Summary of Stakeholder Comments

Submitted following March 2, 2018 Public Workshop on Modifications to Cap-and-Trade Regulation to Comport with AB 398
1. Introduction
Assembly Bill (AB) 398 (Chapter 135, Statutes of 2017) (AB 398) provides legislative direction on the role of the Cap-and-Trade Program (Program) between 2021 and 2030. AB 398 also contains specific provisions directing the California Air Resources Board (CARB) to modify features of the existing allowance price containment reserve (Reserve) into a new cost containment structure for the post-2020 period of the Program.

This staff summary of comments paper (comment paper) is intended to continue the public discussion on how the Cap-and-Trade Regulation (Regulation) will be modified to comport with the direction in AB 398 on establishing a price ceiling and two price containment points, and the distribution of allowances amongst them, while considering total availability of allowances between 2021 and 2030. Specifically, this comment paper summarizes stakeholder comments on the following specific topic areas:

- Price Ceiling to be established in response to direction in AB 398
- New post-2020 Reserve tier prices\(^1\)
- Distribution of allowances within the new post-2020 Reserve and Price Ceiling including:
  - Post-2020 Reserve’s 52.4 million allowances from the 2016 rulemaking
  - Implementing a 2 percent withholding from 2026-2030 to reflect the increased offset use limit
  - AB 398 mandated placement of pre-2020 Reserve allowances to Price Ceiling
  - One-for-one reduction instrument sources and uses
- Banking rules
- Disposition of allowances remaining unsold at auction
- Overallocation as written in AB 398
- Direct Environmental Benefits (DEBs)

Although this comment paper focuses specifically on the topics listed above, CARB staff has reviewed and continues to consider comments submitted on other topic areas as well.

2. Process
After passage of AB 398, CARB staff held an initial workshop in October 2017 with a high level summary of potential regulatory changes required to respond to AB 398’s legislative direction.\(^2\) Staff held a second workshop to continue the conversation on

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\(^1\) As was the case in the initial cost containment concept paper prepared for CARB’s March 2, 2018 workshop, for purposes of this comment paper, “current Reserve” means the existing allowance price containment reserve with three price tiers, “post-2020 Reserve” means the collapsed single tier reserve as currently included in the Cap-and-Trade Regulation, and “new post-2020 Reserve” means the two tier reserve structure as directed in AB 398.

\(^2\) [https://www.arb.ca.gov/cc/capandtrade/meetings/20171012/ct_presentation_11oct2017.pdf](https://www.arb.ca.gov/cc/capandtrade/meetings/20171012/ct_presentation_11oct2017.pdf)
possible revisions to the Regulation on March 2, 2018. Prior to the workshop, a concept paper on cost containment was released to help frame the discussion of AB 398’s new post-2020 Reserve and Price Ceiling.

In response to these staff materials, stakeholders provided feedback on many of the topic areas outlined above. This comment paper coalesces these stakeholder comments into an overview of stakeholder thinking as it pertains to cost containment.

3. Price Ceiling and Price Ceiling Value

This section augments the legislative direction that staff will rely on with stakeholder comments received to date regarding the development of a price ceiling for the post-2020 period of the Program. AB 398 directs CARB to consider the following when establishing the price ceiling:

(I) The need to avoid adverse impacts on resident households, businesses, and the state’s economy.
(II) The 2020 tier prices of the allowance price containment reserve.
(III) The full social cost associated with emitting a metric ton of greenhouse gases.
(IV) The auction reserve price.
(V) The potential for environmental and economic leakage.
(VI) The cost per metric ton of greenhouse gas emissions reductions to achieve the statewide emissions targets established in Sections 38550 and 38566.

(Health & Safety Code § 38562(c)(2)(A)(i))

Staff’s initial concept paper prepared for the March 2, 2018 workshop outlined data available for the consideration of these factors in establishing the price ceiling. For convenience, this data is reproduced as Tables 1 and 2 below.

