



June 21, 2024

Rajinder Sahota
Deputy Executive Officer for Climate and Research
California Air Resources Board
1001 I Street – P.O. Box 2815
Sacramento, CA 95812

Subject: Gas Utility Group Comments on the May 31, 2024, California Workshop on Potential Amendments to the Cap-and-Trade Regulation

Dear Deputy Executive Officer Sahota:

These comments are submitted on behalf of investor-owned, natural gas utilities (IOUs): Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Pacific Gas and Electric Company (PG&E), Southwest Gas Corporation, and publicly owned natural gas distribution utilities (POUs) serving the City of Long Beach. The above utilities are referred to collectively as the Gas Utility Group (GUG or Utilities). The GUG appreciates the opportunity to provide comments on the California Air Resources Board’s (CARB) May 31, 2024, Workshop on Potential Amendments to the Cap-and-Trade Program (Program).

As CARB continues to evaluate potential reductions to the Program’s 2025-2030 allowance budget to better align with the State’s 2022 Scoping Plan Update (SPU), CARB Staff faces a difficult challenge in determining where those reductions should come from. In the face of rising costs due to inflation, global supply chain issues, climate change adaptation, and the investments necessary for a decarbonized future, **mitigating the energy cost burden to California customers from a more stringent Program should be the primary consideration in determining allowance allocation volumes.** Utility allocation remains the most direct way for Program revenues to benefit California residents while still supporting a carbon price, either through bill credits or targeted greenhouse gas (GHG) emissions reduction programs, which are subject to multiple layers of agency oversight and review.

California’s integrated energy system relies on both natural gas and electricity to provide reliable energy for Californians. Further, natural gas plays an important role in the ability of the electricity

system to operate reliably – particularly when renewable energy resources may be limited (or their delivery constrained). As long as the gas system is needed to support California’s energy supply, gas customer bills will reflect the investments needed to support the ongoing, safe and reliable operation of the system. As is discussed in greater detail below, Californians may decarbonize at different paces. Renters/tenants will likely transition later than individual property owners. However, if the number of customers on the gas system decreases – while the State’s reliance on NG remains the same – the same costs would be distributed across fewer customers, ultimately impacting those later in the transition to the greatest extent.

In the May 31, 2024, workshop slides, Staff asked for feedback on whether utility allocation is sufficiently aligned to promote state electrification goals. **The GUG respectfully asserts that the current natural gas supplier (NGS) allocation is indeed aligned with the State’s goals** by reducing cost impacts to our customers in the medium term while promoting build out of the resources California needs to complement electrification, minimize financial impacts to disadvantaged communities, and support decarbonization of hard-to-abate sectors by 2045.

The GUG’s comments below cover the following:

- I. The importance of NGS allocation and how it is determined;
- II. How potential cap adjustment factors (CAFs) do not align with expected Program cost burden;
- III. How NGS allocation can support the 2022 Scoping Plan Update;
- IV. Post-2030 NGS allocation;
- V. How transportation emissions could be more accurately quantified by better aligning data from the Low Carbon Fuel Standard (LCFS) and Mandatory GHG Reporting Regulation.

I. Natural gas allocation is critical for supporting customers through the State’s decarbonization transition.

As noted in the 2022 SPU, the transition to a decarbonized economy will not happen overnight. Different sectors will transform at different paces depending on a number of factors, including but not limited to technology development and availability, incentives, and the ability to permit and construct new projects. Similarly, not all California residents and businesses will be able to transition to lower carbon energy use at the same pace.

In particular, low-income customers are more likely to switch from natural gas usage more slowly than other customers for various reasons. These utility customers should not be penalized for circumstances and constraints that are outside their immediate control. Examples of such constraints include lack of knowledge/familiarity with electric alternatives, high upfront costs for electric appliances and lack of availability of electric appliances when needed. Low-income customers are more likely to rent in older, multi-family housing buildings, which creates additional barriers for electrification – these buildings are more likely to require expensive and/or lengthy electrical upgrades and may not have sufficient space for new, larger, or differently configured equipment.

Further, affordable natural gas benefits low-income customers who pay a higher proportion of monthly household income on energy costs. A sharp decline in NGS allocation in the next five years would reduce the associated revenues for customers and negatively impact the affordability of household natural gas bills, potentially pushing them further into financial strain.

