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September 19, 2016

Rajinder Sahota
California Air Resources Board
1001 I Street
Sacramento, CA 95184

Re: Comments on Proposed Amendments for Third Compliance Period and Post-2020 Cap-and-Trade Program

Dear Ms. Sahota:

On behalf of the Environmental Defense Fund, and our over 60,000 members in California, we appreciate the opportunity to comment on the proposed amendments for the third cap-and-trade compliance period and to establish the post-2020 cap-and-trade program.

In over three years of implementation, California's cap-and-trade program has proven to be a successful part of California's suite of climate policies. Capped emissions are declining, California is adding jobs and growing the economy faster than the national average, the state is able to create more wealth with fewer emissions, Quebec and California are linked and holding quarterly joint auctions, almost all businesses have successfully complied with cap-and-trade requirements, and California communities - especially low-income, pollution-burdened communities - are seeing real benefits from cap-and-trade investments. Cap-and-trade is an essential part of achieving these outcomes because it places an absolute limit on carbon pollution and ensures that polluters are held accountable for their pollution and must include a price on carbon into their regular business decisions.

Because of this success we strongly support ARB moving forward with amendments to extend the cap-and-trade program beyond 2020 and believe this is the right time to do so. The cap-and-trade program needs certainty about future emissions reductions in order to continue providing robust incentives for reducing emissions.

Authority to Act

AB 32 gave the Air Resources Board the responsibility and obligation to regulate greenhouse gas pollution in California. Although, AB 32 set out a specific target for 2020, the language of AB

1107 9th Street
Suite 1070
Sacramento, CA 95814

T 916 492 7070
F 916 441 3142
edf.org

32 is clear that the Board's responsibility does not end in 2020. Therefore, EDF has been fully supportive of ARB's efforts to extend the cap-and-trade program beyond 2020 under their existing AB 32 authority. Furthermore, the California Legislature has now made it clear, through the recently passed SB 32, that ARB does have existing authority to act to reduce greenhouse gasses and that they must use that authority to reduce harmful pollution consistent with reaching a target of at least 40 percent below 1990 levels by 2030.

Post-2020 Cap Setting

Support a 2021 cap based on expected actual emissions in 2020:

Since the impact of greenhouse gas pollution in the atmosphere is cumulative over time, the trajectory of reductions in California is environmentally significant. An earlier reduction on greenhouse gasses has a greater benefit to the atmosphere than an equivalent reduction in a later year. In informal workshop comments, EDF supported ARB setting the 2021 allowance budget based on the most up-to-date expectation of emissions in 2020 (which are broadly anticipated to be below the level of the 2020 allowance budget), rather than based on a straight line reduction from 2020 to 2030. We continue to support this approach.

ARB is proposing an approach where an amount of allowances equivalent to the difference between the 2021-2030 allowance budgets implied by using the most up-to-date expectation of 2021 emissions versus the straight-line (i.e., between the 2020 allowance and 2030 allowance budgets) trajectory would be placed in the Allowance Price Containment Reserve (APCR). If allowances prices remain below the APCR, this would have a similar practical effect to setting the post-2020 budget based on the most up-to-date expectation of 2021 emissions. However, the long-term difference in the aggregate level of the cap could weaken the price signal to the economy. The fact that actual 2020 emissions are expected to be below the 2020 allowance budget shows that businesses can make the sorts of deeper emissions reductions that will be necessary for California to achieve its post-2020 reduction targets. Market participants do not have an established expectations about post-2020 budgets that have not yet been set. Therefore, stakeholders do not have a legitimate claim to allowances that represent a budget set at the straight-line reduction trajectory.

Maintaining consistency with previous cap-setting practices and stated policy positions would also suggest that ARB should set the 2021-2030 allowance budgets based on the most up-to-date expectation of 2021 emissions. ARB set the 2013-2020 allowance budgets based on expected emissions and then set aside APCR allowances from below those budgets. In reference to EPA rulemaking, ARB has noted how important cap adjustments would be if a mass based cap was significantly above actual emission levels, due to unforeseen factors affecting emissions. In this context, a cap adjustment is also appropriate given that factors related to imported electricity may have made it easier than anticipated for importers to bring (or appear to bring) clean energy into California. Given these dynamics we believe ARB should err on the side of being conservative, setting a tighter rather than a looser cap.

EDF believes that the 2021 cap should be set based on the most up-to-date expectation of 2021 emissions and that APCR allowances should be set aside from under that cap level, perhaps with some relationship to the level of the offsets limit.

