Tim Carmichael
Agency Relations Manager

925 L St, Suite 650
Sacramento, CA 95814-3773

Tel: 916.492.4248

Email: TCarmichael@semprautilities.com

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Rajinder Sahota
Chief, Climate Change Program Evaluation Branch
California Air Resources Board
1001 I Street – P.O. Box 2815
Sacramento, CA 95812

Re: SoCalGas and SDG&E Comments on the October 2017 Cap-and-Trade Regulation Workshop

Dear Ms. Sahota:

On behalf of the Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E), we respectfully submit the following comments in response to the topics discussed at the California Air Resources Board's (ARB) October 12, 2017 Cap-and-Trade Regulation Workshop (Workshop). Our comments are generally concerned with providing the tools and flexibility to ensure SoCalGas and SDG&E gas utility customers are gradually introduced to the rate impacts of the cap-and-trade program, and that customers of both utilities are protected to the extent possible against volatility in the carbon markets. We offer our thoughts on the following issues: 1) post-2020 allowance allocation to natural gas and electric distribution utilities, 2) price ceiling, 3) price containment points, 4) allowance supply, 5) allowance banking, and 6) offset limitations.

1. POST-2020 ALLOWANCE ALLOCATION TO NATURAL GAS UTILITIES

Board Resolution 17-21 directed ARB Staff to work with natural gas utilities to "evaluate and propose, as necessary, post-2020 program amendments to ensure adequate rate payer protection…." SoCalGas and SDG&E welcome this opportunity to continue the dialogue with Staff on this important topic. In alignment with the BR 17-21 directive, we urge ARB to continue the existing allowance allocation to natural gas utilities to protect the most vulnerable utility customers from economic hardship and to gradually introduce cap-and-trade costs as the State strives to meet its ambitious greenhouse gas reduction goals. If, as expected, electrification increases electric sector emissions, ARB should also work with stakeholders to adequately increase electric allowance allocation.

2. PRICE CEILING

SoCalGas and SDG&E supported the concept of a price ceiling as part of AB 398. While we see a price ceiling as a valuable tool to limit excessive carbon prices and ensure environmental integrity of the program, we also caution against setting the price ceiling too high. Some independent experts have found that in cap-and-trade markets with a finite compliance period and with hard floor and ceiling prices, the equilibrium price will most likely be at the floor or ceiling. [1] This phenomenon should be carefully considered when evaluating potential ceiling prices.

In addition, the Market Simulation Group (MSG) Report on Supply/Demand and Potential Manipulation found that the incentive for market manipulation may be greater with higher allowance prices. [2] Therefore, a ceiling price at the lower end of the spectrum may serve the purpose of protecting utility customers from market manipulation and sudden and severe rate impacts. We urge Staff to investigate these issues in detail, and we look forward to further dialogue from all stakeholders on the topic.

3. PRICE CONTAINMENT POINTS

SoCalGas and SDG&E support setting two price containment points (PCPs) below the price ceiling. If established properly, the PCPs could provide an important break on runaway prices and reduce the chances of hitting the price ceiling, while protecting California consumers.

SoCalGas and SDG&E believe the PCPs would be most effective if spaced evenly between the floor and ceiling prices. In addition, we believe it is critical for the PCPs to be sufficiently supplied with allowance volume. In the Workshop, Staff requested feedback on where APCR allowances and unsold allowances should be placed. One possible way to help achieve adequate volumes in the PCPs is to transfer APCR allowances and unsold allowances into the PCP reserves.

4. ALLOWANCE SUPPLY

During the first two compliance periods, some auctions did not clear fully and anticipated cap-and-trade revenues were lower than expected. This caused some to warn of

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[1] "Expecting the Unexpected: Emissions Uncertainty and Environmental Market Design", Severin Borenstein, James Bushnell, Frank A. Wolak, and Matthew Zaragoza-Watkins, Energy Institute at Haas Working Paper 274, August 2016.

[2] "Report of the Market Simulation Group on Competitive Supply/Demand Balance in the California Allowance Market and the Potential for Market Manipulation." Market Simulation Group. June 2014.

“overallocation” and urge action to correct this supposed problem by permanently removing emission allowances from the system. It is now generally accepted that allowance demand will outstrip supply sometime before 2030, *including* the usage of previously banked allowances.

SoCalGas, SDG&E, and many other independent observers, view the past uncleared auctions as a reaction to the uncertainty of the future of California’s cap-and-trade program, due to both legal challenge and questions regarding the State’s authority to continue the program past 2020. Since both of those issues have been resolved, the market has reflected this new information.

Furthermore, it is not prudent to assume that pre-2020 availability of allowances will be characteristic of what we can expect in a post-2020 world. SDG&E and SoCalGas urge caution against prematurely tightening the market before it is absolutely necessary, in order to avoid unintended consequences, especially in the face of evidence counter to the oversupply narrative. Protecting utility customers from rate shocks is one of our top priorities.

5. ALLOWANCE BANKING

SoCalGas and SDG&E support existing rules that allow prior and current vintage allowances to be banked for future compliance needs. Banking of allowances performs a critical function in the Cap-and-Trade program. Allowing compliance entities to bank both encourages early emissions reductions and minimizes price volatility. The ARB has established careful holding limits that help to mitigate market participants from using banking to artificially create allowance scarcity, which could lead to price spikes.

Banking is also used in the programs of our linked partners, Quebec and Ontario. Consistent market rules across linked jurisdictions is critical to ensuring equitable access to all participants and reducing chances of market arbitrage. SDG&E and SoCalGas encourage Staff to review carefully whether there is in fact any issues with speculation, windfall profits and price volatility and if there is such a risk, to consider the most effective ways to address the issues without reducing flexibility for compliance entities.

6. OFFSET LIMITATIONS

SoCalGas and SDG&E support a robust offsets market, and while AB 398 reduced the overall usage limits of offset credits for compliance entities from the current level of 8% to 4% between 2021 and 2025 and 6% between 2026 and 2030, we urge ARB to take a less restrictive view of the geographic source of offsets. We support the use of offsets as a means of providing real, additional, quantifiable and verifiable emission reductions cost-effectively for our customers.

While we respectfully recognize the concern for more local action, we oppose a more restrictive interpretation of the 50% in-state requirement. As suggested by ARB staff, we would support implementation of the requirement as two distinct buckets, in-state and out-of-state, that can be filled independently of each other and not requiring that each out-of-state offset be matched with an in-state offset.

In addition, we urge ARB to avoid adopting a narrow view when defining "direct environmental benefits" for application to California offset credit requirements. A more restrictive interpretation based on simple geographic location of the offset project would disqualify many potentially beneficial and important projects. As an example, large amounts of high-GWP refrigerants are collected in California and transported out-of-state to be destroyed, however because no destruction facilities are currently located in California, a more restrictive definition may disqualify these projects even though the emissions avoided would have been within California. In another example, forestry projects located in Oregon that impact the Klamath River Basin watershed may still generate in-state environmental benefits through their impact to the California watershed.

SoCalGas and SDG&E appreciate this opportunity to comment on the areas discussed at the Workshop, and we look forward to additional dialogue to ensure utility customers are not only gradually introduced to the rate impacts on the gas side of the cap-and-trade program, but are protected to the extent possible against volatility in the carbon markets. Please contact me if you have any questions or concerns about these comments.

Sincerely,

Tim Carmichael

Tim Carmichael
Agency Relations Manager
State Government Affairs
SoCalGas and SDG&E