, biogas, boiler electrification, hydrogen electrolyzer, and cement sector technologies).

Again, however, CARB provides no actual modeling or analysis of estimated costs of achieving the 2030 emissions target. Any such analysis, among other things, should take appropriate account of reference case emissions, the full range and estimated costs of abatement opportunities in all covered sectors, and the availability of offsets and other compliance flexibilities. Absent such analysis, there is no rational relationship between the abatement cost ranges in Table 22 and any conclusion regarding the likelihood that the price ceiling would be triggered. Among other things, CARB has not established any analytical basis for concluding that the Alternative 2 price ceiling would not provide a price signal adequate to achieve the 2030 reduction target. In fact, it has not established any benchmark at all for what carbon price may be necessary to achieve the target. Furthermore, as discussed above, the cost per ton needed to achieve the target is only one of the statutory factors, and CARB has not explained why this factor should outweigh the others in determining what price ceiling to select.

Finally, all three of CARB’s alternatives involve use of an escalator, which appears to range from 1.9% to 12.5%. As discussed below, the use of an escalator appears to be arbitrary and not supported by economic theory or any reasonable policy justification. CARB should consider alternatives that do not include an escalator.

D. The Proposed Five Percent Annual Price Escalator Is Arbitrary and Unreasonable

CARB’s proposed price ceiling has two features: the starting level and the 5% annual escalator (in addition to the rate of inflation). While the two features work in tandem, the compounding escalator is independently problematic, because it results in an increase of over 60% in the inflation-adjusted value of the ceiling over the course of the 2021 to 2030 period.

¹⁸ September 4, 2018 Updated SRIA, at 84.

The effect of the escalator is to make the ceiling less and less effective as a backstop price containment mechanism over time, implying a greater and greater tolerance for potential adverse economic impact over time. CARB has offered no rationale or justification for this arbitrary annual increase in the ceiling, and economic theory offers none.

It is important to note that the escalation rate in the current Regulation's single price tier is approximately 1.3%. CARB has not offered any explanation for why the 5% escalator is nevertheless appropriate in setting the ceiling.

As discussed above, to the extent CARB seeks to justify the 5% escalator based on maintaining a certain "window" between the price floor and the price ceiling, this rationale appears to be arbitrary and unjustified. The value of the "window" concept itself is questionable, but even if CARB wanted to maintain a defined spread between the floor price and the ceiling price, it could structure the ceiling to maintain the absolute distance (in constant dollar terms) between them, rather than applying the same percentage-based escalator, which has the effect of widening the gap over time.

It may be that CARB simply intends to mirror the 5% annual escalator in the inflation-adjusted auction reserve (floor) price. The rationale for including this escalator in the floor price, however, appears to be to reflect firms' internal discount rate for the investment of capital – which is typically benchmarked in the 4-5% range. If the real rate of growth in the floor price were not at least as great as this internal discount rate, firms might be incentivized to purchase and bank additional allowances in each year because the rate of return on investment in allowances would be greater than that for alternative investments. This same rationale does not apply to the price ceiling, and accordingly, this is not a defensible rationale for applying the escalator to the ceiling.

In summary, CARB has not provided any justification for the 5% escalator, and WSPA urges the Board to eliminate this arbitrary and unreasonable feature of the proposed price ceiling.

E. CARB's Proposal Will Prevent Linkage with Other Jurisdictions

In addition to the specific factors identified in AB 398, AB 32 directs that CARB shall consult with other states, the federal government, and other nations "to facilitate the development of integrated and cost-effective regional, national, and international greenhouse gas reduction programs."¹⁹ This directive, to develop regulations in a manner that facilitates linkage with the market-based mechanisms of other jurisdictions, applies equally to CARB's design of the price ceiling. Further, facilitation of linkage supports and is consistent with AB 32's overall and repeated direction that CARB's regulations ensure that the program is "cost effective." "As entities buy and sell across programs, allowance prices converge, which lowers economic costs of reducing GHG emissions by harmonizing the GHG price signal across a broader area."²⁰

¹⁹ Cal. Health & Safety Code § 38564.

