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Ms. Rajinder Sahota
California Air Resources Board
1001 I Street
Sacramento, CA 95814

SMUD Comments on Potential Post AB 398 Cap-and-Trade Amendments

Thank you for the opportunity to submit comments concerning amending the Cap and Trade regulations, in response to proposed amendments posted on September 4th (45-day language). SMUD supports the proposal to add a price ceiling mechanism and add speed bumps or price containment points as required by AB 398 but suggests some differences in how these elements of the program should be structured. SMUD also appreciates the clarifications of allowed and prohibited use of allowance proceeds changes in the 45-day language and suggests additional clarifications.

SMUD supports the 45-day language that continues the banking structure from the current Cap and Trade program into and through the 2030 program extension. SMUD thinks that a good banking structure is an essential component of a well-designed Cap and Trade program. To the extent that a bank of allowances has developed in the current program, SMUD believes that reflects early emission reductions, which is evidence of a successful program. Thus, a program change at this time sends the wrong message that successful reductions will be viewed simply as oversupply.

On these topics and others, SMUD has the following comments.

A. Use of Allowance Proceeds

SMUD appreciates the inclusion of additional flexibility for allowance proceeds use, and in particular the addition of Section 95892(d)(3)(C), allowing use for “Other GHG Emission Reduction Activities” (and the specific example of programs to reduce emissions of sulfur hexafluoride – SF₆). This is the kind of “catch all” language or “including but not limited to” language that SMUD has advocated for in our previous comments. SMUD also appreciates the careful crafting that allows use of proceeds for education and outreach expenditures related to allowed uses but does not require demonstration of GHG reductions for the outreach and education expenditures. However, SMUD believes that additional changes are appropriate in 15-day language.

Use for procuring allowances for Compliance: SMUD strongly supports the continued ability to use allowance proceeds to purchase allowances. Use of allowance proceeds to procure allowances for compliance is fully consistent with goals of AB 32. The proceeds come from the sale of allowances that could be used for compliance (through POU consignment) so it's logical that monetization of those allowances can also be used to also establish compliance through the procurement of allowances. Such use benefits ratepayers, as it allows the option of exchanging the allocated allowances for allowances that can be placed in entity holding accounts, and traded if beneficial to the ratepayers, or used for compliance if beneficial to ratepayers. Such flexibility also creates additional liquidity for the secondary allowance market. There is no legislative directive in AB 398 or in AB 32 that suggests a policy by the Legislature to prohibit this use.

SMUD continues to believe that any actual prohibition, or even lack of clarity about such use, could have significant negative consequences, including unnecessary rate increases, hoarding of allowances and allowance price volatility. Rate increases could result because the proposal could force POUs to seek other funding for needed allowance procurement. The proposal also could reduce liquidity in the cap and trade market, causing POUs to designate additional allowances directly for compliance rather than having them available for trading. A plausible scenario could then be that entities who need additional allowances will be unable to find them, causing unnecessary volatility, price spikes, and uncertainty in the market. Such results would run counter to the goal of a cap and trade regulation that is designed to cost effectively achieve carbon reductions by allowing trading under the cap – restricting trade will restrict cost-effectiveness of the market.

While use of allowances for compliance is not expressly prohibited in the 45-day language, such use is not expressly allowed either. The 45-day language does add a proposed prohibition on the use of allowance proceeds to pay for the costs of "... the Cap and Trade Regulation ...", in addition to the costs of complying with MRR and the costs of the AB 32 Cost of Implementation Fee Regulation. SMUD understands this to refer to the administrative costs of compliance with the Cap and Trade Regulation, rather than a compliance cost represented by allowance procurement, as the two current categories prohibited in this sentence cover essentially administrative costs – reporting and ARB administration. SMUD requests clarification of this proposed change as follows:

Use of allocated allowance auction proceeds to pay for the costs of complying with MRR, ~~or the AB 32 Cost of Implementation Fee Regulation, or~~ administrative costs necessary for compliance with the Cap and Trade Regulation is prohibited, except for the costs allowable pursuant to sections 95892(d)(3)-(4).

In addition, SMUD believes some clarification could be achieved by a slight change to the added definition of "Volumetric" in Section 95802(a), as follows:

“Volumetric,” with respect to sections 95892 and 95893, describes an electrical distribution utility’s or natural gas supplier’s distribution of allocated allowance auction proceeds directly to one or more of its ratepayers based on the current or recent amount of electricity, natural gas, or other relevant utility service delivered to those ratepayers, such that higher usage results in ratepayers’ receipt of more funds.