Table 1. Available Data for AB 398 Price Ceiling Considerations

| The need to avoid adverse impacts on resident households, businesses, and the state’s economy | In the development of the 2017 Scoping Plan Update, it was demonstrated that a suite of policies that includes a Cap-and-Trade Program, as currently structured, is the least cost portfolio of climate policies to achieve the 2030 target while meeting other statutory mandates (e.g., minimize leakage, technologically feasible, no disproportionate impacts on the most burdened communities) |

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3 https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_workshop_3-1-18.pdf
4 https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_price_concept_paper.pdf
The 2020 tier prices of the allowance price containment reserve

Information provided in Tables 1 and 2 of the initial concept paper prepared for the March 2, 2018 workshop

The full social cost associated with emitting a metric ton of greenhouse gases


The auction reserve price


The potential for environmental and economic leakage

AB 398 set the assistance factor at 1 from 2021 through 2030 to address concerns regarding leakage

The cost per metric ton of greenhouse gas emissions reductions to achieve the statewide emissions targets established in Sections 38550 and 38566

The 2017 Scoping Plan Update includes AB 197 cost per metric ton values

<table>
<thead>
<tr>
<th>Topic</th>
<th>Information</th>
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<tbody>
<tr>
<td>Voluntary Corporate Carbon Pricing</td>
<td>Voluntary corporate internal carbon pricing that can range from &lt;$1 to &gt;$800 globally and as high as $150 within the United States.(^5)</td>
</tr>
<tr>
<td>Academic Research</td>
<td>Academic study that found the existing social cost of carbon is too low and could be closer to $220.(^6)</td>
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Table 2: Additional Information from Initial Concept Paper

During the March workshop, CARB staff discussed an initial price ceiling value range for 2030 between $81 and $147 in 2015 dollars. In response to a workshop comment, all prices presented in this document are standardized to 2015 dollars using an assumed inflation rate of 2 percent. Staff received numerous informal comments following the workshop regarding the price ceiling value.

Stakeholder comments on the price ceiling and price ceiling value indicated stakeholders had three general recommendations for the price ceiling: a first set of recommendations advocated for a low price ceiling value, a second set of recommendations advocated for a high price ceiling value, and a third set of

\(^5\) The voluntary corporate carbon pricing used year 2016 data. In 2015 dollars, the U.S. company’s internal carbon pricing value is $147.06: https://b8f65cb373b1b7b15febc70d8ead6ced550b4d987d7c03fcd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/001/132/original/CDP_Carbon_Price_2016_Report.pdf?1474269757.

\(^6\) https://www.nature.com/articles/nclimate2481#t1
stakeholders recommended CARB provide further clarity on the price ceiling mechanism prior to selecting a price ceiling value. An additional set of comments provided specific price ceiling design recommendations. Each of these sets of recommendations, and the motivations for them presented in each comment letter, are presented below.

a. **Stakeholder recommendations for a low Price Ceiling value**

A large contingent of stakeholders either argued for a price ceiling value at the low end (near $81) or below the range presented during the March workshop. Most of these stakeholders affirmed the use of Cap-and-Trade in achieving low-cost emissions reductions, but focused on the affordability and political sustainability of the Program in the case of allowance values near the upper edge of the range (near $150). The Climate Change Policy Coalition (CCPC), CalChamber, California Manufacturers and Technology Association (CMTA), Carbon Market Compliance Association (CMCA), California Council for Environmental and Economic Balance (CCEEB), Pacific Gas and Electric (PG&E), Sacramento Municipal Utility District (SMUD), Western States Petroleum Association (WSPA), California League of Food Processors (CLFP), California Independent Oil Marketers Association (CIOMA), and International Emissions Trading Association (IETA) each commented that a close-to-$147 allowance value could lead to unsustainable or unacceptable impacts on consumers and small businesses.

The Southern California Public Power Authority (SCPPA) recommended a low price ceiling value to ensure utility rates remain manageable for ratepayers, especially low-income consumers and small businesses, in the case of sustained allowance values near the price ceiling. SMUD commented that prices near these levels would cause uncertainty in the Program’s continuation in the case of allowance scarcity, and a subsequent decrease in investment in carbon reductions by covered entities. CMCA’s comments expressed the view that a close-to-$147 allowance value could lead to suspension of the Program in advance of utilization of AB 398’s cost containment features.

PG&E also recommended other AB 398 direction take priority over the social cost of carbon, and also pointed towards studies valuing the social cost of carbon as between $60 and $80 and placing the ceiling value within this lower range. PG&E’s range of social cost of carbon values differed from the range of values proposed by the Institute for Policy Integrity (see 3.b. below).

CLFP commented that a price ceiling value close to $150 would add to uncertainty and increase the risk for leakage, and that minimizing uncertainty and leakage should take higher priority than a forecasted social cost of carbon in setting the ceiling value. CMCA recommended the 2021 price ceiling value be between $45 and $70 (in 2015 dollars). SMUD recommended a price ceiling value no higher than $62 per metric ton in 2021, but at most, a 2030 price ceiling value near what the third tier of the current Reserve...
would have been if it were extended to 2030 (around $75 to $90). Turlock Irrigation District (TID) recommended a range of $45 to $70 for the 2021 value to minimize leakage risk.