²⁰ Ex. 1 at 8.

CARB's proposed price ceiling, if adopted, is so high that it will pose an insurmountable barrier to linkage with other programs. As Dr. Schatzki and Dr. Stavins emphasize, other jurisdictions will be "less willing to link with another system if the Price Ceiling is set at a level that is inconsistent with the [other jurisdiction's] policy objectives."²¹ CARB's proposed price ceiling is dramatically higher than current or projected allowance prices in other jurisdictions in North America, as well as in Europe. If it were to adopt the proposed ceiling, this would likely become a serious obstacle to linkage—directly contravening AB 32's directive. CARB has not analyzed this factor or taken it into account in its Proposal, as required by law; WSPA urges it to do so in adopting its final price ceiling.

II. CARB LACKS STATUTORY AUTHORITY OR POLICY JUSTIFICATION FOR RETIRING OR DISCOUNTING ALLOWANCES IN THE MARKET

AB 398 directs CARB to "[e]valuate and address concerns related to overallocation in [CARB's] determination of the number of available allowances for years 2021 to 2030, inclusive, as appropriate." The ISOR (at page 24) states:

AB 398 also directed CARB to address concerns related to possible "overallocation" for the years 2021 to 2030 and to establish allowance banking rules that discourage speculation, avoid financial windfalls, and minimize volatility. CARB has analyzed and sought public comment on these issues through four informal public workshops leading up to this formal amendment process. As a result of this process, staff has found that for these items there is no need to make specific changes to the Regulation.

Appendix D to the ISOR further states (at page 3):

[S]taff found that the currently established caps would constrain GHG emissions from 2013 through 2030. This in turn would support a steadily increasing carbon price signal to prompt the needed actions to reduce GHG emissions. The results of this evaluation show that while there may be unused allowances in the early years of the Program, the design features of the Program and the established declining caps reinforce a steadily increasing carbon price signal through the next decade.

The Appendix D analysis concludes (at page 15-16):

Based on staff and third-party analyses, it is expected that allowance prices will continue to steadily increase in the next decade. Any proposal to remove allowances from the system must acknowledge that the result will be higher allowance prices, reached sooner, than would result from the proposed amendments to the Regulation. . . . [I]n addition to the Cap-and-Trade Program, we need to track all of the policies and sectors to ensure we stay on

²¹ *Id.* at 9.

track with the reductions needed to meet our targets and, if necessary, make adjustments.

If it appears statewide emissions are not declining as needed, recognizing that year-to-year variability due to climate, global fuel prices, or economic factors can influence emissions, CARB staff will evaluate which sectors are not responding as anticipated, review all programs that cover those sectors, and ascertain why, as well as assessing the best path forward to ensure California stays on track to meet its legislatively established GHG targets.

WSPA supports CARB's determination that stakeholder concerns regarding "overallocation" do not justify any changes to the Regulation. Further, as set forth below, CARB lacks legal authority to reduce or discount allowances on this basis. The comments below relating to performance targets and overallocation are intended to proactively respond to arguments advanced by other commenters that an oversupply exists and may impair the Program's ability to achieve the State's climate goals.

A. Background on the Performance Targets

1. California's GHG Emissions Targets for 2020, 2030, and 2050

AB 32, enacted in 2006, requires CARB to set a "statewide greenhouse gas emissions limit" equivalent to the state's GHG emissions level in 1990 and "to be achieved by 2020" (the "**2020 Target**").²² However, AB 32 does not identify this 2020 Target itself as a mandatory annual limit; rather, it refers to the 2020 target in the broader context of ongoing reductions, *i.e.*, as a tool to "be used to maintain and continue reductions in emissions of greenhouse gases beyond 2020."²³ Consistent with this understanding, California courts have interpreted the 2020 Target in terms of longer-term objectives as well. For example, the California Court of Appeals stated in *Association of Irrigated Residents v. Air Resources Board* that the 2020 Target "is but a step towards achieving a longer-term climate goal," noting approvingly that "[CARB] sought to define in the scoping plan measures that will permit the state to reach goals that are attainable by 2020, as a step toward the ultimate objective by 2050."²⁴