The revenue from NGS allocation must be used to support natural gas (NG) customers, in line with the goals of AB 32; the allocation does not benefit the utilities themselves. To date, the NGS allocation has been used to support customers by mitigating the compliance costs of the Program that are passed through to customers; provide an annual, non-volumetric bill credit; and support programs that help reduce GHG emissions. Examples of such programs include: building electrification programs¹, renewable natural gas (RNG) interconnection, citywide electric vehicle chargers, installation of solar canopy systems, and energy efficiency appliance rebates, to name just a few.²

NGS Allocation Calculation

The annual number of allowances allocated to each NGS is calculated based on its 2011 GHG emissions (excluding natural gas sales to facilities directly covered by the Program) and the cap adjustment factor (CAF), which declines each year in proportion to the overall annual Program allowance budget. As CARB reduces the Program's overall annual caps and updates the corresponding CAF, this would automatically result in a reduction of allowance allocation for each natural gas utility.

NGSs are currently required to consign a minimum percentage of their allocated allowances to auction each year, and this percentage increases by five percent each year, reaching 100 percent in 2030. The allowances that are not consigned can be used directly for compliance, which reduces the cost pass-through to customers on their NG bills. Once consignment reaches 100 percent, NGS can no longer use any of the allowances directly for compliance. In other words, as NGS consignment requirements increase, the Program's compliance cost as reflected in NG customer bills, will increase.

As highlighted in the 2024 Standardized Regulatory Impact Assessment, increased stringency of the Program as contemplated in the proposed scenarios is likely to lead to higher market prices.³ This combination of increasing consignment and higher prices implies that natural gas customers will be impacted by higher Program compliance costs on their bills in the next few years.

¹ SB 1477 directs a portion of IOU auction proceeds to fund two building decarbonization programs: the Building Initiative for Low-Emissions Development (BUILD) Program and the Technology and Equipment for Clean Heating (TECH) Initiative. BUILD focuses on increasing electrification in new buildings, and TECH aims to electrify space and water heating, especially in existing buildings.

² See Cap-and-Trade Program Summary of 2015-2022 Natural Gas Supplier Use of Allocated Allowance Value, dated April 2024; https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/allowanceallocation/ngs_2015to2022useofvaluereport.pdf

³ CARB, Standardized Regulatory Impact Assessment, April 9, 2024, p. 46: "Using a weighted average price that reflects the proportion of total auctioned allowances sold at auction in a given year during 2025-2046, staff analysis assumes under the Proposed Scenarios that allowances will be sold at auction for an average price of \$60 (versus \$39 in the baseline)."

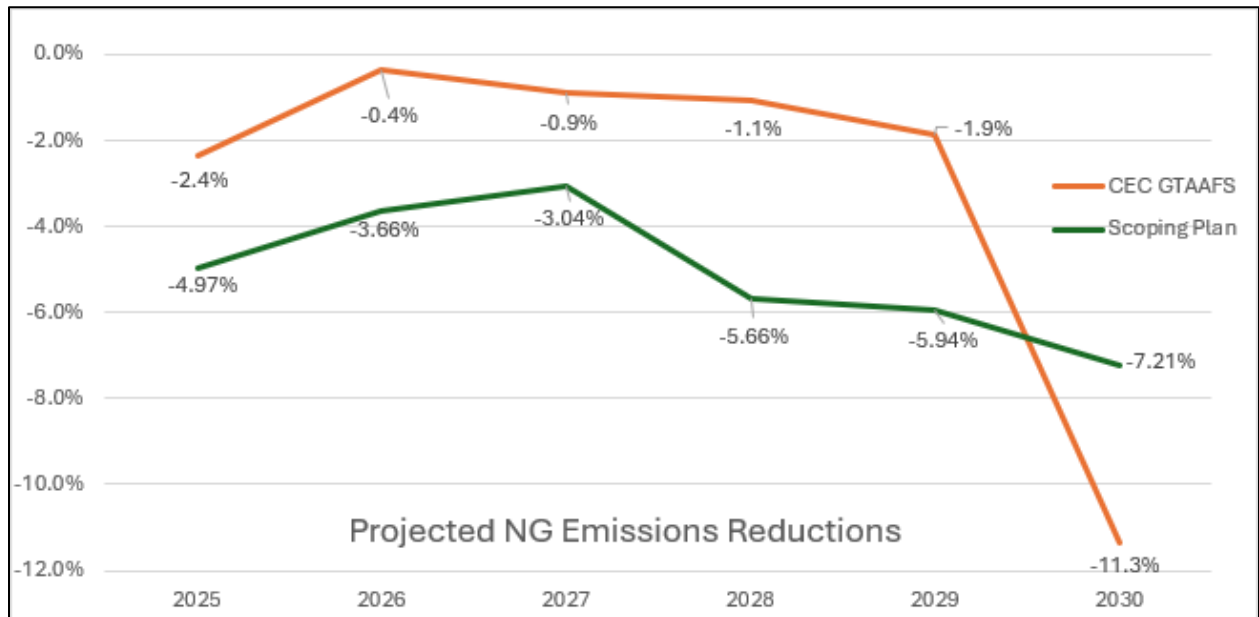
Reductions to NGS allocations from the current regulation would reduce the ability of this allocation to shield customers from higher costs. As noted above, lower-income customers will bear the burden of higher energy costs disproportionately, underscoring the urgency and importance of this issue.

