Workshop to Continue Informal Discussion on Potential Amendments to Cap-and-Trade Regulation
April 26, 2018
Workshop Materials and Submitting Comments

- Presentation and other materials: http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm
- Presentation webcast: https://video.calepa.ca.gov/
- Written comments may be submitted until 5:00 pm Pacific time on Thursday, May 10, 2018, at this site: http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm
- During this workshop, e-mail questions to: coastalm@calepa.ca.gov
Agenda

- Introduction
- Program Topics – focusing on stakeholder comments from March 2 workshop
  - Allowance Allocation
  - Cost Containment Design Features
  - Post-2020 Cap Setting
  - Direct Environmental Benefits to the State
  - Purchasing Metric Tons for Price Ceiling
  - Energy Imbalance Market
  - Other Potential Changes
- Public Engagement and Next Steps
Introduction

- This workshop continues the informal discussion of potential regulatory amendments. The slides are not part of a formal regulatory proposal, nor do they include staff recommendations.

  - Two prior informal workshops

  - Today’s focus: continue discussion of potential changes to the regulation, as presented in workshop materials, and review process and schedule

- Topics not in current workshop materials could be in future release

- Materials reflect comments submitted to CARB; staff will continue to consider stakeholder comments going forward
Approach to Current Rulemaking

- Continue market design for steady, predictable, increasing floor price, with a declining cap, to prompt investments and actions to achieve mid- and long-term GHG reductions
- Carbon price signal should conform to legislation and maintain integrity of the pre-2021 period of the Program
- Avoid penalizing covered entities in response to early action to reduce GHGs or investments in allowances
- Maintain and continue to attract linkage partners
- Maintain benefits of Program’s market features
  - Cost-effective through opportunities to identify lowest GHG reductions across economy
  - Compliance flexibility through trading and multiyear compliance periods
  - Minimize leakage
To evaluate eligibility for an alternate cap adjustment factor (CAF), all covered industrial sectors in Table 8-1 were evaluated using data available for 2012-2015.

Criteria 1: Process emissions > 50% of the total emissions
- Aggregated facility-specific Mandatory Reporting Regulation data at the sector level

Criteria 2: Emission intensity > 5,000 MTCO$_2$e/$M$ value added
- Used publically available national data for 6-digit NAICS codes
  - Direct emissions: US EPA GHG emissions reporting
  - Indirect emissions: US Census Annual Manufacturing Survey
  - Value added: US Census Annual Manufacturing Survey

Criteria 3: High leakage risk classification
- Refers to the current classification specified in Table 8-1 of the Regulation
Cement and lime manufacturing are eligible for an alternate CAF at the NAICS 6-digit classification.

No covered nitrogenous fertilizer manufacturers after 2017.

Coke calciners approached staff to suggest that NAICS 6-digit classification not disaggregated enough to characterize specific manufacturing activities at their covered facilities.

- Coke calcining is included in NAICS code 324199: All Other Petroleum & Coal Products Manufacturing.
- Staff agreed that NAICS code 324199 aggregates many different manufacturing activities.
- Staff evaluated coke calcining-specific data provided by stakeholders.

Staff will review manufacturing activity-specific data if stakeholders demonstrate that the NAICS 6-digit classification does not represent the activities conducted at the covered industrial facilities.
Criteria 1: Process emissions > 50% of total emissions (CBI)
Criteria 2: Emissions intensity > 5,000 MTCO$_2$e/$M$ value added
Criteria 3: High leakage risk classification

<table>
<thead>
<tr>
<th>Sector</th>
<th>Process Emissions</th>
<th>Emissions Intensity</th>
<th>Leakage Risk Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cement Manufacturing</td>
<td>✓</td>
<td>17,885</td>
<td>High</td>
</tr>
<tr>
<td>Lime Manufacturing</td>
<td>✓</td>
<td>19,142</td>
<td>High</td>
</tr>
<tr>
<td>Coke Calcining</td>
<td>✓</td>
<td>&gt; 5,000 MTCO$_2$e</td>
<td>High</td>
</tr>
</tbody>
</table>
Stakeholder Comments: CP3 Assistance Factors (AF)