In 2016, the Legislature adopted SB 32, expanding upon the 2020 Target by requiring CARB to adopt regulations "ensur[ing] that statewide [GHG] emissions are reduced to at least 40 percent below the statewide [GHG] emissions limit no later than December 31, 2030 (the "2030 target").²⁵ Notably, the 2030 target originated in a 2015 Executive Order issued by Governor Brown, which set an emissions reduction goal of 40% below 1990 levels in 2030 as an "interim"

²² AB 32 § 38550.

²³ AB 32 § 38560.5(c), 38562(a).

²⁴ 206 Cal. App. 4th 1487, 1496 (2012).

²⁵ SB 32 § 38566.

target on the path to achieving the 2050 emissions goal set in 2005 by Governor Schwarzenegger.²⁶

2. Methods of Achieving the 2020 and 2030 Targets

As noted above, AB 32 requires CARB to adopt “[GHG] emission limits and emission reduction measures by regulation to achieve the maximum technologically feasible and cost-effective reductions [“MTFCER”] in [GHG] emissions in furtherance of achieving the [2020 Target].”²⁷ The requirement that GHG reductions be achieved in a cost-effective manner is reiterated ten times in different sections of the legislation, including in reference to the adoption of rules and regulations, approval of the scoping plan, and the adoption of the Program.²⁸ AB 398, adopted in 2017, reiterates the importance of cost effectiveness particularly with regard to distribution of emissions allowances, requiring CARB to “[d]esign the regulations, including distribution of emissions allowances . . . in a manner that is equitable [and] seeks to minimize costs and maximize the total benefits to California”²⁹ This demonstrates that cost-effectiveness is not a mere afterthought or subsidiary policy objective; to the contrary, it is a core statutory directive.

However, CARB is given significant flexibility with regard to how it achieves MTFCER, and clearly has the flexibility to evaluate compliance with those targets without focusing myopically on specific emissions levels in any single year. Indeed, AB 398 permits CARB to evaluate the Cap-and-Trade Program’s emission reductions “in the aggregate” rather than focusing on reductions achieved in any specific year.³⁰ For example, AB 32 states that CARB *may*, not must, “adopt a regulation that establishes a system of market-based declining annual aggregate emission limits for sources or categories of sources that emit greenhouse gas emissions.”³¹ Thus, while MTFCER is a clear statutory imperative, an annually declining emissions cap is a policy choice given to CARB.

AB 32 also specifically gives CARB the option of including a “market-based compliance mechanism” (an “MBCM”) in the Regulations adopted in furtherance of MTFCER.³² An MBCM is defined as either:

1. “A system of market-based declining annual aggregate emissions limitations for sources or categories of sources that emit greenhouse gases.”; or

²⁶ Executive Order B-30-15 (April 29, 2015).

²⁷ AB 32 § 38562(a).

²⁸ AB 32 §§ 38560, 38561(a), 38562(c).

²⁹ AB 398 § 38562(b)(1).

³⁰ AB 398 § 38562(c)(2).

³¹ AB 32 § 38562(c).

³² AB 32 § 38562(c).