A related point is that the proposed language in 95892(d)(3), which changes the word “may” to “must” in the phrase reading “... allowance auction proceeds ~~may~~ must be used to reduce greenhouse gas emissions or returned to ratepayers ...” is not clear about the use of allowance auction proceeds for allowance procurement. If allowed, as SMUD hopes, use of allowance proceeds to procure allowances would likely fall under the allowed use in 95892(d)(3)(D) – Non-Volumetric Return to Ratepayers. SMUD believes this is acceptable, as use of allowance proceeds to procure allowances represents an indirect covering of compliance costs that does not appear on a customer’s bill volumetrically. In fact, since POUs can simply place administrative allowances in compliance accounts directly, use of proceeds to procure allowances and substituting those procured allowances in compliance accounts is clearly a non-volumetric return to ratepayers.

SMUD believes that even greater clarity on this would be achieved if ARB expressly included wording stating that use of proceeds to procure allowances for compliance was allowed. One way to add clarification involves changing the initial paragraph in 95892(d)(3). Here, SMUD notes that the words “... used to reduce greenhouse gases or ...” in the paragraph are no longer necessary, as the allowed uses under 95892(d)(3)(A)-(C) describe GHG reducing activities and allowed use (D) is the non-volumetric return option (which does not reduce GHG). SMUD suggests language as follows:

95892(d)(3): Auction proceeds and Allowance value, including any allocated allowance auction proceeds, obtained by an electrical distribution utility shall ~~shall~~ must be used exclusively for the primary benefit of retail electricity ratepayers of each electrical distribution utility, consistent with the goals of AB 32, and may not be used for the primary benefit of entities or persons other than such ratepayers. Allocated allowance auction proceeds ~~may~~ must be used to reduce greenhouse gas emissions or returned to ratepayers using one or more of the approaches described in sections 95982(d)(3)(A)-(D) and may also be used to procure allowances or pay for administrative and outreach costs described in section 95982(d)(4). ~~Any allocated allowance auction proceeds returned to ratepayers must be returned in a non-volumetric manner.~~

Alternatively, ARB could simply add an explicit provision allowing use of proceeds to procure allowances, with restrictions to preserve disallowed uses of allowance proceeds, as follows:

95892(d)(5): Allocated allowance auction proceeds may be used to procure allowances for compliance, provided that the procured allowances are not used to meet compliance obligations for electricity sold into the California Independent System Operator markets, or for compliance obligations related to the sale of useful thermal energy in which a market carbon price is included.

Finally, another alternative to address the concern that allowing allowance proceeds to procure allowances will allow use to cover compliance obligations related to wholesale sales, which is a use prohibited for the original allowances, is to modify section 95892(d)(7) as follows:

95892(d) ~~(5)(7)~~ Prohibited Use of Allocated Allowance Value. Use of the value of any allowance allocated to an electrical distribution utility other than for the primary benefit of retail electricity ratepayers consistent with the goals of AB 32 is prohibited, including:

- (A) Use of such allowances or allowance value to meet compliance obligations for electricity sold into the California Independent System Operator markets.
- (B) Use of such allowances or allowance value to meet compliance obligations related to sale of useful thermal energy.
- (C) Use of allocated allowance auction proceeds to pay for the costs of complying with MRR, ~~or the AB 32 Cost of Implementation Fee Regulation (California Code of Regulations, sections 95200-95207),~~ or administrative compliance costs of the Cap-and-Trade Regulation is prohibited, except for the costs allowable pursuant to section 95892(d)(3)-(4).
- (D) Use of allocated allowance auction proceeds to pay for costs of lobbying, advocacy, employee bonuses, or shareholder dividends is prohibited.
- (E) Returning allocated allowance auction proceeds directly to ratepayers in a volumetric manner is prohibited.

Additional Express Uses of Allowance Proceeds: SMUD appreciates the addition of section 95892(d)(3)(C) that allows use of allowance proceeds for funding programs or activities “other than” the uses allowed in (d)(3)(A) and (B) that are aimed at achieving GHG reductions. SMUD also appreciates the explicit inclusion of programs aimed at reducing SF₆ in section 95892(d)(3)(C)1, but suggests that similar programs not covered in (d)(3)(A) and (B) be expressly included as well. SMUD requests that the following categories be expressly included:

95892(d)(3)(C) ... This includes funding:

1. Projects or activities that reduce emissions of sulfur hexafluoride.
2. Projects or activities that reduce emissions of black carbon and PM 2.5 emissions, such as actions to prevent or reduce forest fires.
3. Projects or activities that reduce emissions of other short-lived climate pollutants, such as hydrofluorocarbon refrigerants and methane;

4. Projects and activities that sequester GHG gases, preventing them from reaching the atmosphere.
5. Projects and activities that reduce GHG emissions or sequester GHG in natural and working lands.
6. Projects and activities that educate and enhance the understanding of the general public about the impacts of climate change and the programs and actions that can be adopted to mitigate those impacts.