Most commenters support move to 100% AF 2018-2020 (CP3) and commented that maintaining lower AFs:

- Would result in significantly higher compliance costs which, paired with increasing difficulty meeting compliance obligations post-2020, makes reduction and efficiency investment more difficult
- Would be disruptive to affected covered entities
- Would increase leakage risk due to competition from entities not subject to carbon costs

Some commenters support maintaining reduced CP3 AFs, and commented that raising AFs to 100%:

- Is not included in AB 398
- Would result in windfalls to covered entities
- Would delay investments in reducing emissions
Allowance Allocation: Industry Assistance

- Objectives of industry assistance
  - Minimize risk of emissions leakage
  - Help industrial sectors to smoothly transition to period of steeper cap declines

- Staff evaluating how to smooth transition to post-2020 period
  - Allowance budget and CAF decline faster in 2021 - 2030
    - 2013 - 2020: About 2% per year (15% cumulative)
    - 2021 - 2030: About 4% per year (36% cumulative)
Allowance Allocation: Decline due to Benchmarks and Cap Adjustment Factor

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

Effect of Benchmark Stringency and Declining Cap Adjustment Factor on Allocation
Allowance Allocation: Smoothing Transition into Post-2020 Period

- **Continued staff analysis of CP3 assistance factors**

  **Estimated Compliance Cost for Sectors in Medium and Low Leakage Risk Categories**

  - Blue bars represent increase in compliance cost if the assistance factor is not 100%. Orange is the steadier increase in compliance cost with 100% assistance factor.

  - Assumes $15 allowance value for 2015 - 2020 and $20 for 2021 - 2023
  - Uses 2016 emissions as a proxy for emissions in 2017 and beyond
Allowance Allocation: Example

- Petroleum refining sector
  - Largest covered industrial sector with medium leakage risk
  - Refineries incur compliance obligations for both on-site emissions and for emissions from supplied transportation fuels
  - There is no allocation for supplied transportation fuel emissions
  - Average refinery faces a 10.8 million MTCO$_2$e compliance obligation annually, and allocation covers ~15% of that
Allowance Allocation: Modifications to Energy-Based Allocation

- A CP3 true-up mechanism may be needed to accommodate potential changes to CP3 assistance factors
  - For vintage 2020 allowance allocation, provide true-up allowances to entities with low and medium leakage risk classification if the CP3 assistance factors increase from 50% and 75% to 100%
  - This will allow for true-up of vintage 2018 and 2019 allocation calculated using the lower assistance factors

- Add process emissions to baseline allocation calculation
  - Address the leakage risk associated with process emissions
  - Maintains consistency with product benchmark development
  - \[ A_t = (\text{Steam} \times B_s + \text{Fuel} \times B_f + \text{ProcessEmissions} - e_{sold} \times B_e) \times AF \times c \]
February concept paper proposed clarifications to allowable uses of allocated allowance proceeds
- Identifies allowable uses, focusing on GHG reducing activities and non-volumetric ratepayer rebates
- Maintains flexibility while addressing requests for clarification on allowable uses of allocated allowance value

Staff requests additional feedback on:
- Methods to increase clarity of allowed uses and oversight, including quantification methods and purchase of allowances using auction proceeds
- Additional GHG reducing uses, criteria, or reporting information that should be included
- Methods to quantify transportation-related load growth emissions (quantifiable & verifiable to allocation standards)
Allowance Allocation: EDU Past Uses of Allowance Value

**POU allowance value uses**

- Deposited for Compliance: 63%
- Consigned Allowances: 37%
  - Renewable Energy: 11%
  - Volumetric Rate Reduction: 1%
  - Non-Volumetric Rebate: 0.2%
  - Unspent: 8%
  - Energy Efficiency: 0.8%
  - Transportation: 0.3%
  - Other: 0.3%

- Total: 2013-16: ~$1.5 Billion

**IOU allowance value uses**

- Residential Climate Credit: 63%
- Residential Volumetric Rate Reduction: 22%
- Indusry Assistance: 7%
- Small Business Climate Credit: 7%
- Admin & Outreach: 0.3%