Pasadena Water and Power (PWP), the Gas Utilities Group (GUG), and CCEEB commented that the existing range seemed inconsistent with current market conditions. GUG specifically recommended a price ceiling value range of approximately $55 and $90 (in 2015 dollars). This was tied to their assessment that a higher ceiling value would increase the difficulty of future WCI linkages. WSPA commented that, of the considerations included in the two tables above, the voluntary carbon pricing value selected in Table 2 was an outlier relative to other voluntary carbon pricing values used by U.S. companies.

b. Stakeholder arguments for a high price ceiling value
A second set of stakeholders argued either for the high end of the $81 to $147 range, or a price ceiling value well above $147.

The Natural Resources Defense Council (NRDC) recommended a high ceiling value (i.e., near $147) based on the interaction of the legislated target of 40 percent reductions below 1990 emissions by 2030 and the 2017 Scoping Plan’s cost per metric ton of other complementary measures. Specifically, NRDC argued that in the case of the ceiling mechanism reaching one-for-one reductions in emissions year 2030, many of the complementary measures needed to ensure consistency with the 2030 emissions target would cost well in excess of $150 per metric ton. The California Environmental Justice Alliance (CEJA) and Asian Pacific Environmental Network (APEN) similarly recommended a price ceiling value of $150.

The Environmental Defense Fund (EDF) also advocated for a price ceiling value “significantly above the current planned reserve price of $81.” EDF commented this value would be consistent with the social cost of carbon; would provide incentives for important within-cap emissions reductions measures such as carbon capture and storage (CCS); and would allow for greater revenue to ensure affordability of high quality reductions if one-for-one reductions are required at the ceiling value. The Institute for Policy Integrity (IPI) also focused on setting the value well above the social cost of carbon. IPI estimated this cost could be well over $80 to $100 per metric ton CO$_2$e. This is motivated by IPI’s recommendation that CARB ensure the full cost of carbon is internalized in the range of potential post-2020 allowance values. Commenter Barbara Haya recommended an even higher price ceiling value based on studies showing social costs of carbon at $2,000 to $5,000 per metric ton CO$_2$e (when not using a discount rate on damages).

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7 Table 10, page 46 [https://www.arb.ca.gov/cc/scopingplan/scoping_plan_2017.pdf](https://www.arb.ca.gov/cc/scopingplan/scoping_plan_2017.pdf)
NextGen California (NextGen) recommended a price ceiling value range between $300 and $1,500 per metric ton. Specifically, NextGen “recommend[s] that CARB adopt as a price ceiling [value] the marginal cost per metric ton associated with the [Alternative 1: No Cap and Trade Scenario], but excluded from the Scoping Plan.” The two highest cost per metric ton measures associated with the Alternative 1 Scoping Plan scenario are the 30 percent Refinery measure and 5 percent utilization of renewable natural gas. The Scoping Plan assessed the cost of these measures at $300 and $1,500 per metric ton respectively. NextGen advocated this as appropriate based on this range’s ability to ensure the Cap-and-Trade Program would induce any reduction at a lower cost than the set of required direct regulations necessary to achieve the 2030 targets in the absence of the Cap-and-Trade policy.

c. Stakeholder arguments for greater clarity on the Price Ceiling
Four stakeholders recommended additional analysis and clarity on the specifics of the ceiling mechanism. IETA advocated for the creation of a series of focus sessions to engage with stakeholders specifically on the price ceiling. IETA was joined by PWP and the GUG in recommending CARB continue to work with stakeholders. Western Power Trading Forum (WPTF) asked for greater clarity on details of the mechanism before taking a stance on specific price ceiling values. WPTF asked for more clarity on the source of one-for-one reductions, and whether or not CARB or compliance entities would be responsible for the cost of introducing the instruments into the market.

d. Stakeholders with specific Price Ceiling design recommendations
Finally, four stakeholders (WPTF, SMUD, GUG, PG&E) provided specific design recommendations for the price ceiling. WPTF suggested the price ceiling be made available based on the triggering of any one of multiple pre-defined market conditions, rather than using a pre-established frequency as discussed in the staff workshop. WPTF suggested two of these market conditions could be high allowance prices for a set length of time and the approach of a compliance event. The GUG recommended continued use of the existing condition triggering (quarterly) reserve sales: the prior auction settlement price at 60 percent of the price ceiling allowance value.