SMUD notes that the GHG reductions from the projects and activities listed above are reductions that occur outside the Cap and Trade sectors. Hence, these programs and activities actually reduce the amounts of or impacts of GHG emissions, whereas the energy efficiency and renewable programs covered in (d)(3)(A) and (B) are reductions within the Cap and Trade program, which results in lower Cap and Trade program costs, but no direct GHG emission reductions overall.

Use of Allowance Proceeds For Outreach Expenditures: SMUD appreciates that section 95892(d)(4) carefully allows use of proceeds for education and outreach expenditures related to allowed uses, without requiring the difficult if not impossible demonstration of GHG reductions for the outreach and education expenditures. SMUD recommends that the language here be slightly broadened to state:

95892(d)(4): ... Allowance auction proceeds may be used for outreach that supports implementation of the approaches described in sections 95892(d)(3)(A)-(D), including expenditures that broadly support GHG reductions from a combination of activities in these sections.

Emission Factors For GHG Reduction Estimation: SMUD notes that the GHG reduction estimation protocols in section 95892(e)(4) include GHG emission factors applicable to the GHG emission reductions from changes in electricity or fuel use, but that do not reflect the GHG reductions from the provisions in section 95892(d)(3)(C) relating to sulfur hexafluoride reductions or the other specific GHG reductions recommended by SMUD above. SMUD recommends the following, additional text to section 95892(e)(4)(B):

...

2. GHG emission factors applicable to the electricity or fuel used or saved or vehicle miles travelled or reductions pursuant to actions from section 95892(d)(3)(C), calculated as follows:

...

d. if the allocated allowance auction proceeds expenditures reduce GHG emissions pursuant to section 95982(d)(3)(C), the Executive Director shall determine an appropriate GHG reduction factor or method to estimate the GHG reductions from the proceeds use.

B. Electrification Related Load Growth

The proposed amendments to the Cap and Trade program do not include any provisions to address Board Resolution 17-21. Board Resolution 17-21 directed the Executive Officer to "... evaluate appropriate quantification methodologies for additional electric distribution allocation that would provide ratepayer benefit for **the Cap-and-Trade program cost burden** to EDUs associated with transportation electrification load growth (in recognition of the requirements of SB 350)." The added electrification load beyond that reflected in the load forecasts underlying utility allocations is an *additional* cost burden to ratepayers, not reflected in the administrative allocations. SMUD believes that conservative estimation methods are most appropriate to address the increased cost-burden and are most consistent with the current base electric sector allocation (which reflected estimated load growth, not metered data). Data-informed estimation methods should be just as acceptable to CARB in the Cap and Trade program as they are for the base electric sector allocations and in the Low Carbon Fuel Standard (LCFS) regulation.

The load forecasts used for allowance allocation do not include the level of electrification load currently envisioned and reflected in State policy goals -- recently increased by Governor Brown. SMUD believes that the Board directed staff action on additional allowances for transportation electrification because of the tremendous importance of reducing vehicle and building emissions if California is to meet the State's GHG policy goals of AB 32, SB 32, and AB 398. An "uncovered" additional Cap and Trade cost-burden to EDUs is a practical barrier to additional EDU investment in transportation electrification. EDUs are projecting significant costs for the infrastructure necessary to accommodate electrification, and the LCFS revenues that EDUs need to invest in infrastructure will be reduced because of recent modifications to the LCFS regulation. The Cap and Trade program should recognize this fact and implement the Board's instructions in Resolution 17-21 to relieve the added cost burden by administratively providing allowances to cover the increased emissions from electrification.

During the informal workshops leading up to the 45-day language, CARB staff requested specific proposals regarding "... methods to quantify transportation-related load growth emissions (quantifiable and verifiable to allocation standards)." When asked what was meant by "allocation standards", CARB staff described an evidence standard that mirrored the same level of demonstration as for industrial sector allocations, which are provided retroactively based on tracked and reported historical data (either product or energy). Such a "metered data or its equivalent" requirement for the cost burden from electrification is not feasible or cost-effective for much of the potential transportation electrification load, or for the potential building electrification load, because these loads are typically not or cannot be separately metered. For example, adding a separate meter to measure the load from replacing a natural gas water heater with an electric heat-pump water heater is infeasible and unnecessary.