- Total: 2014-16: ~$3 Billion

Cost Containment Design Features

- CARB staff asked for stakeholder comments on various cost containment design features presented in February concept paper
  - Price ceiling range
  - Price tiers ("price containment points" in AB 398) range
  - Distribution of allowances to price ceiling or tiers
    - 52.4M allowances allocated to post-2020 Reserve in 2016 amendments
    - 23M allowances that represent two percent of 2026-2030 budgets to reflect change in offset limits from four percent to six percent
- Allowance banking
**Stakeholder Comments: Cost Containment Design (Higher Prices)**

- Some stakeholders want to see higher prices through reduction of allowance supply
  - Set post-2020 caps lower
  - De-value pre-2021 allowances in private accounts in post-2020 period
  - Place expiration dates on banked allowances
  - Retire 52.4M and 23M allowances or allocate to ceiling

- Some stakeholders argued for price ceiling in 2030 near high end ($147 in 2015 dollars) or above proposed range, higher range tier prices
  - Cited complementary measures in Scoping Plan that would cost more than $147 per metric ton
  - Facilitate price discovery
  - Tier prices should be above social cost of carbon
Most commenters want lower allowance prices and price ceiling to backstop compliance costs
- Set price ceiling value at $50 in 2021
- No additional rules on banking or changes to caps
- Focused on affordability and political sustainability and attractiveness of Program to linkage partners
- High ceiling would add uncertainty and increase leakage risk
- Do not redistribute 23M allowances from 2026-2030 budgets

Some stakeholders advocate for lower price tiers and/or tiers equally spaced between price floor and ceiling
- Distribute 52.4M allowances to price tiers
- Allow for two distinct “speed bumps” to protect consumers and signal need for more abatement
Reducing supply may lead to higher compliance costs than needed to achieve the 2030 target and allowance price may hit the price ceiling sooner.

At price ceiling, Program functions like a higher-cost carbon tax:
- No trading of compliance instruments
- Higher prices per metric ton
- Higher potential for leakage
- Higher costs to the economy and consumers

Puts existing and future linkages at risk.
Too many allowances at low prices could mute the carbon price signal
- May undermine incentives for GHG reductions needed to achieve 2030 target
- Affects stringency and risks existing and future linkages

If prices are too low, Program functions like a lower-cost carbon tax
The term “overallocation” is used to reference the fact that covered emissions have been lower than the annual caps.

Some believe the unused pool of allowances will hinder ability to achieve the 2030 target.

Stakeholder suggestions to address concerns:
- Set post-2020 caps lower
- De-value pre-2021 allowances in private accounts in post-2020 period
- Place expiration dates on banked allowances
GHG emissions are lower than the cap and the State is on track to achieve 2020 target early

The Cap-and-Trade Program is working as intended

The relationship between GHG reductions and carbon price requires a more thoughtful and in-depth evaluation—not simply supply vs. demand

Avoid penalizing covered entities in response to early action to reduce GHGs or investments in allowances

Would incent entities to only do minimum

Avoid introducing future allowance scarcity that will increase prices today for compliance and consumers
External commenters estimate 200 million unused allowances between 2013 through 2020

CARB staff used this value as starting point and adjusted this value to reflect existing Program
- Removal of unsold auction allowances to Reserve
- Set-aside for Voluntary Renewable Electricity Program
- Retirement to ensure environmental integrity in situations of bankruptcy

Adjusted unused allowances ~150 million

Several unknowns that would further change quantity of unused allowances
- Linkages, Energy Imbalance Market, amount in private accounts versus State accounts
Holding Limits

- Holding limits limit how many allowances any entity can own.
- Protect against market manipulation.
- Decrease each year in proportion to annual caps.
- Most entities have financial constraints preventing them from holding up to the full limit.
- Market monitor, who provides market oversight, and staff have not observed any evidence of financial windfalls.

