September 19, 2016

Richard Corey
Executive Officer
California Air Resources Board
1001 I Street
Sacramento, CA 95812-2828

RE: California Joint-Utility Group Comments on the Cap-and-Trade Regulatory Amendments

Mr. Corey,

Introduction

The California Joint-Utility Group ("JUG")[1] respectfully submits its comments to the California Air Resources Board ("ARB") on its Proposed Amendments to the California Cap-and Trade Regulation ("Proposed Regulation Order"). The JUG appreciates the continued opportunity to work with ARB staff on improving the cap-and-trade regulation and extending the program beyond 2020. The Joint-Utility Group offers comments on the following six themes:

1. **The Joint-Utility Group supports a well-designed Cap and Trade program to help the state achieve its post-2020 goals.**
2. **Continuation of the customer 'cost burden' principle past 2020 is the right approach to determining utility allowance allocations, but the application of that principle should be broadened.**
3. **Cost containment should continue to be an important element of market design.**
4. **Regulatory certainty is necessary to guide investment and recognize ongoing utility efforts to reduce emissions, such as the RPS Adjustment and Voluntary Renewable Energy (VRE) Program**.
5. **Meaningful linkages with other jurisdictions should be pursued.**
6. **Inter-agency coordination is necessary to ensure that policies seeking to reduce greenhouse gases from the electric sector are complementary.**

[1] Southern California Edison, Pacific Gas & Electric Company, San Diego Gas and Electric, Los Angeles Department of Water and Power, Sacramento Municipal Utility District, Southern California Public Power Authority, Northern California Power Agency, California Municipal Utilities Association, Turlock Irrigation District, Modesto Irrigation District, M-S-R Public Power Agency

Many of the regulatory changes in the proposed regulation order are discussed as they relate to these themes in the following sections.

Key Themes

Key theme: The Joint Utility Group supports a well-designed Cap and Trade program to help the state achieve its post-2020 goals. A well designed market mechanism can keep total program costs down while achieving environmental goals. JUG generally supports the Cap-and-Trade program extension as proposed since the market design includes mechanisms to control costs including the use of offsets, appropriate linkages with other jurisdictions, and the continuation of the Allowance Price Containment Reserve (APCR). The JUG supports additional consideration of cost containment measures that will ensure market continuity and continued access to APCR allowances at a reasonable and sustainable cost.

Also, while ARB's post-2030 annual cap-setting methodology seems reasonable at this time, the JUG believes that a review process should be put into place in the Scoping Plan Update to monitor program costs and feasibility going forward considering the large degree of uncertainty that exists when considering California's multi-decade effort to reduce greenhouse gases. A cap-setting methodology post-2030 has the benefits of allowing California to use the Cap and Trade program as the primary means of compliance with the Federal Clean Power Plan, and provides the opportunity to borrow from future years for the APCR. However, the regulation should include a process to monitor market performance and revisit market design choices in a program extension this far out into the future.

Key Theme: Relieving customer 'cost burden' is the right approach to continuing utility allowance allocations past 2020, but the application of this principle should be broadened beyond this current regulatory proposal. JUG members believe a wider application of the 'cost burden' principle is necessary to assure customer costs for early actions, achievement of state policies designed to reduce GHG emissions (e.g., the RPS), and the role of the electricity sector in achieving emissions reductions in other sectors (e.g., vehicle electrification) are considered. The customer costs of achieving California's climate policy objectives for the electric sector in advance of required deadlines should be considered just as it is for utilities that exceeded RPS requirements. The cost burden principle should include:

- Recognition of early GHG reductions from increased investment in energy efficiency programs
- Recognition of GHG reductions associated with electrification that result in load growth due to fuel switching
- Recognition of carbon reduction actions taken by utilities between 2009 and 2015 above and beyond what was required under various state programs
- Early GHG reductions due to distributed renewable generation
- Continued recognition of Qualifying Facilities and similar "priced at market" contracts
- Recognition of RPS contracts that have been accorded no GHG reduction value to the utility by ARB
- Allocation which recognizes other voluntary commitments (Examples include the Diablo Canyon plan for GHG-free replacement power, and JUG members exiting Intermountain Power Plant contract early)

The JUG observes that ARB Staff has proposed in workshops this year to discontinue the allocation of allowances to electric utilities for emissions associated with electricity use at covered industrial facilities, and instead allocate allowances directly to those facilities to reflect the carbon cost "burden" in electricity prices. JUG members believe that the change is unnecessary now that the CPUC has developed a process for returning cap-and-trade revenue to EITE entities. Such a change would also complicate the pass through of GHG costs to industrial customers of POUs because these EITE entities already benefit from the use of POU cap-and-trade allowance value and it is infeasible to establish a separate rate for EITE entities.