Unlike the allocations provided in the industrial sector, providing allowances for electrification will reduce the demand for allowances without changing overall supply, since transportation sector emission reductions more than offset the increases in the electric sector. Providing allowances for electrification will act to reduce prices in the Cap and Trade market and free up allowances for use by others. While allocating allowances for electrification would reduce the supply of allowances available to the general Cap and Trade market, it will also cause a greater reduction in the demand for allowances in that general market as transportation sector emissions decrease. Nothing like this happens with the industrial sector allowance allocation structure.

SMUD hopes that CARB staff understands how expensive it would be to require metering or similar documentation of electrification load growth. SMUD believes that the barrier to productive dialogue on this is CARB staff's continued fealty to industrial sector "allocation standards," and there is no clear, cost-effective proposal that can be developed and provided to CARB that meets that strict requirement. SMUD is prepared to develop and provide methods of estimation that take into account baseline electrification already included in allocations, expectations of emission increases from additional load above baseline as resources change, use of advanced metering data to improve estimation of load, etc.

SMUD remains concerned that the path CARB describes of quantifying the need for additional EDU allowances using industrial sector "allocation standards" is akin to making the perfect the enemy of the good and would cause the State to lose or have delayed vital transportation sector GHG reductions, making achieving the 40% reduction goal in SB 32 and AB 398 more difficult and expensive.

C. Cost Containment Design Features

Price Ceiling Structure: SMUD believes the price ceiling structure included in the 45-day language should be modified. The whole point of a hard price ceiling is to provide market stakeholders with additional certainty about the longevity of the Cap and Trade program so that abatement investments are clearly going to pay off. If the price ceiling is set so high that market stakeholders believe policymakers will step in to suspend the program well before it is reached, it is pointless. A high price ceiling will likely reduce, rather than drive, investment in abatement technologies and actions. The province of Ontario's withdrawal from the linked Cap and Trade program after the provincial election this summer reinforces the importance of politically defensible price containment.

There is no modeling or projections known to SMUD that indicate Cap and Trade market prices will come close to the price ceiling in the early years of the next decade. Hence, the critical period for the price ceiling is the years 2025-2030, and ARB's proposed escalation of 5% plus inflation annually makes the ceiling level too high in these years. SMUD suggests a price ceiling mechanism that mirrors the current regulation for post-2020 APCR – setting a level that is a real increment

above the floor price, starting at \$60 in 2021. This mechanism creates a ceiling price that starts significantly higher in 2021 but has a lower upward slope, yielding significantly lower ceiling prices by 2030.

SMUD recommends that the price ceiling sales procedure proposed in section 95915(f)(A) and (B) be replaced by the language similar to that in section 95913(k) in the current regulations, as follows:

~~(A) Beginning in 2021, entities may purchase allowances or price ceiling units from the price ceiling account at \$65 per allowance or price ceiling unit.~~

~~(B) After 2021, the purchase price will increase annually by five percent plus the rate of inflation as measured by the most recently available twelve-month value of the Consumer Price Index for All Urban Consumers.~~

(A) Beginning in 2021, each year ARB will set the Price Ceiling Price equal to the annual auction reserve price determined for that year pursuant to section 95911(c)(3)(A), plus a fixed dollar amount.

(B) In 2021, the fixed dollar amount used to determine the Price Ceiling Price will be equal to \$60.

(C) In each subsequent year the fixed dollar amount will be the previous year's fixed dollar amount adjusted for the rate of inflation as measured by the most recently available twelve months of the Consumer Price Index for all Urban Consumers.

(D) The financial...

Price Containment Point Structure: SMUD believes that the price containment point structure in the 45-day language should be modified. The proposed levels at one half and three quarters of the distance between the floor price and the ceiling price are too high and too close together. The escalation built into the price containment levels should be altered to remain sufficiently below SMUD's proposed price ceiling structure above. In addition, the auction structure should be modified so that allowances from both price containment points are not offered at the same time.

SMUD has consistently recommended price containment point levels that are well spread out from each other so that they act to brake market prices at two separate times or events. SMUD would prefer to see a price spread between the containment points of \$20 in real terms, ensuring that the market has ample time to respond to the influx of supply when a price containment point is accessed, without consideration that additional supply from the second point is also accessible. The price containment points should be pauses where stakeholders consider additional investments in abatement technologies, rather than waiting for or immediately considering the supply from the next price containment point.