<table>
<thead>
<tr>
<th>Year</th>
<th>Holding Limit</th>
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<tbody>
<tr>
<td>2018</td>
<td>15,717,500</td>
</tr>
<tr>
<td>2019</td>
<td>15,217,650</td>
</tr>
<tr>
<td>2020</td>
<td>14,715,200</td>
</tr>
<tr>
<td>2021</td>
<td>14,302,950</td>
</tr>
<tr>
<td>2022</td>
<td>13,848,950</td>
</tr>
<tr>
<td>2023</td>
<td>13,392,700</td>
</tr>
<tr>
<td>2024</td>
<td>12,936,200</td>
</tr>
<tr>
<td>2025</td>
<td>12,482,200</td>
</tr>
<tr>
<td>2026</td>
<td>12,025,950</td>
</tr>
<tr>
<td>2027</td>
<td>11,569,475</td>
</tr>
<tr>
<td>2028</td>
<td>11,115,725</td>
</tr>
<tr>
<td>2029</td>
<td>10,659,225</td>
</tr>
<tr>
<td>2030</td>
<td>10,202,975</td>
</tr>
</tbody>
</table>
Scoping Plan Public Data

GHG Emissions Forecasts: Complementary Policies Only

Emissions (MMTCO₂e)

2021 2022 2023 2024 2025 2026 2027 2028 2029 2030

SP Linear Line  Covered Sectors  Covered + Non-Covered
Post-2020 Caps in Current Regulation


- Emissions in Covered Sectors with No C&T
- SP Linear Line
- Covered + Non-Covered
- Cap & Trade Caps
### Evaluation of Post-2020 Caps

- Assume post-2020 emissions equal allowances and offsets available

<table>
<thead>
<tr>
<th></th>
<th>Case A (MMT)</th>
<th>Case B (MMT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Covered emissions without Program (PATHWAYS)</td>
<td>3,054</td>
<td>3,054</td>
</tr>
<tr>
<td>Post-2020 caps (excluding Reserve)</td>
<td>2,532</td>
<td>2,532</td>
</tr>
<tr>
<td>Unused v2013-2020 allowances available</td>
<td>0</td>
<td>150</td>
</tr>
<tr>
<td>Offset credit usage*</td>
<td>96</td>
<td>103</td>
</tr>
<tr>
<td><strong>Total compliance instruments (or total emissions)</strong></td>
<td><strong>2,628</strong></td>
<td><strong>2,785</strong></td>
</tr>
<tr>
<td>Total reductions from Cap-and-Trade 2021-2030</td>
<td>426</td>
<td>269</td>
</tr>
</tbody>
</table>

- In either case, the Program achieves reductions needed to meet the 2030 target, but compliance costs are higher in Case A

* Both cases assume no APCR or post-2020 Reserve allowances used and an offset usage rate of 3% for 2021-2025 and 4.5% for 2026-2030
Sources of uncertainty must be considered when discussing unused allowances and post-2020 caps.

- Projections of future covered emissions
  - Performance of other GHG programs
  - Population and economic growth projections
- Usage rate and availability of offset credits
- Abatement opportunities in linked jurisdictions
- Quantity and timing of unsold allowances moving into the Reserve after eight auctions
- Allowance retirements for environmental integrity
Post-2020 caps are currently set in the Regulation as a decreasing straight-line trajectory from 2020 to 2030.

Analysis indicates caps will limit emissions from covered sectors, even in the context of 150 million vintage 2013-2020 allowances carrying forward.

Program includes a feature to address uncertainty when demand is low that has proven to be effective.

- Transfer of unsold auction allowances to Reserve after 8 auctions.
Staff Request for Comment

- Additional areas of uncertainty?
- Additional abatement opportunity and cost data staff should review?
- Comments on methodology
- Comments on assumptions
Stakeholder Comments: Direct Environmental Benefits (1 of 2)

- AB 398 states that a percentage of ARB offset credits surrendered for compliance must provide direct environmental benefits to the State (DEBS)
- Vast majority of stakeholders support using the precise statutory language in the amended Regulation
  - All projects located in California should automatically meet the DEBS standard
  - Out-of-state offset projects can still have DEBS in California if they can demonstrate they meet DEBS standard
  - Find a way for ODS projects to meet the DEBS standard
- A small number of stakeholders asserted that not all instate projects could meet DEBS standard
Stakeholder Comments: Direct Environmental Benefits (2 of 2)

