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June 21, 2024

Ms. Rajinder Sahota
Deputy Executive Officer, Climate Change & Research
California Air Resources Board
P.O. Box 2815
Sacramento, CA 95812

Submitted electronically

SUBJECT: SDG&E Comments on the May 31, 2024, ARB Workshop on Potential Amendments to the Cap-and-Trade Regulation

Dear Ms. Sahota:

The San Diego Gas & Electric Company (SDG&E) appreciates the opportunity to provide comments on the recent California Air Resources Board's (CARB) workshop regarding potential amendments to the Cap-and-Trade Regulation Program (C&T Program). The C&T Program has historically played, and will continue to have, a significant role in promoting emissions reductions across California. The May 31, 2024, workshop highlighted a key component of the C&T Program: the allocation of allowances to electric distribution utilities (EDUs) and natural gas suppliers (NGSs).

SDG&E is committed to helping meet California's goal to reach net zero greenhouse gas (GHG) emissions by 2045,[1] and supports gradual modifications to the C&T Program that bolster the pursuit of climate goals via progressive, economically viable reductions in emissions. Addressing the specific queries and overall discussion themes raised by staff at the workshop, SDG&E respectfully offers the following feedback: (1) the direct allocation of allowances for EDUs and NGSs aligns with state decarbonization and equity goals; (2) EDU allocations are critical to achieving the State's electrification goals and should be preserved; (3) NGS allocation methodology should be modified to account for the anticipated cost burden for natural gas customers; (4) EDU and NGS allocations should be continued post-2030, and should account for expected cost burden as well as how changes may impact broader economywide decarbonization objectives, and; (5) the current structure around use of EDU and NGS allowance values appropriately recognizes

[1] SDG&E's *The Path to Net Zero: A Decarbonization Roadmap for California* was released in April 2022 and outlines key strategies for advancing a carbon neutral future.

that flexibility may be needed to ensure revenues are effectively used for the benefit of customers.

Further, SDG&E offers its support for the comments submitted by the Joint Utility Group (JUG) and Gas Utility Group (GUG) and acknowledges that many of the issues discussed in those letters align with positions presented herein.

I. The direct allocation of allowances for EDUs and NGS aligns with state decarbonization and equity goals.

As CARB evaluates potential reductions to the C&T Program's 2025-2030 allowance budget to better align with the State's 2022 Scoping Plan (SP), the staff is challenged with identifying the sources of these reductions. In the face of escalating expenses due to inflation, global supply chain disruptions, and climate change adaptation, CARB's primary focus in this update should be on mitigating the impact of proposed program changes on California's energy costs. This focus is particularly significant due to the critical role that the energy system has in supporting the transition to economywide decarbonization.

SDG&E understands that the C&T Program is not the only factor impacting energy costs and, therefore, cannot reasonably be expected to address the entirety of the State's affordability challenges. Indeed, SDG&E is actively seeking opportunities to address affordability by pursuing, for example, federal funding and other methods to reduce costs for its customers while continuing to provide safe, reliable, and clean service. However, acknowledging the importance of the energy sector for the vitality of California residents and businesses, the C&T Program was established with the intent of protecting energy customers from the cost burden associated with program compliance. This intent is fully appropriate and is even more important today and looking forward to the years leading up to economywide decarbonization.

Further, the current allocation for EDU and NGS is not only in line with, but also a strong statement of, the State's commitment to reducing GHG emissions and promoting equitable, cleaner energy sources. The current EDU and NGS allocations ease the financial burden on energy ratepayers over time and facilitates the transition to clean energy in the building and transportation sectors, as well as in harder-to-decarbonize areas of the economy. It also supports the development of necessary resources in California for electrification and reduces economic strain on underprivileged communities, demonstrating the State's comprehensive approach to environmental and social equity and sustainability.

II. EDU allocations are critical to achieving the State's electrification goals and should be preserved.

Electric utilities are the backbone of the State's electrification and decarbonization efforts; affordable and reliable electricity is essential for supporting customers in their energy transitions. SDG&E and CARB are united in their aim to boost electrification, a key factor in decarbonizing other sectors such as buildings, industry, and transportation, and ultimately achieving the State's GHG emission reduction goals. Any increase in electricity rates poses a threat to customers' ability to electrify. Therefore, it is imperative to ensure that regulatory changes to the C&T Program do not exacerbate electricity affordability challenges and dampen customer motivation to electrify. In light of this, SDG&E aligns its position with that of the JUG and asserts that CARB should maintain the existing valuable cost protections provided via allowance allocations for electricity ratepayers.

