June 22, 2024

Dr. Liane Randolph
Chair, California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Comments on May 31 CARB workshop regarding updates to California's Cap-and-Trade program

Dear Chair Randolph,

On behalf of Environmental Defense Fund, NextGen California, and The Climate Center, we appreciate the opportunity to provide comments on the May 31, 2024, workshop on updates to the California Cap-and-Trade Program. Our organizations deeply value CARB's continued work on this program, and we look forward to ongoing engagement throughout this rulemaking process. These comments respond to several ideas presented in this workshop and considerations for future workshops.

We continue to applaud CARB's commitment to strengthening this program, and respectfully request further details on implementation.

Our organizations strongly support CARB's commitment to pursue increased ambition in the California cap-and-trade program through this rulemaking, and we applaud CARB's proposal to adjust the emissions cap to achieve a 48% reduction by 2030. To avoid the worst impacts of climate change, we need to secure as many emissions reductions as possible in this decade. The 2022 Scoping Plan also recognized that meeting California's net-zero goal by 2045 will require accelerating emission reductions in the near term, achieving at least a 48% reduction below 1990 levels by 2030. Earlier reductions in emissions translate to greater cumulative reductions, making it easier to ensure that California achieves its targets. Given the urgency of cutting climate pollution and the necessary emissions trajectory to achieve the goals of the 2022 Scoping Plan, we appreciate CARB's proposal to tighten the emissions cap to achieve a 48% reduction by 2030.

We further appreciate CARB for not only evaluating the necessary "end point" in 2030 (i.e., a 48% reduction) but also appropriately calibrating an adjustment to the cap between 2025 and 2030 to achieve cumulative reductions in line with that target. This approach highlights that the path we take towards achieving emissions targets — and the cumulative reductions achieved over time — is even more important than reaching a specific emissions level in a particular year. As we've written previously, we strongly support Proposed Scenario A as laid out in the Standardized Regulatory Impact Assessment (SRIA) as a pathway to achieving these reductions. The pools from which allowances are removed have a significant impact on actual emissions reductions, and Scenario A is the only scenario which guarantees emissions will be reduced in line with the targets laid out in the 2022 Scoping Plan because it does not rely on removing allowances from the Allowance Price Containment Reserve (APCR) tiers. Removals from APCR tiers only translate to actual emissions

reductions in the case that those reserves are triggered and exhausted, which is not a guarantee. We commend CARB's focus on driving cumulative reductions in line with the state's target, helping accelerate emissions reductions and secure a safer climate future.

The role of cap-and-trade isn't just as a driver for reductions but as an 'insurance policy' to secure cumulative reductions consistent with California's climate targets. The primary feature of the program – the cap – sets an emissions budget that ensures covered emissions do not surpass set limits, acting as a safeguard if other strategies and policies fall short. The 2022 Scoping Plan emphasized this program as a key tool to bridge the gap between expected reductions from other policies and the necessary cuts to achieve California's goals. With uncertainty around the timely scale and deployment of technologies like green hydrogen and carbon capture by 2030, a firm and properly calibrated emissions cap is essential. California's commitment to tightening its allowance budget is a significant advancement in strengthening the state's emissions backstop and, in turn, bolstering the state's entire suite of climate policies.

We appreciate CARB's commitment to engaging with stakeholders as this process enters the formal rulemaking phase. To allow for meaningful engagement going forward, CARB should prioritize providing clearer timelines for this process and more details on the significant proposed changes, including new allowance budgets and the implementation of allowance budget reduction. This information is critical for stakeholders to understand the practical implications of the proposed adjustments.

We strongly support updating inputs to the industrial allocation methodology, including product benchmarks and cap decline factor

Our organizations recommend that the product benchmarks used for output-based allocation (OBA) should be updated to reflect new advancements in industrial technology and processes. In the May 31 workshop and in the SRIA, CARB indicated that it is evaluating updates to industrial allowance allocation, including the product efficiency benchmarks. This is essential in order to hold industry to the efficiency standards that are achievable today and prevent emissions leakage while incentivizing the decarbonization of emissions-intensive, trade-exposed (EITE) industries.

California's output-based allocation (OBA) method is a strong approach to achieve these goals; it can help to effectively reduce climate pollution from emissions-intensive industries while supporting in-state production. OBA rewards industrial facilities based on two key metrics: 1) the amount they produce in-state, and 2) their production efficiency measured against an efficiency benchmark. Facilities that increase in-state production while reducing emissions receive more allowances than those that do not increase production or reduce emissions.