WPTF and SMUD agreed with the initial staff thinking that price ceiling instruments should be used solely for compliance by being placed directly into compliance accounts (though WPTF recommended new post-2020 Reserve allowances not be restricted solely to compliance use). PG&E instead recommended minimal restrictions on how entities could use these instruments. PG&E commented that placing instruments directly into compliance accounts might result in unforeseen market consequences. PG&E advocated that even with minimal restrictions, as price ceiling instruments would

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9 “NGCA Cap and Trade Reg Revision Discussion Draft Comment 3-16-2018.pdf” page 3: https://www.arb.ca.gov/lists/com-attach/28-ct-3-2-18-wkshp-ws-BWshZAd+ByBSM1M2.zip
11 Table 10, page 46 https://www.arb.ca.gov/cc/scopingplan/scoping_plan_2017.pdf
be the highest cost instruments in the market entities would naturally seek to reduce obtaining any price ceiling instruments beyond those needed for compliance.

SMUD recommended the price ceiling have separate mechanisms for allowances and AB 398’s additional metric tons. SMUD recommended the allowances populating the ceiling be subject to existing Reserve rules on proceeds and auction structure (i.e., placed in the Greenhouse Gas Reduction Fund and subject to the existing conditions to hold auctions).

4. New post-2020 Reserve tier prices
AB 398 is silent on the placement of the new Post-2020 Reserve tier prices. As with the price ceiling, however, CARB staff will use the information in Tables 1 and 2 as well as stakeholder feedback to inform a proposal for specific new post-2020 Reserve tier prices. Stakeholders provided three broad initial recommendations for setting the new post-2020 Reserve’s tier prices: recommendations for low tier prices, recommendations for high tier prices, and a third recommendation for tier prices equally spaced between the auction reserve price (ARP) and price ceiling value.

a. New Post-2020 Reserve: low tier prices
IETA, CIOMA, WSPA, and TID recommended low tier prices. IETA advocated for reserve tier prices lower than the $70 per metric ton range contemplated during the workshop. IETA and WSPA expressed concern that a first cost containment point at or above $70 would provide insufficient time to prevent price spikes, and prevent the Independent Emissions Market Advisory Committee (IEMAC) from providing meaningful feedback on the Cap-and-Trade market’s probability of accessing the price ceiling. CIOMA also advocated for lower tier prices to help protect consumers in advance of reaching the ceiling. TID recommended using the first and second tiers of the current Reserve as a guide for the new post-2020 reserve tier prices.

Near Zero recommended low tier prices in the early 2020s, escalating quickly over time so long as large downward adjustments are made to the emissions allowed under the Program (see Section 8: Overallocation as Written in AB 398).

b. New Post-2020 Reserve: High Tier Prices
NextGen recommended the new post-2020 Reserve tier allowances not be placed at prices that would prevent price discovery in the range of prices between the ARP and price ceiling value. NextGen suggested evaluating 75, 85, and 95 percent of the price ceiling value as potential prices for the reserve tiers, with an annual price adjustment consistent with the ARP methodology. As with the price ceiling value, IPI focused on the social cost of carbon, emphasizing that “the [reserve] tier prices should be above the Interagency Working Group’s ‘central’ estimate of $58 per [metric] ton of CO₂ (in 2015 dollars).”


April 2018
c. New Post-2020 Reserve: Equally Spaced Tiers

A third set of stakeholders recommended an equal spacing of tiers between the ARP and price ceiling value.

Some stakeholders had specific reasons for why they preferred this methodology. EDF supported an equal spacing approach so that each tier might serve as a signal to compliance entities that a new suite of abatement strategies might now be cost effective. Similarly, SMUD recommended significant spacing to allow for additional abatement activities that include multi-year lead times, and to provide two distinct “speed bumps” if allowances became scarce. While CLFP, CMCA, and British Petroleum (BP) did not take a stance on specific prices, they advocated for tiers sufficiently spaced to provide clear signals to market participants to engage in new reduction activities. CCEEB did not take a position on a specific price ceiling value, but commented that an equally spaced approach would allow time for the IEMAC to provide recommendations. Finally, SMUD recommended the allowances obtained from the new Post-2020 Reserve not be restricted solely to use for compliance.