Finally, on the potential increase of electric sector emissions due to increased electrification, JUG members support developing a methodology to allocate allowances to the electric sector for electrification activities that reduce greenhouse gases from other sectors. This effort is consistent with the legislative intent of SB 350, which was to help offset the ratepayer impacts of vehicle electrification through cap-and-trade allowance allocations. JUG members agree that more time would be beneficial to consult widely with stakeholders and get these methodologies right.

Key theme: Cost Containment should continue to be a key element of market design. Cost Containment proposals should not just focus on what the state can do in the event of a sudden allowance price spike, but instead should also consider market design choices that could prevent a spike from occurring in the first place. This regulatory package includes several proposals that could result in the tightening of allowance supply and/or proposals that could increase the costs of compliance for regulated entities.

On the treatment of unsold allowances, JUG members believe that removing allowances from the market into the APCR after two years is premature and could have unintended consequences of significantly increasing the costs of the Cap-and-Trade program. The Cap-and-Trade program has been subject to significant uncertainty due to regulatory, judicial, and legislative controversies. A first-of-its-kind greenhouse gas market could be expected to face such challenges, and is still clearly feeling the effects of lingering uncertainty. JUG members suggest that ARB should continue monitoring market performance and allow current rule challenges to be settled to understand how demand may bounce back after additional certainty appears in the market. The mechanism to hold unsold allowances out of the market for a time should be structured to return them to the market at prices lower than the proposed APCR $60 plus premium over the floor price. Otherwise, if unsold allowances are removed from circulation into the APCR, prices could spike higher on a rebound than they would if unsold allowances were allowed to continue in circulation in some fashion.

Additionally, JUG members believe that collapsing the Allowance Price Containment Reserve can be workable, but offering allowances at what was previously the highest price tier would reduce access to lower cost allowances in the event of a price spike. JUG members propose that ARB utilize the difference in 2020 between the floor price and the previous lowest or middle APCR tier (rather than the highest-price tier) as a starting point for determining the post-2020 APCR price.

Finally, a focus on cost containment leads JUG members to call for increased efforts to encourage offset supply, ensure ability to use offsets up to the offset limit, and pursue reasonable linkage opportunities with other jurisdictions. All of these proposals will help control the costs borne by utility customers while enabling Cap-and-Trade to deliver the emission reductions necessary to achieve the state's long-term climate goals. When viewed as a key element, JUG members believe cost containment can increase the effectiveness of California's Cap-and-Trade program and demonstrate leadership to jurisdictions considering their own climate policies.

Key Theme: Regulatory certainty is necessary to guide investment and recognize ongoing utility efforts to reduce emissions, such as the RPS Adjustment and Voluntary Renewable Energy Program. Utilities plan for investments and infrastructure far into the future, as do many other California businesses. Regulatory certainty is necessary to ensure that early investments and ongoing planning decisions are made in line with the right economic incentives.

The most pressing need for regulatory certainty in this proposed regulation is the proposal to remove the Renewables Procurement Standard (RPS) Adjustment sections of the Cap-and-Trade and Mandatory Reporting regulations (MRR). The RPS Adjustment is a critical cost mitigation element of the Cap-and-Trade Program for any utilities. By reducing the compliance obligation of Californians based on the renewable firmed and shaped electricity being brought from out of state to help meet California's RPS requirement, the program recognizes the investment Californians have made in renewable energy and the associated GHG emissions reductions.

JUG members have worked together to submit a clear and comprehensive solution to this accounting problem. By reporting Renewable Energy Credit (REC) serial numbers pursuant to the MRR and clarifying the requirements for claiming RPS Adjustment, similar accounting issues can be avoided in the future. The details of the utilities' January 2016 solution to the RPS Adjustment problem can be found in Appendix A of this document.