If the “floor price plus \$60” ceiling price mechanism is adopted, SMUD notes that continuing escalation of the price containment points at inflation plus 5% will result in the price containment points moving towards the price ceiling level over time. In fact, the second price containment point level will exceed the price ceiling level by 2027. SMUD suggests adopting the same “floor plus a fixed price” structure for the price containment points, starting at floor plus \$20 for the first point and floor plus \$40 for the second point in 2021. This can be accomplished by changing section 95913(h)(5) and (6) as follows:

- (5) In 2021, sales of allowances from the Reserve shall be conducted at the following prices equal to the auction reserve price plus a fixed dollar amount:
- (A) Allowances from the first tier shall be offered at a price equal to the auction reserve price for that year plus \$20 for \$41.40 per allowance.
 - (B) Allowances from the second tier shall be offered at a price equal to the auction reserve price for that year plus \$40 for \$53.20 per allowance.
- (6) Increase in Reserve Tier Prices in calendar years after 2021. Tier prices from the previous calendar year will be increased by five percent plus In each subsequent year the fixed dollar amounts used for the first and second tiers will be the previous year’s fixed dollar amounts adjusted for the rate of inflation as measured by the most recently available twelve month value of the Consumer Price Index for All Urban Consumers.

SMUD also contends that the price containment point auctions should be separate auctions, so that the supply from the second price containment point is not offered at the same time as supply from the first and not offered until supply from the first price containment point has been sold. Again, SMUD believes that the price containment points should be pauses where stakeholders consider additional investments in abatement technologies, rather than prematurely accessing the supply from the next price containment point. With sufficient allowances in each price containment point (67 million in the first point, 100 million in the second), market participants should naturally turn to the market for a period of time prior to accessing the second point’s supply (or turning to the additional supply available at the price ceiling level).

In practice, SMUD believes that participating entities will likely only submit bids for the lowest Tier available for auction after the switch to the two-tier structure post-2021 (it is also likely that there will be no reserve auction participation through 2020). However, it is still important to provide certainty to the market about how the price containment point auctions are structured. To ensure separate auctions, SMUD suggests the following changes be applied to the post-2021 Reserve sales:

- 95913(d)(2) For any Reserve sale that will be offered, the Reserve sale administrator shall provide all eligible participants with notice of the number of allowances available for sale and the terms of the sale at least 30 days prior to the sale.

(A) For Reserve sales prior to 2021, the Reserve sale administrator shall offer all of the allowances in the Reserve for any Reserve sale offered.

95913(i) Purchase Determinations.

(1) For Reserve sales prior to 2021, the reserve sale administrator will conduct sales from each tier in succession, beginning with the lowest priced tier and proceeding to the highest priced tier. For Reserve sales after 2020, the reserve sale administrator will conduct sales from each tier separately. A reserve sale for the second tier shall not be held until the allowances from the first tier have been sold.

(A) The Reserve sale will continue until either all allowances made available in each sale pursuant to ~~sections 95870(a), 95871(a), and 95911(g)~~ are sold ~~from the Reserve~~ or all the accepted bids are filled.

Section 95913(4)(B) is no longer needed after 2020, as bids will not be submitted for the second Tier during a first Tier auction.

95913(4)(B) For Reserve sales prior to 2021, If allowances remain in the tier after the sales pursuant to section 95913(ih)(4)(A) are completed, the reserve sale administrator will assign a random number to each bundle of 1,000 allowances for which entities submitted a bid for the tier above the current tier being sold. Beginning with the lowest random number assigned and working in increasing order of the random numbers assigned, the reserve sale administrator shall sell a bundle of allowances to the bidder assigned the random number until the remaining allowances in the tier are sold or all accepted bids have been fulfilled. The price for the allowances sold under this procedure will be the price for the tier from which they are sold, not the bid placed.

95913(6) For Reserve sales prior to 2021, after completing the sales for each tier the reserve sale administrator will repeat the processes in sections 95913(ih)(4) and (ih)(5) above for the next highest price tier until all bids have been filled or until the Reserve is depleted. At that time the reserve sale administrator will inform the Executive Officer of the sales from the Reserve to each participant. After 2020, the reserve sale administrator will inform the Executive Officer of the sales from the Reserve after each Reserve auction in which bids are accepted.

