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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 November 16, 2023, Joint California-Quebec 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 California Air Resources Board (CARB) recent workshop considering potential amendments to the Cap-and-Trade Regulation (C&T). The C&T program plays an important role in facilitating emissions reductions in California.

The findings of the initial price modeling underscore the need for robust cost containment provisions and market rules that maintain the integrity of the program. The existing C&T construct addresses these needs well. As CARB considers changes to the regulations, it will be critical to deeply analyze the anticipated impacts in effort to avoid unintended consequences.

It was appropriately caveated during the workshop that, while the modeling results are informative, they should not be taken as an indication of what actual prices may be in future years. SDG&E agrees that there are a number of externalities which could impact future allowance prices. Furthermore, SDG&E is supportive of evaluating the impact of additional abatement measures (such as replacement of existing fossil fuel sources with hydrogen, or use of carbon capture and sequestration) to further reduce costs while supporting continued GHG emissions reductions. Should CARB have an opportunity to complete additional modeling of pricing, it would be valuable to understand how the incorporation of additional abatement measures like those listed above might impact pricing.

In response to the information presented during the workshop, SDG&E offers the below commentary on the importance of cost containment mechanisms; the need for continued allowance banking for covered entities; and clarifications around the applicability of holding limits for companies with corporate associations.

I. Cost containment is critical for maintaining a cost-effective and well-functioning Cap-and-Trade Program.

The allowance price modeling presented during the workshop indicated lower prices near the price floor are anticipated pre-2030 due to higher allowance supply, with prices escalating as 2030 nears due to retirement of excess allowances and proposed reductions in circulated allowances starting in 2026. The modeling presented showed that, absent additional emissions abatement measures, prices would hit the price ceiling as early as 2030.

This modeling exercise demonstrates that the price ceiling and allowance price containment reserve (APCR) will be critical for protecting against unbounded compliance costs. For utilities, specifically, these features protect against unanticipated increases in the cost of complying with C&T. In addition to the price ceiling and APCR, directly allocated allowances to electric distribution utilities and natural gas suppliers serve effectively as further means of cost containment to insulate against rising energy costs.

Affordable energy will be critical to achieving cost-effective decarbonization. Currently, the cost of C&T compliance for electric utilities is reflected via a \$16 per megawatt-hour greenhouse gas (GHG) emissions adder for the price of electricity in the California Independent System Operator (CAISO) market. In a scenario where allowance prices are set at \$150 per allowance, similar to what was presented in the modeling results, the anticipated result would be a \$64/MWh GHG adder or a four-fold increase in the cost of procuring resources that may be needed to support electric reliability. This value directly impacts electricity costs for Californians. Utility allowance allocations provide critical cost protections for utility ratepayers and, amidst anticipated prices nearing the price floor, become ever more important. Any reductions contemplated for utility allowance allocations should be limited for this reason.

II. Allowance banking for covered entities should be retained to help insulate against future increases in C&T compliance costs.

SDG&E believes it is critical to retain the ability for covered entities to bank allowances for future use. As CARB noted, allowance banking plays an important role in providing compliance flexibility for covered entities which reduces compliance costs and mitigates concerns about price volatility. With the modeled allowance pricing presented during the November 16 workshop, this flexibility will be very important – particularly as we consider post-2030 compliance costs. The ability to purchase allowances pre-2030 (at these lower price points) and bank for post-2030 program may help manage the cost of program compliance over the longer term. However, it could also drive pre-2030 allowance prices

up to a greater extent than the modeling anticipated. Indeed, this occurred a few years ago when the C&T program was extended through 2030. Similarly, in the most recent November 2023 auction, prices cleared at 174% above the floor price – whereas compared to auctions as recent as February 2021, trading was more aligned to the floor price.¹ Retaining the flexibility to bank allowances can provide some insulation from projected high costs in the future.

III. Current exemptions from consolidated holding limits for corporate affiliates that are utilities should remain unchanged due to applicable affiliate compliance rules.

During the workshop’s discussion of market rules, presenters raised the potential interest in modifying consolidated holding limits for allowances and exemptions from those limits for covered entities in direct corporate association. SDG&E appreciates CARB’s interest in mitigating the risk of market manipulation to safeguard the integrity of the C&T market.

An example to illustrate direct corporate association noted that this would apply to corporate affiliates that share a parent company. SDG&E, Southern California Gas Company (SoCalGas), and Sempra Gas & Power Marketing (SGPM) are affiliates that share a parent company: Sempra Energy. These companies are also separate covered entities with independent compliance obligations under current C&T rules.

Affiliate transaction rules² imposed by the California Public Utilities Commission (CPUC) and Federal Energy Regulatory Commission (FERC) prohibit these companies from sharing certain resources and information, including, but not limited to, the joint or coordinated procurement of allowances and offsets. As set forth in 17 CCR Section 95833(c)(1), any “registered entity subject to affiliate compliance rules promulgated by state or federal agencies shall not be required to disclose information or take other action that violates those rules.” SDG&E, SoCalGas, and SGPM are forbidden from sharing any sensitive market information. As a result of these affiliate compliance rules, SDG&E and SoCalGas are currently exempt from group holding limits normally imposed on entities in a corporate association. It is critical to maintain this exemption to avoid creating conflicts with the affiliate transaction rules compliance obligations.

Separately, it may be appropriate for CARB to consider modifications to holding limits on non-compliance entities who purchase allowances. Further consideration should be given as to whether modified holding limits would help deter a situation where entities that do not have a compliance obligation purchase and hold allowances to gain a significant market share. Allowing non-compliance entities to stockpile allowances and corner the market would result in pressure on allowance pricing, creating a challenging landscape for those with compliance obligations. Thus, evaluating potential adjustments to non-

¹ This information is based on data available on CARB’s Joint Greenhouse Gas Allowance auctions website: <https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/auction-information>.

² The affiliate transaction rules collectively refer to the following: CPUC Decisions D.06-12-029 and D.98-03-073, and FERC Orders 697, 707, and 717.

compliance entity holding limits may be helpful for ensuring the long-term integrity of the market.

Conclusion

Thank you for your consideration of SDG&E's comments. As noted above, SDG&E appreciates CARB's interest in exploring improvements to the program to prevent market manipulation and gaming. However, if further changes to C&T market rules are being contemplated, clear proposals should be presented to stakeholders so that impacts can be fully evaluated. It was not entirely apparent during the November workshop whether there are specific changes to market rules that are being considered at this time. As CARB well understands, modifications to market rules could have significant implications for the cost of compliance with C&T and, as such, should be thoroughly assessed.

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 facilitating a robust stakeholder process to inform updates to this important regulation.

Sincerely,



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