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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 April 23, 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 California Air Resources Board's (CARB) recent workshop considering potential amendments to the Cap-and-Trade Regulation (C&T). The C&T program plays a vital role in facilitating emissions reductions in California.

Electric distribution utilities, including SDG&E, will be instrumental in supporting the decarbonization of not just the electricity consumed in our state, but also in reducing emissions via a transition to electrified end uses in the industrial, building, and transportation sectors, among others. It is crucial to reiterate that energy affordability must be top of mind to encourage a clean transition for these sectors.

Historically, the C&T program has provided critical cost protections for utility ratepayers in the form of directly allocated allowances. The allocated allowances are sold at auction and the revenues are returned directly to utility ratepayers at regular intervals via the California Climate Credit and a variety of decarbonization programs. These allowances, which have proven to be of significant value, facilitate continued progress in greenhouse gas emissions reductions *at a lower cost to ratepayers.* However, if compliance costs were to increase, the cost of energy would increase and be passed through to customers in the form of higher monthly energy bills. Based on CARB's initial modeling of potential changes to the C&T program, allowance price increases are expected, which in turn will likely result in an increase in utility compliance costs due to the higher price for purchasing compliance instruments. However, and for this reason, it is imperative that CARB continue to acknowledge the important value that the proceeds from directly allocated allowances can provide to support a commensurate benefit for utility ratepayers, counteracting potential increases in compliance cost. SDG&E looks forward to continuing to engage on this issue in future workshops and throughout the development of regulatory language.

In addition to the general themes discussed above, SDG&E offers specific feedback on elements raised during the April 23rd workshop that may benefit from additional clarification.

<u>Corporate Association Group (CAG) Issues</u>

I. Covered entities should retain the ability to bank allowances to help insulate against future increases in C&T compliance costs.

SDG&E continues to note that it is critical to retain the ability for covered entities to bank allowances for future compliance use. Distinct from the benefits that other market participants may yield with banked allowances, the ability of covered entities to purchase allowances at a lower cost for later retirement can serve as an important cost mitigation strategy. As CARB noted, allowance banking is essential in providing compliance flexibility for covered entities, reducing compliance costs, and mitigating concerns about price volatility. With the modeled allowance pricing presented during the November 16, 2023, workshop, this flexibility will be significant – particularly as we consider an escalation in post-2030 compliance costs. The ability to purchase pre-2030 allowances (at lower price points) and bank for post-2030 compliance may help manage the cost of program compliance over the longer term.

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

During the collaborative workshop's discussion of market rules, presenters raised the potential modification of consolidated holding limits for allowances and exemptions from those limits for covered entities in direct corporate associations. SDG&E appreciates CARB's interest in mitigating the risk of market manipulation to safeguard the integrity of the C&T market. However, CARB should retain the current consolidated holding limits for utilities' corporate affiliates, as corporate affiliates are prohibited by law from sharing information about allowances and offset procurement.

Under CARB's proposal, these rules would apply to corporate affiliates that share a parent company. For example, 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 rules[1] imposed by the California Public Utilities Commission (CPUC) and Federal Energy Regulatory Commission (FERC) prohibit these companies from sharing specific resources and information, including, but not limited to, the joint or coordinated procurement of allowances and offsets. As outlined 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. This exemption is a crucial aspect of these entities' compliance obligations and must be maintained to ensure their security.

Separately, it is crucial for CARB to consider modifications to holding limits on non-compliance entities that purchase allowances. The potential risks of entities without a compliance obligation purchasing and holding allowances to gain a significant market share cannot be overlooked. Allowing non-compliance entities to stockpile allowances and corner the market would result in upward pressure on allowance pricing, creating a challenging landscape for those with compliance obligations, as these costs are embedded in the price of energy passed through to customers. Thus, evaluating potential adjustments to non-compliance entity holding limits is not just helpful, but necessary for ensuring the long-term integrity of the market.

III. Clarification on the disclosure requirements for individuals associated with CAGs will help ensure that provisions can be implemented in alignment with existing regulatory obligations.

The C&T regulations currently require the disclosure of consultants/advisors and employees with knowledge of the company's market position. CARB presented potential modifications to expand the list of disclosed individuals to include "any individuals" with such knowledge or access. While the expansion is well-intended, further clarification on potential exemptions would facilitate the ability of entities to comply.

SDG&E and other investor-owned utilities meet regularly with the CPUC to discuss C&T compliance, including specific information on compliance instruments and pricing. During these discussions, CPUC staff are notified that the information being shared is confidential. However, SDG&E has the flexibility to share this information with CPUC pursuant to 17 CCR § 95914(c)(2)(D), which allows for the release to "an agency that has regulatory jurisdiction over privately owned utilities in the State of California of information regarding compliance instrument cost and acquisition strategy and other disclosures specifically required or authorized by the regulatory agency pursuant to any of its applicable rules, orders, or decisions." According to the same section, SDG&E has previously disclosed similar information to the Securities and Exchange Commission (SEC) auditor when an audit requested information about financial controls regarding the purchase of compliance instruments.

SDG&E does not believe that the CPUC and SEC regulatory staff are the intended target of ARB's proposed expansion. However, as presented, it is not clear whether the

[1] 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.

proposed expansion would require the disclosure of individuals at these regulatory agencies. SDG&E may not have insight into all the individuals at a given regulatory body that may have accessed the protected information.

<u>Compliance Periods</u>

IV. Longer and more consistent compliance periods provide greater market certainty and reduce the likelihood of allowance price swings.

ARB presented two options during the workshop for potential changes to compliance period (CP) end years to align with GHG emissions reduction target years in 2030, 2040, and 2045. Option 1 would change CP6 to four years, ending in 2030, and alter subsequent CPs to five years each, ending in 2035, 2040, and 2045. Option 2 would modify CP6 and CP7 to be two years each, with CP7 ending in 2030. In addition, it would alternate between three and two-year compliance periods so that every other CP would end in 2035, 2040, and 2045.

SDG&E believes that Option 1 would provide greater stability for covered entities, helping to reduce volatility in allowance pricing from one compliance period to the next. Historically, there appears to be a correlation between allowance price increases and the end of a CP, as referenced by CP3, which may identify that a pattern exists. However, various factors, such as floor price adjustments and market fundamentals, could also contribute to this trend. Shorter CPs are likely to result in more price volatility and provide less flexibility for entities to cost-effectively comply with the regulation.

A longer CP (Option 1) offers more stability and would enable entities to better plan and execute emissions reduction strategies more economically and efficiently over a longer time period. A longer CP provides entities with more flexibility in compliance planning, which would likely translate into cost efficiencies. These longer periods also facilitate more effective risk management by allowing for smoother transitions, lowering the risk of market volatility. Furthermore, a longer CP would give load serving entities greater capacity to accommodate more intricate projects or regulatory changes, ensuring a smoother and more sustainable trajectory for the regulation.

<u>Conclusion</u>

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 ARB 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.

Sincerely,

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