SMUD notes the section correction included in the above paragraph should occur even if ARB does not accept SMUD's broader reserve sale timing recommendations. Finally, SMUD suggests a reordering of the wording of section 95913(h)(1)(E) to avoid confusion about the meaning. This section describes the allowances that will make up the main amounts of supply for the price containment Tiers. SMUD suggests the following wording change:

95913(h)(1)(E) In 2021, the Executive Officer shall divide evenly between the two new Reserve tiers ~~the remaining two-thirds of the allowances allocated pursuant to section 95870(a), as well as the allowances allocated pursuant to section 95871(a), less the allowances allocated pursuant to section 95913(h)(1)(D) as well as the remaining two-thirds of the allowances allocated pursuant to section 95870(a).~~

Use of Revenue from Sale of Price Ceiling Units. SMUD would not have supported the hard price ceiling concept without the environmental integrity provisions included in AB 398, which require ARB to use the revenues from selling “additional” allowances in the market to achieve at least one-to-one reductions in GHG emissions. SMUD supports:

- Going beyond one-to-one reductions where feasible to insure integrity;
- Inclusion of ready to implement offset projects such as REDD projects;
- Procuring and retiring compliance instruments from other jurisdictions where appropriate and feasible; and
- Early consideration of policies to develop and establish options and projects, so that emission reductions can be readily and quickly accessed if the price ceiling is reached.

Additional Cost Containment Actions: SMUD reiterates recommendations that CARB should continue to develop and consider policies that decrease the demand for allowances, such as electrification, and policies that provide supply flexibility when needed in order to foster stable market prices at levels below the price ceiling. The best market structure is one where the price ceiling influences the market by providing political certainty to help drive abatement but is never reached (not because it is set high, but because abatement actions flourish and keep prices below the ceiling). SMUD suggests that it is appropriate for CARB to consider structural changes including:

- Additional electrification measures to reduce demand for allowances;
- Policies that ensure that the amount of offsets allowed under the lowered and constrained offset limit can be fully utilized in the market, such as offset banks, offset limit trading or spreading, etc.; and
- A limited amount of banking to smooth the transition between compliance periods, similar to the banking allowed within compliance periods, but only available for a transitional time as one compliance period ends, and another begins.

D. Banking and Oversupply

SMUD continues to support the CARB staff position that there is no current need to take actions, such as taking away or devaluing entity-banked emissions, that would

penalize covered entities while exacerbating market uncertainties. SMUD believes that any action to remove allowances from the market today would introduce the potential for future allowance scarcity in the market, which would raise current compliance prices for our customers and increase concerns about unearned benefits to entities currently holding allowances in good faith. No regulatory action is currently necessary to address perceived oversupply concerns beyond those that ARB has already taken – such as establishing holding limits, moving unsold allowances to the APCR after some time, placing 52 million allowances into the APCR structure, and adding another 22.7 million allowances from the budgets in 2026-2030 into the APCR structure.

CARB ably defended their reasonable analysis of the potential for oversupply in the June 21st workshop. This analysis confirms that the current “bank” of allowances will very likely be needed and used prior to 2030, hence presenting no danger to the specific GHG target in that year. SMUD also agrees that significant sources of uncertainty remain that imply that further action to address oversupply may be counterproductive. To the list of uncertainties identified by CARB in their analysis presented at the June workshop, SMUD would add the potential for reduced hydroelectric generation and increased electricity demand in future years, due in part to the impacts of Climate Change itself on California weather.

SMUD advocates a “wait and see” approach to the question of changes to market supply (the caps) given significant uncertainty in market demand going forward over the next decade and beyond. If the current bank persists over the next five years or so, that means that emission levels are following the Cap trajectory downward, and there is no clear reason why they would not continue to do so – that’s a good thing. If the bank is declining over time, that means that emission levels are not declining with the cap, but it also means that the bank is useful and that prices in the market will rise to reflect the changing conditions and foster increasing abatement in the future. There is not an economic rationale that supports the position that simply because there is a “bank” of allowances, market entities will ignore cost-effective abatement opportunities in favor of dipping into a bank of higher-cost allowances to cover unabated emissions. CARB should not be overly concerned today about a “bank” of allowances threatening the achievement of the “by 2030” target of GHG emissions 40% below 1990 levels for many reasons, including but not limited to:

- Increases or decreases in emissions over time are based on the price of allowances versus the cost of abatement and on complementary program actions, not the existence or size of a “bank”.
- The market expectation that the Cap and Trade program will extend beyond 2030, meaning that held allowances have long term value, rather than having a 2030 “use it or lose it” aspect.
- The fact that California’s climate laws and the Cap and Trade structure do not mandate any particular amount of GHG emissions in the year 2030, or any other year.

While some may suggest that the politically driven departure of Ontario from the linked Cap and Trade structure raises the importance of addressing perceived oversupply, SMUD asserts the opposite. The experience with Ontario reinforces the importance of keeping a stable structure, including supply of and pricing of allowances, to avoid the potential for political abandonment of carbon policy overall. A stable and predictable increase in carbon prices as caps decrease, supported by a gradual increase in the price floor, will best avoid politically driven abandonment of the program, and increase the potential for additional linkages to other jurisdictions to replace or even at some point re-include Ontario.