Support including fugitive methane emissions:

The issue of fugitive methane emissions is not directly addressed in this rulemaking except to the extent that natural gas consignment might incentivize a reduction in fugitive methane emissions. EDF believes that ARB should begin taking steps to accurately account for fugitive methane emissions in the cap post-2020. In reality, all natural gas is already under the cap since importers of natural gas and natural gas extractors have compliance obligations under the cap. However, those compliance obligations are based on the emissions associated with combusting that natural gas. When that natural gas is leaked from a pipe, for example, as methane, the greenhouse gas impact associated with that now fugitive methane is much higher.

When ARB initially set the cap before compliance began, measurement techniques were not yet sophisticated enough to accurately account for fugitive methane emissions. However, major progress has been made since that time in the ability to measure fugitive or leaked methane. ARB will need to do a thorough evaluation of the steps necessary to include fugitive methane in the cap and an evaluation of the available data. Much of that discussion is beyond the scope of these comments but we look forward to engaging with ARB on this topic. We do encourage ARB to complete this effort in time to include fugitive methane in the post-2020 cap starting with the 2021 compliance year.

Support updating global warming potentials:

EDF supports ARB's decision to update the GWPs relative to the second IPCC assessment but encourages ARB to continue considering moving to the fifth, rather than the fourth IPCC assessment.

Linkage

Support linkage with Ontario

EDF supports ARB moving forward with the process to link Ontario to the California-Quebec market. There are many potential benefits of this linkage but one of the most significant is the work it will do to further California and Quebec's example of how local, bottom-up partnerships and action can help to solve a global threat. The early collaboration that took place in the WCI process continues to bear fruit and allowed participating jurisdictions to consider action at their own pace and adapted to their own local needs. Once Ontario was well situated to take up the issue of cap-and-trade again, they were able to act very quickly and are implementing a cap-and-trade program on a very aggressive timeline because of the intervening work completed by California and Quebec. This avoided delay is a major benefit to the atmosphere which will benefit California and its partners.

Other benefits of the Ontario linkage include market benefits such as a broader market with potentially more cost-effective emissions reductions and greater market liquidity. There are also administrative benefits of cost-sharing within WCI, Inc., for example, related to maintaining the CITTS system and administering auctions. As climate leaders we also hope that California, Quebec, and Ontario will encourage one another to set ambitious caps, caps that not only meet their established targets but that recognize that the trajectory taken to achieve those targets also has significant environmental impacts.

Ontario is well suited for the type of full linkage contemplated in this rule making. Ontario was a WCI participant and is in the process of adopting a cap-and-trade regulation that is well aligned and appears to be harmonized with California and Quebec's programs. Ontario has also set 2020, 2030 and 2050 targets that are more stringent than California's in 2020, slightly less stringent in 2030, and equivalent in 2050. This seems a comparable level of ambition adequate to meet California SB 1018 standards.

<u>Support to develop a regulatory proposal for sector-based offsets from tropical forests</u>:

Although the current proposed regulations do not include amendments to allow the use of international sector-based offsets from tropical forest for compliance in California's program, the staff's Initial Statement of Reasons (ISOR) does contemplate this option for the program's third compliance period. We would like to take this opportunity to briefly emphasize why we believe that is critical for the State of California to develop a compliance pathway for jurisdiction-scale reductions in emissions from tropical forests through its cap and trade program, and to do so as soon as possible. First, tropical deforestation is a significant global contributor to climate change. Climate modeling suggests that reducing deforestation below current levels is crucial to stabilizing global average temperature below key thresholds above pre-industrial levels. Without economic incentives that make standing forests worth more alive than dead, the unsustainable conversion of forests worldwide is likely to continue and will further fuel the disastrous effects of climate change.

The jurisdictional and sector-based approach to crediting international offsets from the tropical forest sector being currently contemplated by CARB (i.e. one that is implemented comprehensively at state, provincial, regional, and ultimately national levels) offers critical features that overcome many of the most prominent criticisms of the project-by-project model for reducing emissions from tropical deforestation. A pathway for credits from such sector-based and jurisdictional-level programs in tropical forest jurisdictions, done right, could set a global gold standard and drive other states and countries to take action to address this significant source of global emissions. California can leverage its program to achieve emissions reductions beyond its borders at a large scale by incentivizing high-integrity programs abroad the can demonstrate reduction in deforestation emissions and benefits for tropical forest communities. In addition, an adequate supply of high-quality offsets within the regulatory offsets limit is an important cost-containment feature for California's program.