2. “Greenhouse gas emissions exchanges, banking, credits and other transactions, governed by rules and protocols established by the state board, that result in the same greenhouse gas emission reduction, over the same time period, as direct compliance with a greenhouse gas emission limit or emission reduction measure adopted by the state board pursuant to this division.”³³

Thus, CARB may include either a system of declining annual aggregate emissions, GHG emissions credit trading, or both. The reference to achieving reductions “over the same period” in the second definition for MBCM is ambiguous as to whether the applicable period must be the period in which the declining emission limits are given (*i.e.*, year-by-year) or whether the period can be the life of the Program. However, the inclusion of “banking” in the definition implies that the Legislature specifically contemplated that GHG emissions authorized in an early year of the Program could be surrendered in a later year, in addition to emissions authorized for such a later year by CARB.

The Program does, in fact, establish a “declining annual aggregate emission limit” in the form of the cap, which declines every year, and the emissions reductions reflected in the cap (as extended under AB 398) comply with both the 2020 Target and the 2030 Target. Accordingly, if the integrity of the cap is preserved (*i.e.*, compliance entities are forced to meet their compliance obligations), the declining annual emissions limits (and hence, the Targets) are arguably reached even if the surrender of banked allowances results in emissions in 2020 or 2030 greater than the applicable limit.

B. Removing Allowances from the Program to Address “Overallocation” Concerns Is Neither Necessary Nor Permitted

In the period between the passage of AB 398 and issuance of the Proposed Regulations, some commenters have suggested that the Program will be oversupplied in 2021-2030 on the basis of a prediction that compliance entities will retire extra allowances to satisfy emission reduction targets, rather than reduce their own emissions.³⁴ These commenters have suggested that reducing the number of allowances in the program may be an effective way to correct this “oversupply.” However, there is no evidence that oversupply or overallocation is currently an issue in the Program or will be an issue in 2030. CARB’s own analysis of allowance budgets from 2021 to 2030 noted that “CARB staff and third-party analysis all indicate that the market from 2013 through 2030 is not *overallocated* with allowances and that cumulative supply will be

³³ *Id.*

³⁴ See, e.g., Chris Busch, “Oversupply Grows in the Western Climate Initiative Carbon Market,” Energy Innovation: Policy & Technology LLC (Dec. 2017); Legislative Analyst’s Office, “Cap-and-Trade Extension: Issues for Legislative Oversight” (Dec. 12, 2017); Danny Cullenward, “Critical issues in post-2020 cap-and-trade market design: Hot air and carbon offsets,” *Climate Policy* (June 23, 2017), <https://static1.squarespace.com/static/549885d4e4b0ba0bff5dc695/t/5952c7436b4998a9abdce3dc/1498597187813/Hot+air+and+offsets.pdf>.

below demand.”³⁵ Moreover, CARB lacks statutory authority to remove allowances from the Program. Concerns about “overallocation” are essentially concerns about “banking,” which refers to the ability of covered entities in the Program to hold onto allowances received or purchased in one compliance period for use in future compliance periods. Commenters have expressed concern that entities can avoid reducing emissions in the future by banking allowances today and retiring them in the future as the cap declines.

1. The Program Was Designed to Include Banking as A Method of Achieving MTF CER

But far from being an unanticipated problem, CARB specifically designed the program to allow banking of allowances for future use beginning with the first iteration of the Regulation issued in 2010. This decision was consistent with the recommendations of the Market Advisory Committee (the “Committee”) created by the California Secretary for Environmental Protection, which issued recommendations on design of the Program, including a recommendation to “allow for unrestricted allowance banking.”³⁶ The Committee’s recommendations were echoed by the California Climate Change Center at UC Berkeley, which recommended allowing the use of unlimited banking in order to “reduce[] the overall cost of emission reductions and help[] to avoid short-run volatility in allowance prices.”³⁷ Experienced environmental groups also have supported banking as a cost-effective method of maximizing GHG emissions reductions.³⁸

In allowing banking, CARB was applying the lessons of the EU-ETS, which saw a collapse in allowance prices during the first phase because of the inability of participants to bank allowances (because unused allowances would have no value after expiration of the compliance period). Closer to home, the Committee noted that the RECLAIM program likely would have resulted in earlier implementation of post-combustion NOx controls had banking been allowed.³⁹

Banking also facilitates achievement of the statutory directives of AB 32. For example, the Committee’s Recommendations noted that banking encourages early action, reduces cumulative compliance costs and promotes early investment in emissions reductions:

³⁵ 2018 ISOR, Appendix D at 14.