The 2021-2030 EDU allowance allocation was established in the 2016 C&T rulemaking, where staff proposed "to continue allocation to electric distribution utilities [EDUs] for the benefit of ratepayers, consistent with the goals of AB 32, beyond 2020."[2] The JUG proposal, which SDG&E supports, upholds the significant value that the direct allocation of allowances offers to electric utility ratepayers, while aligning the allocation calculation with the updated Renewables Portfolio Standard (RPS) requirements. SDG&E provides the below excerpt on the JUG proposal for EDU allowance allocations through 2030. Though the methodology focuses on allocations through 2030, SDG&E and the JUG recognize the importance of continuing EDU allowance allocations beyond 2030 and address the post-2030 in a later section of these comments.

Implementation of SB 100 and the Flexibility Afforded via RPS Portfolio Content Categories: In addition to protecting ratepayers from the Cap-and-Trade program compliance costs, the 2021-2030 EDU allowance allocation was also intended to create regulatory certainty and incentivize EDU investments to decarbonize the electricity supply. The JUG recommends preserving essential cost protections for electricity ratepayers by limiting changes to the EDU allowance allocation to a minor update to align with current RPS requirements as modified by SB 100.[3] Ensuring that the EDU allowance allocations recognize the full range of procurement allowed by the RPS is increasingly important as renewable procurement targets increase. Utilities face growing challenges due to lingering supply chain issues, project siting complexities, and increased competition with Western states for renewable resources. SB 100 increased the minimum RPS targets from 50% to 60% by December 31, 2030, with intermediate targets in intervening years. However, to properly reflect the RPS requirements, the EDU allowance allocation calculation method must recognize that some RPS-compliant resources still carry a compliance obligation under the Cap-and-Trade Program. Current EDU allowance allocations reflect this to an extent but do not incorporate the extent of RPS procurement that is granted – and may be necessary – for some utilities to comply with the higher RPS target. This flexibility to procure different types of RPS-eligible resources becomes more critical as electric utilities increase the proportion of their portfolios consisting of RPS procurement, with simultaneous load growth, to meet the 60% target in 2030.

More specifically, in SB 100, the legislature mandated that at least 75% of the generation used for retail load comes from renewable resources categorized as portfolio content category (PCC) 1. PCC 1 RPS-eligible electricity is directly delivered from renewable generating resources, is treated as zero-emission under the CARB GHG emission reporting regulation and has no Cap-and-Trade program compliance obligation. SB 100 allows up to 25% RPS-compliant generation to come from PCC 2 or PCC 3 resources in recognition of the variability of utility procurement and the need

[2] California Air Resources Board, First Notice of Public Availability of 15-Day Amendment Text, Attachment C. December 21, 2016
[3] Senate Bill 100, De León. California Renewables Portfolio Standard Program: emissions of greenhouse gases. https://legiscan.com/CA/text/SB100/id/1819458.

to ensure flexibility in resource planning. PCC 2 and PCC 3 resources are not treated as carbon free under the CARB GHG emission reporting regulation and, therefore, have compliance obligations under the Cap-and-Trade Regulation. The EDU allocation methodology should thus recognize that PCC2 and PCC3 RPS-eligible products result in Cap-and-Trade compliance obligations and remove the maximum allowable PCC 2 or PCC 3 procurement from the assumed percentage of zero-emission RPS electricity. This 25% proportion, when applied to the 60% RPS mandate by 2030, would yield an effective 45% RPS for 2030. However, this number differs for the intervening years.

Retaining the RPS Adjustment: To prevent potential conflicts between the RPS Adjustment provision and the Effective RPS, the JUG proposes to modify the application of the RPS Adjustment to apply only to PCC-0 resources.

SB 100 Effective RPS and Utility Forecasts: The electricity sector load growth associated with data centers, expanded transportation electrification, large-scale housing and industrial developments, hydrogen production, and experiential entertainments, among other factors, is expected to increase[4]. In the past load growth not reflected in the IEPR forecast have been addressed and accounted for in utility allowance allocations following the presentation of verifiable data. The JUG believes that CARB should continue to work with the utilities in the same manner to address this expected growth. In summary, updates to the EDU allowance allocation in Table 9-4 should be limited to the SB 100 informed effective RPS, and utility-specific load growth modifications to 2015.

III. The NGS allocation methodology should be modified to account for the anticipated cost burden for natural gas customers.

As CARB staff have articulated in the C&T Program workshops, the proposed reductions in C&T allowance budgets to align with a 48% reduction in 1990 GHG levels by 2030 will, by default, result in modified cap adjustment factors (CAFs). Information presented by CARB staff in these workshops indicates an approximate 8 % - 11% annual reduction in allowances via this modified CAF.[5]

Because the allowance allocation for a natural gas supplier (NGS) is adjusted annually commensurate with the CAF, the CAF reductions would result in a significant and concerning decrease in the amount of allowances available to provide cost protection for NGS customers. Further, the magnitude of the change in CAF appears to be much greater than the expected reductions in C&T cost burden for NGS customers. Any reduction in NGS allocations from the current regulation would weaken the NGS allocation's ability to shield customers from heightened costs. Notably, lower-income customers are expected to bear a disproportionate burden of the increased energy expenses as they may encounter higher barriers to transitioning to electric appliances and vehicles due to associated costs and constraints around tenancy as compared to property ownership. **SDG&E is concerned that the adjusted CAFs will result in NGS allocations that are**

[4] California Energy Commission's Integrated Energy Policy Report (IEPR) workshop on May 16, 2024
[5] Based on information provided in CARB's October 2023 and May 2024 Cap-and-Trade workshops.

inadequate for supporting the intended purpose of the allocation: to protect customers from the cost burden associated with the C&T Program.