<u>Support following international best practices on accounting:</u>

With only one linkage partner, Quebec, the mechanics of linkage so far have been relatively simple. However, as California engages with new linkage partners and considers new types of linkage such as Retirement-Only Linkage and Retirement-Only Linkage Agreements these relationships and their emissions impacts of them will grow increasingly complex. The Paris agreement has identified this challenge as countries consider voluntary cooperation to achieve their nationally determined contributions ("NDCs"). Article 6.2 of the Paris Agreement requires parties to "apply robust accounting to ensure, inter alia, the avoidance of double counting" when engaged in emissions trading to meet their NDCs. The Conference of the Parties will be providing further guidance to parties on what is required under this provision. Although subnational jurisdictions are not parties to the Paris agreement, California and its partners are viewed globally as a model for emissions trading and contributing to and following best practices on issues such as accounting is critical to maintaining that position. We encourage California and partners to follow developments within the Conference of Parties closely and to consider contributing to the development of best accounting practices where appropriate as the state's linkage relationships mature. EDF is deeply engaged in discussion about accounting practices under the Paris Agreement and looks forward to working with ARB on this topic in the future.

Allowance Allocation

Consignment Requirements for the Natural Gas (NG) Sector:

EDF supports the staff proposal to increase the percentage of allowances NG suppliers are required to consign to auction. Some transition assistance was appropriate. However, increasing the consignment percentage for the NG sector will create more parity with electric utility sector and create a more even price signal across the cap-and-trade program. Furthermore, EDF supports ARB continuing to disallow a volumetric return of allowance value to customers. In the electricity sector, the climate credit provided by utilities to households is providing a progressive benefit that shields low-income customers from overall increased costs while preserving an incentive to implement like energy efficiency that will lower electricity use. Moving to 100% consignment without a volumetric return of value in the NG sector will have a similar effect.

Including Purchased Electricity or Steam in Industrial Benchmarks:

EDF strongly supports ARB's proposal to include purchased electricity and steam in the calculation of industrial benchmarks, and strongly advocates that ARB apply EDU or purchase-specific (in cases where an industrial source purchases electricity directly from and EGU, for example) emissions factors. Applying EDU or purchase-specific emission factors will provide the correct economic incentives to industrial sources to substitute between electricity and steam supplied by an EDU, or other third party, and on-site combustion. In contrast, applying a state average emission factor would unduly penalize sources of electricity and steam with emission factors below the state average and unduly advantage sources with emissions factors above the state average, potentially distorting technology choices of covered industrial sources and leading to higher GHG emissions.

ARB should reduce the annual allocation to each EDU by an amount equivalent to the total annual allowance allocation to industrial sources for electricity or steam purchased from that

EDU. This netting out should be conducted on an updating annual basis in concert with the allocation to industrial sources for purchased electricity and steam. As opposed to forecasting approaches, which would reduce the allocation to EDUs by projecting emissions associated with purchases of electricity or steam by covered industrial sources, this approach guarantees that allocations to EDUs are appropriately adjusted for net sales, avoiding under or over compensation associated with sales of electricity or steam to covered industrial sources.

Allocation to EDUs for Increase End-use Electrification:

EDF believes ARB has taken the appropriate step by continuing to consider the question of whether and how to update allowance allocation to EDUs to account for expanded electrification deserves further study and consideration. Driven by decarbonization of the grid, electrification increasingly presents an opportunity for deep carbon reductions in a variety of sectors, most notably the transport sector. As emissions in those other sectors fall, increased demand for electricity will result in greater emissions associated with the electric sector, potentially warranting greater allocation to fund direct investments in decarbonization. That said, it will be critical that allowances are not used to blunt the carbon price signal in electricity rates. Using allowances to distort the price signal in electric rates could potentially disadvantage alternative technologies, leading to higher GHG emissions and delaying (or derailing) critical innovations.

Another potential source of risk in updating allocations to EDUs stems from the method used to update the allocations. If allocation are updated based on changes in load, as opposed to well-identified instances of substitution toward electric alternatives (i.e., by measuring the change in electricity demanded by the EV fleet, for example), there is potential to disincentive energy efficiency. That is, if allocation is based on changes in load, as opposed to changes in load driven by specific, and well-quantified, instances of electrification, then EDUs will have a strong disincentive to invest in activities that reduce load.

Sincerely,

Erica Morehouse

Erica Morehouse
Senior Attorney, Global Climate