Additional stakeholders with a preference for the equally-spaced tiers approach recommended specific tier prices. SCPPA, GUG, PG&E, and IETA each recommended a ceiling value near $80, or recommended a range of acceptable ceiling values that included $80. Given their preference for equally-spaced tiers, and a projected ARP around $25, this would imply that they recommended the first cost containment tier be placed between $40 and $45, and the second tier be placed between $60 and $65. SMUD recommended a lower range around $30 for the first tier and $50 for the second tier. EDF’s higher price ceiling recommendation would imply a first containment point between $60 and $70, and a second containment point slightly above $100.

5. Distribution of allowances within the New Post-2020 Reserve and Price Ceiling

Two additional topics discussed during the March workshop were the sources of allowances that might populate the new post-2020 Reserve, and the GHG reductions behind the “additional metric tons [offered to compliance entities] once [all price ceiling] allowances are… used.”13 New post-2020 Reserve tier and price ceiling allowance sources discussed in the March workshop included the approximately 52 million allowances that would be removed from the post-2020 annual allowance budgets and moved to the post-2020 Reserve specified in the 2016 rulemaking, and the 22 million allowances reflecting the increase from 4 percent to 6 percent offset usage limit from 2026 through 2030.

Stakeholders provided an array of recommendations on each of the allowance pools, including the recommendation to retire them. A second set of stakeholders provided comments on mechanisms to procure one-for-one reductions.

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13 Slide 12: [https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_workshop_3-1-18.pdf](https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_workshop_3-1-18.pdf)
a. Post-2020 Reserve’s 52.4 million allowances from 2016 rulemaking

Stakeholders took three positions on the 2016 rulemaking’s post-2020 Reserve allowance supply of approximately 52 million allowances from under the post-2020 budgets. EDF, CEJA, and APEN recommended directly retiring the 52 million allowances to account for the expected 2021 emissions levels, rather than the straight-line decline in the regulation. EDF recommended this retirement based on the following elements: accelerating the speed with which one-for-one reductions would be used for cost containment; the introduction of absolute price protection via a hard price ceiling decreasing the need for large cost containment tiers; and consistency with EDF’s assessment of the original cap setting process that created the 2013 budget based on emissions reporting.

Instead of directly retiring the 52 million allowances, NRDC recommended placing them in the price ceiling. If the 52 million allowances were instead placed in the new post-2020 Reserve, NRDC advocated revisiting the projected post-2020 budgets based on more recent pre-2021 emissions data. IPI recommended placing the allowances to the second tier or price ceiling to ensure price containment would be above a potential higher future revaluation of the social cost of CO$_2$e, unless other AB 398 considerations require that the allowances go to the lower tier.

Finally, IETA, CMCA, PG&E, CCEE, GUG, WPTF, TID, and Near Zero recommended issuing the approximately 52 million allowances to the new post-2020 Reserve tiers. IETA, CMCA, PG&E, CCEE, the GUG, and WPTF recommended placing the allowances into the new post-2020 Reserve to expand the availability of allowances at prices below the price ceiling value. CCEE, CMCA, and PG&E commented that placing any additional allowances in the ceiling would be ineffective in providing additional cost containment, as the ceiling will be modified to offer one-for-one reductions when required. TID specifically recommended the approximately 52 million allowances be placed in equal proportion into the first and second tiers to make each tier “more effective in slowing down potential price spikes.”

Near Zero supported placement of these allowances into a reserve tier or the price ceiling. This recommendation was part of a broader recommendation to reduce allowances available via auction while making the tier prices and ceiling price start from lower values, but then escalate quickly through the 2020s.

b. Two percent withholding of vintage 2026-2030 allowances

During the March workshop, staff sought comments on withholding 2 percent of the 2026 through 2030 budgets (22 million) to reflect the increase in offset usage. NRDC, IPI and EDF were supportive of this idea. NRDC and IPI preferred placing the instruments in the price ceiling, or alternately into the second tier. EDF had no

recommendation of where the instruments should be placed. CEJA and APEN recommended retiring the allowances rather than placing them in cost containment.