In addition, as noted by Staff, the impacts of GHG emissions are related to the cumulative amount of CO_{2e} in the atmosphere, rather than the specific amount released in 2030. Lower emissions in the years leading up to 2030 are better because fewer GHGs have accumulated, even if these lower emissions prior to 2030 result in an available “bank” in that year. Flexible banking rules encourage such early reductions.

E. Energy Imbalance Market

SMUD continues to support use of CARB’s current “bridge solution” for dealing with potential “outstanding” (secondary dispatch) emissions in the Energy Imbalance Market (EIM). The bridge solution covers the identified outstanding emissions in the Energy Imbalance Market (EIM) by retiring allowances from the Cap and Trade market. The 45-day language, in combination with CAISO’s revised tariff¹ approach to reduce secondary dispatch, complicates EIM market participation, and raises the potential that our ratepayers may be overcharged for the obligation.

We continue to oppose asking California ratepayers to shoulder the costs of emissions beyond our state borders – and assigning compliance obligations for emissions that are not within the control participating California utilities. However, if CARB moves forward with a policy to preserve environmental integrity other than the bridge solution, there should be a simple and transparent method for assessing individual compliance obligations and utilities should have the option of electing whether they wish to retire compliance instruments to satisfy that obligation on their own, or if they would rather have CARB retire allowances on their behalf.

The 45-day language proposal does not solve the “incentive” issue that concerns ARB staff with regard to the bridge solution – that retiring allowances generally does not incentivize reductions in the secondary dispatch problem. Rather, the “EIM Participant” option imposes additional rules and costs on EIM participants simply for being part of the market, not in any manner related to a choice to procure or not procure of GHG emitting resources. It is unclear to SMUD how EIM participants would be able to change their market practices to reduce their imposed obligation.

¹ CAISO filed its EIM Tariff revisions in August 2018, which propose a new dispatch method for EIM that is aimed at reducing the quantity of secondary dispatch energy from generators outside CA.

The option as stated in the 45-day language and the MRR would create potential Cap and Trade obligations for entities that currently have none, and that are not consciously procuring power that has a GHG emissions signature. This option is likely to simply reduce participation in the EIM market, contrary to the State's goals.

The current regulation retires allowances for the outstanding emissions identified from the unsold pool of allowances that is gradually being returned to the market slowly over time or transferred to the APCR after 24 months off the market per the Cap and Trade regulations. The 45-day language recognizes the limited supply from this source and changes the source of allowances to retire from the general budget rather than the pool of unsold allowances, but only through March of 2019. SMUD recommends extending the bridge solution retirement at least through the end of 2019. This will give stakeholders more time to understand the overcharging and market participation implications of the EIM purchaser proposal in the 45-day language. SMUD's recommended language change is:

95911(h)(2): Starting in 2019, ARB will retire allowances from the allowance budget two years after the current allowance budget year that is not already allocated to entities pursuant to sections 95870(a) and 95871(a) in the amount of EIM Outstanding Emissions as defined in section 95111(h)(1) of MRR for data year 2018 and for ~~January 1 through March 31 of~~ data year 2019. Each year, ARB will retire these allowances no later than the surrender deadlines specified in section 95856(d) and (f).

[The recommended changes to the regulations above are new and not in track changes, but in the text above that the changes are shown. My current understanding of the 45 day language is that ARB has already made the change recommended in the draft from last week, but only through March 2019.]

F. Allocation to Legacy Contract Generators

SMUD appreciates the inclusion in the 45-day language of provisions continuing allowances to be allocated to cover legacy contract emissions for generators with counterparties that are not otherwise included in the Cap and Trade program. Such allocation was allowed for these circumstances through the 2017 program year (the end of the second compliance period) but removed from the current regulation from 2018 forward.

However, SMUD sees no reason at this point to continue to use the provisions previously in the regulations that tied the legacy contract allocations in these cases to historical 2012 information, rather than to actual emissions from generation or useful thermal energy supplied under a legacy contract. For legacy contracts with an industrial counterparty, the allocation is based on actual emissions as provided in data reporting from the year prior to the application for allowances – the latest data available, and subsequently trued up in following years to actual data. SMUD

sees no reason not to differentiate at this point between the process for legacy allowance allocation with or without an industrial counterparty.

A previous rationale for providing legacy contract allocations was for transition assistance, similar to the 100% assistance factors for industrial entities through the end of the second compliance period. With AB 398 and the 45-day language, that transition assistance rationale no longer stands – assistance factors are at 100% after 2020 and proposed to be at 100% for the third compliance period (2018-2020).