II. The new potential cap adjustment factors shared to-date do not align with the latest data on Program cost burden for natural gas customers. For this reason, CARB should consider modifying its approach to NGS allocation to more closely align with anticipated cost burden for natural gas customers, providing important customer protections.

In the October 5, 2023, workshop, CARB Staff shared potential CAFs that would align with a 48% 2030 target. This scenario comes out to an 11.1% annual reduction in allowance allocations between 2025-2030. In the May 31, 2024, workshop, CARB shared an illustrative example of the CAF from the SRIA’s Proposed Scenario B, which would result in an ~8% annual reduction.

In contrast, the latest forecasts for natural gas demand and estimated associated emissions through 2030 indicate a *much* lower annual decline in Cap-and-Trade cost burden. This difference is highlighted below.

Projected Change in Annual Natural Gas Supplier Emissions from 2025-2030 for California



As demonstrated in the above graph, both the 2022 SPU and the California Energy Commission's 2023 Integrated Energy Policy Report (IEPR) Gradual Transformation Additional Achievable Fuel Substitution Scenario (GTAAFS)⁴ estimate substantially lower annual declines in natural gas demand, which in turn result in lesser reductions to associated emissions. The SPU 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. In both instances, the modeled average annual decline is far less than the 8-11% decline anticipated with the modified CAFs.

The example CAFs shared by CARB staff in informal workshops, while not yet a formal proposal, do not align with the anticipated Program cost burden for NGS customers (as indicated by the data noted above). This discrepancy is a significant concern. If the NGS allocation methodology is not adequately addressed, an automatic adjustment to the allocation via the CAF (if it is more in range with the examples to-date) would not align with the latest forecasts and CARB's own modeling, on the actual pace of the transition from fossil NG usage.

The GUG, therefore, requests additional discussion of how best to align the NG allocation with the expected cost burden of the Program.

III. Natural gas allocation supports the energy transformation envisioned in the 2022 Scoping Plan Update and should not be further limited.

The 2022 SPU states that:

To support the transformation needed, we must build the clean energy production and distribution infrastructure for a carbon-neutral future. The solution will have to include transitioning existing energy production and transmission infrastructure to produce zero-carbon electricity and hydrogen, and utilizing biogas resulting from wildfire management or landfill and dairy operations, among other substitutes. In almost all sectors, electrification will play an important role. That means that the grid will need to grow at unprecedented rates and ensure reliability, affordability, and resiliency through the next two decades and beyond. It also means we need to keep all options on the table, as it will take time to fully grow the electricity grid to be the backbone for a decarbonized economy. We also know that electrification is not possible in all situations.⁵

NGS allocation is not only critical for mitigating the compliance cost burden for NG customers through this transition (especially those without near-term alternatives to NG consumption), the revenue from consigned and auctioned allowances can also help accelerate the investments needed in renewable energy and clean fuels – the latter of which is critical for the decarbonization of hard to electrify sectors of the economy.

⁴ See, CEC 2023 IEPR California Energy Demand Gradual Transition AAFS Scenario : <https://efiling.energy.ca.gov/GetDocument.aspx?tn=255741&DocumentContentId=91578>

⁵ CARB, 2022 Scoping Plan Update, p. 9

CARB's Scoping Plan, the Legislature via SB 1440, and the California Public Utilities Commission (CPUC) have all confirmed the importance of utilizing biogas, especially in those situations where electrification is not feasible. Thus, the use of a portion of the NG allocation proceeds to support biomethane procurement pilot projects and provide an incentive to support biomethane interconnection⁶ is directly in line with the State's decarbonization goals and offers an opportunity to make such investments at lower cost to utility customers (i.e. the same programs would otherwise have to be funded directly from customer bills).

