



February 15, 2018

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

via e-mail at: [rsahota@arb.ca.gov](mailto:rsahota@arb.ca.gov)

Re: Support for Updated AB 398 Implementation Rulemaking Schedule

Dear Ms. Sahota:

The organizations listed above write to express our support for CARB staff's updated rulemaking schedule for implementation of AB 398 and the extension of the second compliance period industry assistance factors to the third compliance period such that the rule changes are effective by January 1, 2019.

As industries essential to the daily lives of all Californians, we are writing to emphasize that completion of the regulatory changes will help avoid direct/indirect effects and unintended consequences of a lengthier rulemaking that would result in greater uncertainty amongst obligated parties and market participants.

***Background***

The state has historically emphasized the importance of having a climate change program that provides a means of reducing the potential negative economic impacts of a carbon policy and at the same time ensures that the state can meet its environmental goals. To that end, AB32 includes specific direction to CARB to minimize leakage. In order to guard against leakage, academics and economists have advised the state to consider, as part of the design of the cap-and-trade program, a system of allowance allocation that includes industry assistance.

In recognition of this important component of the state's cap-and-trade program, the CARB Board issued Board Resolution 17-21 at its July 2017 Board meeting. The resolution directed staff to "propose subsequent regulatory amendments to provide a quantity of allocation, for the purposes of minimizing emissions leakage, to industrial entities for 2018 through 2020 by using the same assistance factors in place for 2013 through 2017." During the workshop on October 12, 2017, CARB staff discussed the extension of the previously adopted industry assistance factors, making the important point that such an extension would not mean that entities are allocated all allowances they need to comply with the state's cap-and-trade program. CARB staff correctly highlighted that by 2030 most industrial sectors will receive less than 50% of the allowances needed to cover their compliance obligations.

During this workshop, CARB also provided a potential timeline of mid-2019 for the completion of rulemaking to extend the second compliance period industry assistance factors to the third compliance period as directed by the aforementioned Board Resolution.

However, at CARB's December Board hearing, the Board adopted Board Resolution 17-46 which, among other things, addressed the timing of the process to amend the cap-and-trade regulation per AB398, specifically referencing December 31, 2018. CARB staff have subsequently updated the rulemaking schedule to reflect this direction from the Board.

We appreciate that the Board recognized the importance of the extension of industry assistance for the third compliance period as well as the direction from the Board to amend the cap-and-trade regulation by December 31, 2018. Continuing the rulemaking process beyond 2018 would create a lack of certainty for market participants. This lack of certainty can in turn lead to a relative increase in risks for obligated parties and the cap-and-trade market at large. In addition, CARB's current cap-and-trade regulation lacks a provision to guide how the agency would withhold the requisite number of allowances that would be needed for the future true-up, thus creating additional risk. These issues are discussed below.

#### ***Delayed Rulemaking Creates Risk for Obligated Parties***

If rulemaking is delayed, affected obligated parties under the cap-and-trade program may choose a more conservative path and purchase allowances at a faster pace than they would otherwise have done, had there been certainty of the proposed change to the third compliance period allowance allocation. In some cases, company policies and procedures may require compliance with and/or accounting against current regulations, as opposed to what *may* happen at some future point. For these companies, such a scenario could result in company cash management decisions that could be significantly different than if there were regulatory certainty, potentially resulting in a reduction of current year cash availability for other investments such as actual emission reduction projects.

These risks could be particularly burdensome for smaller players for whom even a temporary withholding of industry assistance could have detrimental impacts on the business.

Conversely, business risk to these affected obligated parties increases if they choose to wait two years for additional allowance allocation. For example, an obligated party that chooses to wait runs the risk of facing potentially higher compliance costs if CARB were to decide not to restore the industry assistance factor.

Also, companies may be required by accounting policy to show potential financial liability in internal and external financial reporting, if allowances are not purchased at a faster pace. This complexity clouds market perception and/or company economic position.

Under both scenarios, companies have a lack of certainty about compliance costs and purchase obligations for current year(s). The fact that the annual surrender for the first two years of the third compliance period is 30% only partially abates this uncertainty.

***Delayed Rulemaking Creates Risk for Cap-and-Trade Market*** If affected obligated parties are more risk averse and choose to take a more conservative approach, such behavior could permeate the market. In response, other obligated parties may react similarly as they see a tightening in the market. Such activity could create artificial upward pressure on allowance prices, thus impacting the overall cost of compliance.

If this is not mitigated, it could create a ripple effect in the market, creating the potential for increased market volatility by increasing demand vs. auction supply in early auctions during the third compliance period, and then reducing demand vs. auction supply in later auctions during the period. This undesirable impact adds price uncertainty and market volatility and could increase the likelihood that third-party market speculators could take positions on whether the restoration of industry assistance will or will not happen.

Other secondary outcomes could include: 1) changes in the number of unsold allowances, resulting in reintroduction to auction, and diversions to ceiling price reserve; or 2) changes in APCR sales that would change diversions to speed bumps and ceiling price reserve.

The market fundamentals could be significantly impacted and confidence in the market and sustainability of the program could be undermined. Any such impacts would result in unpredictability of GGRF funding and project funding.

***Recommendation*** The organizations listed above encourage CARB to continue to follow the updated rulemaking schedule that calls for implementation of the AB 398 and third compliance period industry assistance factors changes by January 1, 2019 in order to mitigate the potential risk that this uncertainty poses to obligated parties, market participants and the health of the cap-and-trade market. We look forward to continuing work in support of this goal and California's overall GHG reduction goal.

Thank you for the opportunity to share our views.

California Chamber of Commerce  
California League of Food Processors  
California Manufacturers and Technology Association  
California Independent Oil Marketers Association  
California Independent Petroleum Association  
Climate Change Policy Coalition  
Western States Petroleum Association