³⁶ CARB, Market Advisory Comm., Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California at 13, June 30, 2007 (the “Recommendations”), <https://www.energy.ca.gov/2007publications/ARB-1000-2007-007/ARB-1000-2007-007.PDF>.

³⁷ Dallas Burtraw et. al., Chapter 5: Lessons for a cap-and-trade program at 5-38, The California Climate Change Center at UC Berkeley, <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.565.3718&rep=rep1&type=pdf>.

³⁸ See, e.g., Nathaniel Keohane, “How cap and trade works,” Environmental Defense Fund, <https://www.edf.org/climate/how-cap-and-trade-works> (last visited Oct. 22, 2018) (banking “increases the pool of available capital to make reductions, encourages companies to cut pollution faster, and rewards innovation.”).

³⁹ Recommendations at 13.

Banking allows entities to over-comply in an early phase of program implementation and save allowances for surrender or trade in future compliance periods. This improves environmental performance by achieving reductions earlier; it also reduces cumulative compliance costs by creating an incentive for early over-compliance by entities that have low near-term marginal abatement costs. By providing flexibility, banking reduces price volatility and thereby promotes investments that provide deeper reductions in the near term. The Committee acknowledges these favorable properties of banking and supports a program with unlimited banking. That is, the Committee believes that allowances that are not submitted in a given period should qualify for use in any future period.⁴⁰

This reasoning was echoed by CARB staff, which listed banking as one of four cost-containment mechanisms included in the Program to ensure MTF CER in its initial statement of reasons for the 2010 rulemaking (“**2010 ISOR**”).⁴¹ The 2010 ISOR further notes that banking “provides an incentive for covered entities to make early reductions since the declining cap could push allowance prices higher over time.”⁴² In contrast, CARB considered and rejected an alternative rule allowing no banking because “it provides no financial or environmental benefits and would not necessarily increase the environmental integrity of the program.”⁴³

2. Banking Will Not Affect the Program’s Ability to Achieve the 2020 and 2030 Targets

As economists generally recognize, a multiyear program that allows banking by definition will not ensure compliance with a specific annual cap in a specific year. AB 32 and AB 398, however, both expressly authorize CARB to design the Cap-and-Trade Program to achieve “the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions, *in the aggregate*.”⁴⁴ As CARB explained in its initial rulemaking for the Program, in a program that allows allowance banking, “program stringency is best evaluated by considering all years” of the program rather than just the final year of the program.⁴⁵

Moreover, as discussed above, this potential result was not unanticipated by CARB. Indeed, in recommending unlimited banking be included in the Program, the Committee acknowledged that “[w]hile the number of emission allowances issued in 2020 will be set equal to 1990 emissions, it should be noted that actual emissions in any given year may be higher or lower than the number of allowances issued in that year because of banking and other flexibility

⁴⁰ Recommendations at 66.

⁴¹ 2010 ISOR at 14.

⁴² *Id.* at 34.

⁴³ *Id.* at 130.

⁴⁴ AB 398 § 38562(c)(2) (emphasis added).