In the May 31 Workshop slides, CARB Staff asked for feedback on whether there should be any additional limitations on the types of GHG reduction projects that can be funded with NGS allocated allowance revenue. The GUG believes that additional clarification on the types of eligible projects is warranted to ensure that there is sufficient flexibility for the NGS revenue to support the Scoping Plan objectives in various ways over time. For example, the ability to use NGS allowance revenue for projects such as the procurement of biomethane, deployment of fuel cells to support building electrification, support for transitioning biomethane fuels currently incentivized through the LCFS to non-transportation and stationary end uses, and scaling up hydrogen production and its delivery are also critical elements of the State's decarbonization plan. We cannot know now what other technologies or applications may benefit from NGS allocation revenue as we progress in the State's decarbonization transformation. Narrowly confining the eligible uses would be counterproductive.

IV. Post-2030 NG allocation

The GUG supports a continued allocation to NGSs post-2030 to continue to protect customers. While the GUG's focus in these comments is on allocations pre-2031, the Utilities support NGS allocations post-2030 to align with expected cost burden of the Program. The proposal identified above, to align NGS allocations with forecasted natural gas demand, is one way to protect customers by offsetting the expected NGS cost burden. Continued NG allocation of allowances will continue to mitigate the compliance cost burden for NG customers through this transition while also supporting GHG reductions through GHG reduction projects.

V. Transportation emissions could be more accurately quantified by aligning data between the LCFS, Mandatory GHG Reporting Regulation (MRR) and Cap-and-Trade Programs.

During the Workshop, CARB staff noted the objective of ensuring that the MRR incorporates complete and accurate emissions data associated with non-fossil transportation fuels. To this point, the GUG respectfully offers that there are several critical disconnects in current accounting practices between LCFS and Cap-and-Trade, ultimately resulting in an undercounting of the true volumes of biomethane distributed through common carrier pipelines. Furthermore, this undercounting amounts to an overstatement of the actual emissions associated with the natural gas

⁶ CPUC D.22.02-025 requires the IOUs to set aside \$40M from Cap-and-Trade allowance proceeds in 2022 to fund biomethane procurement pilot projects. D.20-12-031 requires the establishment of a biomethane interconnection incentive program.

system that are reported to CARB. The GUG encourages CARB to examine which biomethane pathways under LCFS would qualify for Cap-and-Trade treatment. Specifically, when biomethane is procured for natural gas vehicle (NGV) refueling, it is transported to NGV refueling facilities through pipelines owned and operated by NGS. As NGSs, these utilities are subject to the Cap-and-Trade program and are required to keep track of the volumes of natural gas flowing through their systems, as well as the volumes of biomethane.

Under Cap-and-Trade, these biomethane volumes are exempt from compliance obligations because they displace the fossil natural gas that would normally be flowing in these pipelines. Production pathways in California and out-of-state biomethane producers in new facilities are likely Cap-and-Trade compliant. Unfortunately, biomethane procured by third parties and carried by means of NGS common carrier pipelines is designated as fossil gas emissions under the current reporting structure due to limited information available in the Cap-and-Trade Program. Specifically, if a third party is transporting biomethane via common-carrier pipeline, but is not subject to the required compliance thresholds for Cap-and-Trade, CARB would not have access to those volumes of biomethane in circulation. The utilities also have limited visibility into the volumes procured by third parties for transport across common-carrier pipelines. However, the NGS would be required to report these volumes on its system as fossil gas – as the NGS cannot differentiate between emissions content.

The GUG encourages CARB to identify data sharing opportunities between the LCFS and Cap-and-Trade programs to more accurately identify Cap-and-Trade eligible biomethane volumes produced under LCFS pathways that are subsequently distributed through common-carrier pipelines. The GUG also recommends that CARB aggregate the volumes for those pathways (minus any volumes already claimed by entities with their own Cap-and-Trade compliance), eliminate the sharing of any confidential information, and then distribute the aggregated data to each respective NGS. This could be similar to how CARB nets out the volume of natural gas attributed to Cap-and-Trade eligible facilities from the NGS compliance obligation. Providing such data will foster more accurate emissions reporting by each NGS distributing biomethane procured by third parties and help resolve any potential discrepancies to support the intersectional success of both LCFS and Cap-and-Trade. Increased volumes of biomethane in the pipeline system will also benefit ratepayers by reducing NGS Cap-and-Trade compliance obligations.

Conclusion

The GUG appreciates the opportunity to provide comments on the May 31 Workshop on Potential Amendments to Cap-and-Trade Program and is committed to a decarbonized energy system that is affordable for all Californians. The GUG looks forward to continued engagement in CARB's process.