As time passes, basing the legacy contract allocation for instances without an industrial counterparty on historical 2012 information becomes less and less accurate. The best structure would follow the “latest data plus true-up” structure used for contracts with an industrial counterparty.

Also, there is no reason to restart the allocation of allowances for this purpose in 2020 rather than 2019. Board Resolution 17-21 directs staff to: “...work with any remaining entities with legacy contracts and their non-industrial counterparties to resolve the parties' issues related to recovery of greenhouse gas costs, or, as necessary, to propose regulatory amendments to be in place ***no later than*** the allocation of vintage 2021 allowances to ensure reasonable transition assistance for greenhouse gas costs throughout the term of the legacy contract.” (Emphasis added).

The Board Resolution does not constrain staff from starting the allocations for these purposes with 2020 allowances allocated in 2019, nor does it prevent consideration of true up for the 2018 emissions not covered in the current regulations.

Rather than add the complication again of two different methods for determining allocations for legacy contracts with and without industrial counterparties, SMUD supports the much simpler change of simply adding contracts without industrial counterparties into the current structure for those with those counterparties, as follows:

95894(a)(1) A letter to ARB stating covered entity’s name and ARB ID, ~~identification~~identity of legacy contract counterparty, if applicable, and statement requesting transition assistance for the previous data year’s legacy contract emissions.

(A) Previous data year’s legacy contract emissions, pursuant to section 95894(c).

~~(B) 2012 data year’s legacy contract emissions, pursuant to section 95894(d).~~

95894(c) Allocation to Legacy Contract Generators ~~with an Industrial Counterparty~~. If the counterparty (or entity in a direct corporate association with the counterparty) is a covered entity or opt-in covered entity that is in a sector listed in Table 8-1, the following formulae apply based on the type of generation facility

95894(c)(2) For legacy contract generators ~~with an industrial counterparty~~ subject to section 95894(c), but not covered by section 95894(c)(1), the following equations apply:

...

~~95892(d) Allocation to Legacy Contract Generators without an Industrial Counterparty. Legacy contract generators not covered by section 95894(c) may receive allowance allocation only for budget years 2021 through the life of the legacy contract~~

All remaining parts of 95892(d) struck.

G. Changes to Offset Policies

SMUD supports the comments provided by The Verified Emission Reduction Association (VERA), and like VERA appreciates the opportunity to continue working with the Board and CARB staff on this component of the Cap and Trade program. SMUD has previously supported offsets as a critical cost-containment tool, and more importantly, as a method to include non-capped sectors and other jurisdictions in California's leading efforts to address Climate Change.

SMUD agrees with VERA in supporting the following staff proposals:

- Definition of Direct Environmental Benefit and Ceiling Price Unit
- The construction of § 95854(b)—Quantitative Usage Limit on Designated Compliance Instruments—including Offset Credits
- Determination that in-state projects using CARB-approved offset protocols meet the DEBS definition
- Inclusion of a pathway for out-of-state offsets to demonstrate Direct Environmental Benefits to California
- Inclusion in § 95977.1(b)(3)(M) of a materiality provision
- Revised provisions for regulatory compliance in § 95973(a)(2)(C)
- Appendix E's recognition of the relationship between offset compliance and occupational and health and safety regulations

AB 398 also created the Offset Protocol Task Force (OPTF) -- charged with finding *more* offset protocols to use in the program. SMUD believes that with the increased focus on offsets that provide direct environmental benefits (DEBs), the OPTF should consider new offset protocols established for land-based carbon sequestration. There are enormous challenges to implementing offset projects (for compliance or even voluntary markets) on a farm or a ranch, where natural systems combine to create variability and interdependency that is very unlike outputs from stacks or other engineered systems. The available supply of offsets that provide DEBs is not clearly sufficient to meet the amounts required by AB 398, and local land based offsets could become a significant new source.

SMUD sees a significant potential opportunity in land-based carbon sequestration to help meet our goals to reduce local and regional GHG emissions and plan for a “net zero” GHG future for our region. These potential offset projects would benefit from protocols that support small project aggregation (for multiple measures implemented on a single farm, and single or multiple measures implemented on multiple farms) and leverage transparent scientific benchmarks without being overburdened with undue administrative costs for creating offsets from the projects. SMUD looks forward to working with the OPTF on this topic.

/s/

WILLIAM W. WESTERFIELD, III
Senior Attorney
Sacramento Municipal Utility District
P.O. Box 15830, MS A311
Sacramento, CA 95852-0830

/s/

TIMOTHY TUTT
Government Affairs Representative
Sacramento Municipal Utility District
P.O. Box 15830, MS A313
Sacramento, CA 95852-0830

cc: Corporate Files