IETA was supportive of moving an unspecified number of allowances from within the post-2020 budgets to the new post-2020 cost containment tiers, but was not supportive of withholding the 22 million. PG&E also recommended against putting the 22 million into cost containment: they believe this would magnify the impact of AB 398’s reduction of the post-2020 offset usage limits. SMUD also commented that an additional 2 percent of 2026 through 2030 would be relatively ineffective, and instead recommended continued use of the existing borrowing from future allowance budgets. SMUD recommended potential borrowing be reduced to 5 percent of future vintage budgets, rather than the existing 10 percent.

c. AB 398 mandated placement of pre-2020 Reserve allowances to Price Ceiling

NextGen recommended retiring the 42 million allowances that AB 398 directs CARB to take from the current Reserve and place into the price ceiling. This is motivated by NextGen’s assessment that the Program should have smaller post-2020 allowance budgets; and a desire to trigger contracts with sources of one-for-one carbon reductions, and the potential to use excess revenue to reduce in-state emissions.

d. One-for-one reduction instrument sources and procurement

Seven stakeholders (WPTF, EDF, CMCA, PG&E, SMUD, NextGen, and TNC) provided additional recommendations regarding categories of instruments that could be used for one-for-one reductions, as well as ways to procure these instruments.

EDF, PG&E, CMCA, SMUD, and NextGen all recommended CARB prepare a list of eligible projects that could provide the reductions required under AB 398’s one-for-one requirement for additional metric tons made available through the price ceiling if allowances within the price ceiling are exhausted. PG&E advocated for instant eligibility of instruments generated through any offset protocols active in any of the Western Climate Initiative (WCI) jurisdictions, and instruments from one-way linkages.

PG&E and CMCA also advocated for developing multiple procurement methodologies to quickly obtain eligible instruments upon generating the revenue from metric tons sold through the price ceiling mechanism, as well as identifying conditions under which pre-contracting might start. PG&E and CMCA suggested establishing requirements that one-for-one projects be completed within a set number of years.

TNC recommended identifying natural and working lands as the preferred source of one-for-one reductions. TNC recommended advanced contracts with these one-for-one reduction sources prior to 2021 via use of Greenhouse Gas Reduction Fund (GGRF) and other funding sources. TNC argued that advanced contracting could allow for better achievement of the 2030 target, and serve as a motivator for innovation in identifying qualified measures from natural and working lands.
6. Banking rules
CARB staff also discussed banking during the March workshop, and requested stakeholder feedback on “which factors, in addition to those in AB 398, are important to assess to determine if any modifications to existing banking rules are needed.”

LADWP, Latham and Watkins (L&W), and SCPPA emphasized that banking encourages early action, and that changes to banking rules midway through the Program would penalize the early action that has allowed for greater initial reductions to date. EDF commented that existing holding limits were sufficient to address any potential issues with banking while CCEEB and PG&E recommended an expansion of holding limits to reduce market volatility.

CCPC, LADWP, SMUD, BP, CMCA, and CalChamber support the existing banking rules as they pertain to market power mitigation and market efficiency. CCPC stated that the Program’s banking rules allow for “long-term stability and investment that drives GHG reductions… [and ensure] both transparency and market oversight. LADWP and CMTA also stated that to date, their perspectives are that market power issues do not warrant changes to banking.

SCPPA commented that for electric distribution utilities, banking would become increasingly important going forward based on the combination of restricted allowance supply and decreasing allocation. Similarly, the GUG advocated that any banking rule modifications should take into account that CARB’s auctions provide allowances that are only eligible for compliance with the following year’s emissions, i.e., entities participating at auction with variable future allowance needs would be penalized by significant restrictions on the ability to acquire allowances for future use.

NextGen and Near Zero recommended changes to the existing Program’s banking rules. NextGen recommended proactively preparing for changes to banking practices as allowances become more scarce, but recommended doing so by decreasing the value of banked allowances, or enacting some mechanism to credit entities a fraction of the value of the allowances that would otherwise be banked across compliance periods. Near Zero recommended discounting allowances in entity’s holding accounts to reduce the total supply of allowances. CEJA and APEN recommended eliminating across-year banking, requiring that emissions be at or below each year’s allowance budget, much like a cap and decline program.

7. The disposition of allowances remaining unsold at auction
Four stakeholders (CCPC, CLFP, CCEEB, and EDF) commented on the treatment of allowances remaining unsold at auction. While CCPC, CLFP, and CCEEB advocated for the termination of the provision for unsold allowances to be placed into the Reserve after 24 months, AB 398 gives direction to continue this mechanism. Resources for the

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Future (RFF) via EDF, discussed the option of reducing the speed at which unsold allowances re-enter each auction. This would have the effect of increasing the portion of unsold current vintage allowances moved to the new post-2020 Reserve tiers or price ceiling in response to a sequence of undersubscribed auctions.