To address this concern, SDG&E and the GUG propose to modify the NGS allocation methodology so that it more closely aligns with the expected cost burden for NGS customers. This can be achieved by incorporating gas demand forecast data from publicly vetted sources, such as the 2022 Scoping Plan or the California Energy Commission (CEC) 2023 Integrated Energy Policy Report (IEPR) forecasts.

When compared to the 8-11% annual decline expected with the modified CAF, both the Scoping Plan and the 2023 IEPR forecast's Gradual Transformation Additional Achievable Fuel Substitution Scenario (GTAAFS) estimate that more natural gas will be needed in the years leading up to 2030. This, in turn, results in a higher anticipated cost burden than would otherwise be available with the projected NGS allowance allocations. The Scoping Plan models a ~5% annual decline in NG emissions between 2024 and 2030, while the GTAAFS scenario models a ~3% annual average decline in NG emissions during the same period.

SDG&E is aligned with the comments from the Gas Utilities Group (GUG) on this recommendation and looks forward to additional discussion with C&T staff on this issue.

IV. EDU and NGS allocations should be continued post-2030 and should account for expected cost burden as well as how changes may impact broader economywide decarbonization objectives.

SDG&E appreciates CARB's efforts to initiate discussions about the allocation of allowances beyond 2030. Addressing this issue is an important initial step in providing the necessary regulatory clarity for the stability of the C&T Program. SDG&E looks forward to continuing to work with CARB to improve the strategy for post-2030 allocations in a way that protects utility consumers and supports state objectives. SDG&E emphasizes the importance of anticipating potential changes in the allowance budget and EDU allocations after 2030 within the C&T framework. Accurately predicting these changes is crucial for establishing clear market indicators, which will help achieve our long-term decarbonization goals more cost-effectively. Taking this proactive approach will give entities required to comply sufficient time to adjust, avoiding disruptions that could occur if updates were delayed until closer to 2030. Delaying these updates risks disrupting the smooth transition needed to achieve our decarbonization goals by the 2030 deadline.

V. The current structure around use of EDU and NGS allowance values appropriately recognizes that flexibility may be needed to ensure that revenues are effectively used for the benefit of customers.

As discussed above, since its inception, the C&T Program has provided essential cost protections for utility ratepayers through directly allocated allowances. These allocated allowances are sold at auction, creating revenues returned **directly** to utility customers. SDG&E customers benefit from these revenues in the form of a bill credit (the California Climate Credit) and various incentive and decarbonization programs. In 2024, SDG&E

customers received a combined ~$156 for their gas and electric Climate Credits.[6] These allowances provide significant value for SDG&E customers and facilitate continued progress in GHG emissions reductions at a lower cost to ratepayers.

While SDG&E will continue to reduce the GHG intensity of the resources served for its customers, the expected increases in allowance prices will likely result in an increased cost burden associated with C&T compliance. These costs are passed through to the customers in the form of higher monthly energy bills, which heightens the importance of retaining EDU and NGS allowance allocations to help offset the anticipated increase in cost burden.

During the workshop, CARB staff posed the question of whether the use of allowance value for NGS should be revisited. Staff also asked whether there should be any additional limitations on the types of GHG reduction projects that can be funded with EDU and NGS allowance value.

SDG&E believes that the existing limitations and reporting requirements are sufficient. The limitations on using allowance value reflect significant stakeholder discussion and revisions during the 2016 Amendments rulemaking process. Any changes or additional limitations imposed now would jeopardize existing programs and investments and harm electricity customers.

The existing restrictions on using allowance value serve as essential guardrails. These limitations prevent misuse, ensure transparency, and protect electricity customers. However, more flexibility in using allowances could spur innovation. This flexibility might revolutionize the energy industry by supporting emerging technologies during their nascent stages. Striking the delicate balance between encouraging innovation and safeguarding customer interests remains a critical challenge, one that requires careful consideration and thoughtful decision-making.

VI. Conclusion

Thank you for your consideration of SDG&E's comments. Please do not hesitate to contact me should you have any questions about the information provided in this letter. SDG&E appreciates CARB staff's diligence in exploring opportunities to strengthen the C&T Program and to continue advancing toward achievement of California's climate goals in an equitable manner. We look forward to engagement with CARB staff and stakeholders on these extremely consequential issues.

Sincerely,

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[6] California Public Utilities Commission. California Climate Credit 2024. https://www.cpuc.ca.gov/climatecredit.