A crucial element of this approach is the efficiency benchmark, which compares emissions performance across similar industrial facilities. Product-based benchmarking sets an emissions performance standard for each product, rewarding more efficient facilities comparatively. These benchmarks, developed on a product-by-product basis, reflect the performance of highly efficient or "best in class" facilities in each sector. Regular updates to product benchmarks are essential to reflect advancements in technology and innovation, providing ongoing incentives for facilities receiving free allowances to reduce emissions. **We urge CARB to update these benchmarks to align with the latest best-performing standards for each industry.**

We strongly support CARB's consideration of updating its approach to efficiency benchmarks for all covered industries, including its proposed changes for cement production specifically. CARB should prioritize changes that unlock cement decarbonization - by approaching allocation to cement producers with an output-based approach, rather than its current approach based on clinker and

mineral additives, CARB can more effectively incentivize the transition to lower carbon blended cements. Using blended cements is one of the most accessible decarbonization options for cement manufacturers, which reduces the clinker content in cement products. By determining allocation based on cement output, rather than on clinker and mineral additives produced, CARB can more strongly encourage the use of blended lower-carbon cements.

In addition to product benchmarks, the cap decline factor is a key input for industrial allocation, reducing free allocation to industry over time in line with the overall emissions cap. This gradual reduction ensures that EITE industries face an increasing price signal to support emission reductions and innovation. As CARB tightens the program-wide emissions cap, it is crucial that this tighter cap is reflected in the OBA formula through the cap decline factor.

We also encourage CARB to explore innovations in the industrial allocation method to support stronger pollution reduction outcomes in overburdened communities. For example, CARB could apply a more stringent cap decline factor to industries with localized pollution impacts on disadvantaged communities. This adjustment could ensure that free allocation of allowances declines faster in these areas, providing a stronger incentive for reducing emissions where air quality improvements are most urgently needed.

CARB should eliminate the exemption for biofuels under cap and trade

The May 31 workshop included discussion of an initial concept to address existing exemptions for ethanol fossil denaturant CO2 emissions. CARB presented an idea to amend the mandatory reporting requirement (MRR) so that supplied fuel ethanol appropriately accounts for the volume of fossil fuel denaturant, which is currently reported as 100% biogenic ethanol with associated CO2 emissions considered exempt under cap-and-trade. Our organizations support CARB's move toward more accurate reporting of emissions associated with fossil fuel denaturants and urges CARB to carry this proposed change to a more ambitious end point by eliminating the exemption for biofuels under cap-and-trade altogether.

As EDF commented in our October 2023 submission to CARB, it is imperative that CARB amend its treatment of biogenic emissions under cap-and-trade in order to account for the full lifecycle impacts of bioenergy production and use. Under current treatment, different fuels with vastly disparate life cycle analysis values are all counted nominally as zero-emissions under cap-and-trade accounting in California. This fails to capture the reality that some fuels at the top of the GHG intensity range can have impacts several fold those of the fuels at the bottom end of the range. CARB should ensure that biofuels are rewarded on a performance basis, to protect the integrity and effectiveness of the cap-and-trade system. With this in mind, we recommend that CARB eliminate the exemption for biofuels under cap and trade and instead fully include biogenic CO2 emissions in a covered entity's obligation. Bioenergy usage should only be rewarded to the extent that emissions reductions relative to the displaced fossil fuel usage exist on a life-cycle basis, with special attention to carbon leakage.

As allowance budgets are adjusted, the program should continue to protect ratepayers

The May 31st workshop discussed allowance allocation to utilities. As CARB outlined in its presentation, utilities are required to spend the auction proceeds from allocated allowances to benefit ratepayers. These revenues most commonly fund non-volumetric return to ratepayers (e.g., the California Climate Credit) or projects that reduce GHG emissions (which must benefit ratepayers in the utility's service territory). We reiterate the importance of utility allocation design, as well as revenue from consignment of that allocation, for protecting ratepayers and– particularly

low-income ratepayers – as the program's allowance budgets are tightened and allocation adjusted accordingly.

Moreover, as CARB tightens the cap to align the program with California's updated climate goals, **most if not all allowances should be removed from those that would be directly allocated and offered at auction** – as opposed to removing allowances from the Allowance Price Containment Reserve (APCR) or the price ceiling. To the extent that CARB must deviate from this recommendation, allowances should be retired *only* from the APCR exclusively for the protection of low-income ratepayers, and CARB should only consider removing as many allowances as are necessary to achieve this goal. We recommend CARB publish the modeling results of the various scenario options as soon as possible so the emission benefits of removing allowances from the different categories can be assessed. CARB should also consider independent modeling of the program, including forthcoming analysis from Resources for the Future. Drawing allowances from the APCR, or from the price ceiling, would not be effective ways to achieve the goal of this program adjustment and would risk disincentivizing near-term reductions. Removing allowances from the APCR should only be considered for the purpose of targeted ratepayer protections.

Our organizations reiterate our appreciation for CARB staff's ongoing work to update this important climate program, and we look forward to ongoing engagement in this rulemaking process.

Sincerely,

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