8. Overallocation as Written in AB 398

In stakeholder comments, perspectives on overallocation was discussed largely in the framework of whether the post-2020 emissions budgets were sufficient to drive emissions reductions in the 2020s and the year 2030.

CCPC, CMTA, WPTF, SCPPA, PG&E, SMUD, WSPA, and LADWP viewed potential reductions to post-2020 caps as premature. CCPC, PG&E, CalChamber, CMTA, SMUD, and LADWP framed overallocation as “over compliance,” and the result of success in achieving early action and reductions in the existing program. CCPC and CMTA both recommended CARB wait until at least 2025 before seeking to adjust for potential oversupply. L&W viewed overallocation as a condition where long-term supply exceeds long-term demand such that it compromises long-term reduction goals, and stated that the Program was not yet in a position of overallocation.

L&W, SMUD and PG&E commented that if the program were extended post-2030, a portion of banked supply would likely be used post-2030 as caps continued to decrease. L&W stated that shrinking emissions budgets now would create uncertainty for market participants, and that existing design features were sufficient to prevent potential overallocation. L&W and SMUD generally advocated for delaying any potential adjustments to allowance supply until further into the Program. SMUD listed continued economic growth, unsold allowance placement to the new post-2020 Reserve or price ceiling, future linkages, and reduced availability of hydroelectricity as some of the demand-side reasons for caution in restricting future budgets. SMUD and WSPA commented that linkage with Ontario and Québec would affect allowance supply available to California entities, with WSPA assessing that Ontario and Quebec would be net buyers of WCI allowances.

SCPPA and PG&E stated it is too early in the market’s history to justify supply adjustments, and that permanent reductions in allowance supply could increase allowance values in earlier years of the program to levels unnecessary to achieve the 2030 target. CCEEB views reductions to future budgets and new post-2020 Reserve tier allowances as likely to drive the allowance value to the price ceiling value. They believe that over time, the greater speed of post-2020 reductions relative to the current Program will gradually tighten the market.

NextGen defined overallocation as the sum of 2013 to 2020 allowances held in the auction account, Reserve, and entity holding accounts after the end of the third compliance period. They believe this will be between 100 and 200 million allowances. They recommended reducing the post-2020 caps in an amount equivalent to this then-calculated oversupply; decreasing the value of allowances held in holding accounts, the
auction account, and the Reserve in proportion to the oversupply; or directly retiring allowances from entity holding accounts, or the pools of post-2020 cost containment allowances.

The Center for Biological Diversity believes the Program will have banked allowances between 190 to 300 million in excess of pre-2021 compliance obligations, and recommends retiring or devaluing all banked allowances from the pre-2021 Program. CEJA and APEN recommended retiring all allowances from the first three compliance periods (i.e., all 2013-2020 allowances) at the start of 2021.

Near Zero commented that some prior analysis has shown the market has allowances exceeding near term demand, and recommends “program cap adjustments, discounting banked allowances, and / or other creative approaches developed collaboratively with stakeholders” at the same time as enacting lower tier prices and a low price ceiling value in the early 2020s that increase quickly over time. PG&E, L&W, TID, WSPA, and Modesto Irrigation District opposed these measures. WSPA commented that “it [would be] virtually impossible for obligated parties to develop a compliance strategy based on a moving target.” SMUD commented that decreasing the compliance value of previously-purchased allowances would constitute a “taking” of value that was purchased from the State in good faith.

9. Direct Environmental Benefits (DEBs)

Offsets are an important source of cost containment for the Program. AB 398 provided direction that one half of offsets used to comply with the Program post-2020 should provide Direct Environmental Benefits (DEBs) to the state of California. Specifically:

For purposes of [defining DEBs eligibility of an offset generated in the post-2020 Program], “direct environmental benefits in the state” are the reduction or avoidance of emissions of any air pollutant in the state or the reduction or avoidance of any pollutant that could have an adverse impact on waters of the state.19

A majority of stakeholders voiced support that CARB should adopt the precise language of the statute into the Regulation. These include Dentons US LLP (Dentons), Honeywell International, Inc. (Honeywell), Finite Carbon (Finite), Native American Venture Fund (NAVF), Verified Emission Reduction Association (VERA), American Carbon Registry (ACR), The Nature Conservancy (NAC), New Forests (NEF), The Center for Biological Diversity (CBD), Indigenous Peoples Reducing Emissions (IPRE), EDF, NRDC, CLFP, and CMCA support CARB staffs’ proposal to use the exact words in the statute to define DEBs in the Regulation. CEJA and APEN commented that the

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19 Health and Safety Code 38562(c)(2)(E)(i)-(ii)
proposed process of determining DEBs should be rejected as vague, inconsistent, and vulnerable to loopholes.