Removing the RPS Adjustment without providing alternative compensation would have an estimated cost impact of $25 to $70 million a year to California utility customers. The proposed amendments do include an alternative method of compensation to account for the cost of these renewable investments in the form of a flat percentage increase in allowances factored into the calculation of each utility's allowance allocation. ARB is to be commended for recognizing that utility customers should not pay an additional carbon cost for their renewable investments. However, the proposal in its current form does not provide protection for ratepayers commensurate with the RPS Adjustment as had been expected when implemented. Furthermore, the flat percentage number proposed does not recognize the varying number of firmed and shaped contracts (and associated cost exposure) held by different utilities, the fact that the limit on Portfolio Content Category 2 (PCC2) contracts under the RPS is 66% higher than the ARB proposal presumes, or the fact that firmed and shaped grandfathered resources for any utility are not accounted for in the proposal and may exceed the PCC2 procurement limits. The ARB proposal also negatively impacts the economic viability of future firmed and shaped contracts, which will lead to higher costs to California ratepayers to achieve the RPS and carbon goals. The JUG recommends that the ARB retain the RPS adjustment, and work with affected stakeholders to revise the guidance language.

Another clear example of the need for additional regulatory certainty is the proposed lack of allocations of post-2020 allowances to the Voluntary Renewable Energy Program (VREP). The previous lack of demand for allowances for the VREP is not indicative of future demand, as many California utilities are just getting their green rate programs off the ground, and Senate Bill 350 removes barriers for POUs to develop and pursue such programs. This is a clear example where utilities created their own programs to further state goals and increase customer choice. The VREP is the primary mechanism for ensuring the participants in these voluntary programs that their participation is actually reducing GHG emissions. Without the VREP, these programs are likely to suffer. JUG members believe the continuation of the VREP allowance set-aside should be an ARB priority, and we would like to continue the discussion regarding how those allowances may be sourced from the overall Cap-and-Trade program cap.

Key Theme: Meaningful linkages with other jurisdictions should be pursued. JUG members support the state's plans to link with Ontario and urge the state to pursue additional linkages with domestic and international jurisdictions. The signing of the Paris Accord signals a unique opportunity to seek out trading partners, and JUG members encourage the state to actively pursue this opportunity.

JUG members also support the state's use of the Cap-and-Trade program to demonstrate equivalence with the U.S. EPA's Clean Power Plan and suggest that the state actively pursue opportunities to link with other jurisdiction that may opt to comply with the federal rule through mass-based trading programs.

Key theme: Inter-agency coordination is necessary to ensure that policies seeking to reduce greenhouse gases from the electric sector are complementary and recognize existing precedent. With so many policies and programs guiding the electric sector towards a decarbonized future, it is necessary to ensure that agencies and the programs they administer work together. The differing focus at state agencies can result in myopic policy making that impacts utility efforts to achieve state goals at other agencies.

One clear example of this need for interagency collaboration is the recent focus on "secondary emission effects" that result from the California Independent System Operator (CAISO) EIM optimization. On Friday, August 26, CAISO released a study demonstrating that the EIM dispatch actually displaced emitting generation for a net benefit to the atmosphere in the first half of 2016. In light of this information, JUG members do not support the current method proposed in the regulation for addressing the secondary emissions issue, as it would not incorporate costs from secondary emissions as part of the EIM optimization, thereby disrupting economic EIM dispatch, and does not take into account the net benefit to the environment of increased electricity market trading. JUG members suggest that additional opportunities for public input and discussions with all relevant agencies on this issue should be held after the first Board hearing of these amendments and before the release of 15-day language.

Additional cross-agency initiatives include the Integrated Resource Plans, the 50% RPS requirements, and utility requirements to develop transportation electrification proposals and bring them before the CPUC and POU Governing Boards. With utilities playing such a prominent role in the state's long term climate change strategy, it is imperative that state agencies work to create a synergistic regulatory environment.

Conclusion

The Joint-Utilities Group appreciates the continued dialog with ARB staff and management on these important issues. JUG members urge the Air Resources Board to adopt changes in their proposed regulation order in line with the themes and specific recommendations made in these comments. Thank you for your time and for your careful consideration of these issues.

CC:
Rajinder Sahota
Jason Gray