⁴⁵ 2010 ISOR at 165.

provisions included in the program design. The opportunity for banking can lead to over-compliance in the early years of the program and can help bring technologies into the market.”⁴⁶ In other words, banked allowances represent early reductions in excess of those required by the declining cap and are beneficial to the Program. For this reason, the Committee noted that the Program will still deliver real emissions reductions, provided that the cap is set at a level below the then-current level of emissions.⁴⁷

The concern about stockpiling allowances follows directly from an unjustified assumption that the Program will end in 2030. If the Legislature decided to cancel the Program in 2030, compliance entities would be incentivized to “cash in” all of the allowances they have held up to that date because they will have no compliance value afterwards. But if the Program is not discontinued, surrendering all of an entity’s banked allowances to hit an interim 2030 target will turn out to have been a poor compliance strategy. Entities that have opted to invest in stockpiling allowances early rather than investing in sustainable emissions reductions strategies may face skyrocketing compliance costs once they exhaust their reserves of banked allowances. Other entities that have reduced their emissions will have a smaller allowance purchasing requirement going forward, but entities that have relied on stockpiling would likely continue to have high emissions and have no choice but to purchase allowances at 2031 prices.

But if compliance entities would be imprudent to base their compliance strategies on an assumption that the Program will not continue past 2030, it would be even more unjustified for CARB to issue regulations governing the Program on that basis, because there is every reason to believe at this point that the Program will continue. For example, Executive Order S-03-05 establishes an ambitious GHG reduction target of 80 percent below 1990 levels by 2050. CARB has treated both the 2020 and 2030 Targets as steps towards that ultimate goal, rather than as isolated goals in themselves. The current Regulations governing the Program establish annual budget years for the Program through 2050. Likewise, the recent Scoping Plan update frames the 2030 Target as a stepping stone toward achieving the 2050 GHG emissions goal.

3. Removing or Discounting Allowances from the Program or Disallowing Banking Would Be Contrary to Law

No California statute authorizes CARB to remove allowances from the Program or to remove or disallow the use for compliance purposes of allowances already issued within the Program. But more fundamentally, CARB lacks authority to remove allowances or prohibit banking, because doing so would violate AB 32’s statutory directive to design the Regulations “in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions.”⁴⁸

The effect of removing allowances from the market now to address a perceived “oversupply” would be to reverse course on CARB’s prior policy decision to allow banking – a

⁴⁶ Recommendations at 21 n.8.

⁴⁷ *Id.* at 12.

⁴⁸ AB 32 § 38562(a)(1).

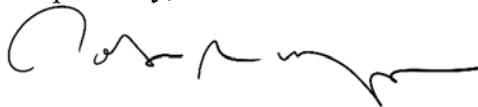
drastic course of action. Rather than encourage early action to reduce GHG emissions, as required by statute, removing allowances would punish market participants who made early reductions by tightening the market and creating the risk of higher compliance costs in the future. This action would also violate the statutory mandate to distribute emissions allowances “in a manner that is equitable.” It is simply unfair to set market expectations that influence purchasing decisions and then reverse the rules that formed the basis of those decisions.

Removing allowances ultimately may not guarantee a certain quantity of emissions in the Program, but as commenters have noted, it would make it more likely that allowance prices would hit the price cap.⁴⁹ This outcome is inconsistent with CARB’s statutory obligations to achieve cost-effective reductions, particularly because there is no guarantee that pushing the price to the ceiling more quickly will keep emissions below the cap at any given point in time.

* * * * *

In summary, WSPA urges CARB to change its proposed price ceiling to reflect a reasonable interpretation and application of the relevant statutory factors, consistent with the approach advocated above. WSPA requests that CARB conduct a full and transparent analysis of the impacts of alternative policy designs on each of the factors, eliminate the 5% escalator for the price ceiling, and adopt a price ceiling that does not exceed a reasonable estimate of the social cost of carbon in 2030. Further, WSPA urges CARB to uphold its proposal not to make changes to the Program based on purported concerns with “overallocation” and to reject any calls to reduce or discount allowances based on such concerns.

Respectfully,



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⁴⁹ Severin Borenstein and Jim Bushnell, “California’s Carbon Cap is Not in Jeopardy, Because It’s Not Really a Cap,” *Energy Institute at Haas* (January 3, 2018), <https://energyathaas.wordpress.com/2018/01/02/californias-carbon-cap-is-not-in-jeopardy-because-its-not-really-a-cap/>.