ACR, Dentons, commenter Galen Ross, CBD, BP, CLFP, and PG&E commented that location should serve as criterion for determining DEBs, with projects located in California automatically qualifying for DEBS. IETA and PG&E commented that projects physically located in California should automatically qualify for DEBs for both past and future CARB offset credit issuances. Commenter Barbara Haya, CBD, and CEJA and APEN commented their view that projects located in CA do not always create DEBs in CA, citing ODS projects as an example.

Dentons, SCPPA, Honeywell, Finite, CAR, NAVF, EDF, IETA, VERA, CCEEB, CLFP, PG&E, BLUE, IPRE, and CMCA support CARB’s assertion that out of state projects have DEBs in California. CAR, CCEEB, PG&E, and IPRE encourage CARB to consider the ways ODS projects generate DEBs in California.

The Climate Action Reserve (CAR), NRDC, and NAC urge CARB to develop criterion to determine if a project qualifies as DEB. Finite, VERA, NAC, and NEF recommended that once a project has been approved as DEB, a system should be implemented that would allow substantially similar projects to be awarded DEB determination with minimal additional expense/cost burden to entities. BP recommended CARB should include the DEBs determination in the listing process to avoid delays during the project verification process. BP also noted that if DEB assessments are public, the process could encounter delays. NAVF and Shell Energy (Shell) encourage CARB to implement a timeline process by which the DEB determination would be completed to provide more certainty for offset project developers and financiers.

NAC and CBD commented that developing and applying criterion for DEBs would be a challenging undertaking. Dentons, Finite, NRDC, VERA, Bluesource (Blue), and IPRE voiced concern about legal issues arising if bright line criterion were created to determine DEBs, instead suggesting broad interpretation of DEBs to protect against legal issues.

Dentons asks CARB to actively consider adopting additional protocols to supply more DEBs qualified offsets. NextGen commented that for an offset to bear the distinction of being a true DEB, it should be over and beyond any indirect benefits attributed to the project.

Concerning the use of watersheds, commenter Galen Ross, and BP commented that the definition of watershed should be more clearly defined as, “water sheds of state waters” as these have an effect on waterways in California. Pacific Forest Trust (PFT) and CMCA propose that CARB stipulate that forest offset projects in watersheds that flow into California meet the DEB requirement. Commenter Barbara Haya argued that a project located adjacent to a waterway flowing into California does not guarantee DEBs in the state, stating that not all emissions effect water quality.
Concerning retroactive project evaluation, NAVF and VERA strongly encourage CARB to reconsider applying AB 398 to existing projects and projects with issued credits before 2020. WPTF and commenter Galen Ross urge CARB to develop criterion to retroactively determine if projects qualify as DEB before 2022 compliance deadline. Finite, NAVF, and VERA voiced concern about financial repercussions that could occur if projects with credits already in the marketplace were retroactively evaluated for DEBs. VERA and PFT also voiced concern about the potential significant expenditure of stakeholders and CARB if projects are subjected to retroactive evaluation. ACR commented that to disqualify projects based on DEB criteria would be subjecting them to standards that did not exist when the investment decision was made. Finite, VERA, NEF, and Blue recommend that offset projects listed/existing credits prior to the finalization of this rulemaking be exempt from the DEBs evaluation process. Finite, VERA, NEF, and PFT recommend that all offset projects with issued credits prior to the finalization of this rulemaking be exempt from the DEBs evaluation process and the new DEBs usage limitations should not apply. Finite and VERA believe that offset credits from projects listed with an OPR by December 31, 2020 should automatically be deemed to have met the DEBs requirement.

10. Next Steps
This comment paper was drafted to aid stakeholders in orienting themselves to the major comments submitted to date on the topics outlined in this comment paper. As mentioned previously, additional comments submitted on other topics not included in this comment paper have been reviewed and continue to be considered by CARB staff. CARB staff looks forward to additional comments submitted following the April 26, 2018 workshop. As indicated in the listserv Notice for the April 26 workshop, stakeholders will have an opportunity to provide written comments during an informal comment period following the workshop. Any additional comments must be submitted by 5:00 p.m. Pacific time on Thursday, May 10, 2018.