- Stakeholders were split on whether explicit criteria should be developed for DEBS, noting that:
  - Explicit criteria would leave the Regulation subject to legal challenge and may be difficult to define due to the diversity of offset projects
  - Explicit criteria are necessary to assure conformance with the intent of the statute

- Most stakeholders did not support retroactively applying DEBS to offset credits issued prior to 2021
  - Concerned about financial repercussions to existing projects, and applying a standard not in place when project was developed
  - Support for exempting from or automatically meeting DEBS standard for previously issued offset credits

- Stakeholders were also in support of defining watersheds for DEBS and adopting additional offset protocols
Commenters proposed the following for supply of metric tons for price ceiling:

- CARB preparing a list of eligible projects
- Instant eligibility of instruments generated through any offset protocols
- Developing multiple procurement methodologies to obtain eligible instruments sold from the ceiling mechanisms, identify conditions for pre-contracting, complete projects within an established timeframe
- Identifying natural and working lands as preferred source for one-for-one reductions and allow advanced contracts prior to 2021
Under AB 32, CARB must account for the total annual GHG emissions in the State, including all GHG emissions from the generation of electricity delivered to and consumed in California, whether that electricity is generated in-state or imported.

ARB is currently using a “bridge solution” because the design of EIM does not account for the full GHG emissions experienced by the atmosphere from imported electricity under EIM and results in emissions leakage.

Any staff proposal will only address EIM transactions, not day-ahead market transactions or grid regionalization.
Beginning in 2016, CAISO and CARB coordinated to address GHG accounting inaccuracies.

CARB initially proposed to assign a compliance obligation to California entities purchasing EIM electricity (“EIM Purchaser”).

CARB implemented interim “bridge solution,” retiring State-owned allowances in proportion to EIM Outstanding Emissions in anticipation of implementing a Two-Pass Solution at a later date.

In late 2017, CAISO conducted tests of the existing EIM and Two-Pass Solution.

These tests showed the Two-Pass more fully captured emissions serving California load; however, stakeholders identified issues.

In early 2018, CAISO released a new proposal that addresses some, but not all GHG accounting issues.
Although CAISO’s latest proposal addressed some GHG accounting issues, CARB must still ensure that it is accounting for all GHGs from electricity serving California load.

The bridge solution was always intended to be temporary.

Staff is re-evaluating the “EIM Purchaser” option, where the EIM Outstanding Emissions compliance obligation would be assigned directly to California EIM Purchasers.

Any proposal will concern only EIM transactions and not the day-ahead market or grid regionalization.

Questions for stakeholders:

- Are there recommendations for how CARB might implement an EIM Purchaser approach for California entities?
- Are there any other regulatory options staff should consider?
Topics for Ongoing Consideration

- Staff invites input on the following potential topics for regulatory amendment consideration:
  - Revising invalidation provisions to further narrow types of activities or actions that could result in an invalidation
  - Revising offset project activities within scope of regulatory compliance evaluation list to cover all project types, and further clarify assessments and timing of noncompliance
  - Alternative cap adjustment factor for certain industrial sectors
  - CP3 assistance factors
  - Use of allocated allowance value
  - Design of cost-containment features
  - Approach for unused vintage 2013-2020 allowances and post 2020 caps
  - Methods for assessing compliance obligations for EIM emissions
Public Engagement

- Additional Workshop(s)
- Regulatory drafts
- Formal rulemaking process
- CARB staff will use due diligence to ensure all market influencing information is made available to all stakeholders at the same time
- Join Cap-and-Trade list serve on CARB website
Next Steps and Tentative Schedule

- Written comments may be submitted until 5 pm (PDT) Thursday, May 10, 2018, at this site: http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm
- CARB evaluating convening informal market design reviewers to support staff regulatory development process
- Public workshops first half of 2018
- Tentative first Board hearing Fall 2018
- Tentative final Board hearing December 2018