Elevate Climate

CALIFORNIA CARBON MARKET COLLABORATIVE
COMMENT LETTER TO CARB
08 MAY 2024

Re: California Carbon Market Collaborative Comments on CARB's Informal Workshop on Potential Amendments to the Cap-and-Trade Program

The California Carbon Market Collaborative (CCMC) appreciates the opportunity to provide public comment on the California Air Resources Board's (CARB) informal workshop on potential amendments to the Cap-and-Trade (C&T) Program held on 23 April 2024. This comment letter should be read together with our letters submitted to CARB on 17 August 2023, 26 October 2023, and 15 December 2023.

Elevate Climate convenes the CCMC in support of the design and implementation of an ambitious and equitable California C&T Program through 2045 and beyond. The CCMC gathers a wide array of C&T stakeholders to deepen mutual understanding and undertake careful examination of key Program design features. Participants of the CCMC include Environmental Defense Fund, Liminality Capital LP, and Pacific Gas & Electric.

1. **The CCMC continues to support prioritizing allowance removals from the allocation and auction pools to increase environmental ambition.**

Consistent with the CCMC's 26 October 2023 public comment letter, the CCMC encourages CARB to prioritize removals from allowance pools that lead directly to increased environmental ambition (i.e., greater GHG emissions reductions). Therefore, the CCMC continues to support prioritizing allowance removals from the allocation and auction pools, which provides the greatest possible certainty of achieving further emissions reductions in line with the 2022 Scoping Plan. This approach is most consistent with "Proposed Scenario A" in the Standardized Regulatory Impact Assessment (SRIA). As outlined below, any alternative approaches that remove allowances from other pools do not guarantee emissions reductions outcomes envisioned by the 2022 Scoping Plan.

As explained in the CCMC's 26 October 2023 public comment letter, removing allowances from the Allowance Price Containment Reserve (APCR) only leads to emissions reductions if and when the containment reserve is triggered and subsequently exhausted. The CCMC recognizes that the SRIA is not a formal staff proposal, but notes for illustrative purposes that the SRIA projects allowance prices well below Tier 1 of the APCR. Page 47 of the SRIA explains that "specifically, staff analysis suggests that, as GHG emissions fall in response to California's suite of climate change programs, cumulative allowance demand through 2045 may not exhaust cumulative Program budgets and thus average allowance prices may find a middle ground between the auction price floor and the price ceiling."

The above finding implies that allowances from the APCR Tiers are never released to the market. If this were true, then removing allowances from the APCR Tiers would <u>not</u> reduce GHG emissions because these allowances would never have been used anyway. It follows that SRIA Proposed Scenarios B and C, which include removals from the APCR tiers, would <u>not</u> reduce GHG emissions as much as Proposed Scenario A. This points to a contradiction in the SRIA's assumption that there is “only one emissions reduction outcome” across Proposed Scenarios A, B, and C.

The CCMC also notes that removing allowances from the APCR tiers per Proposed Scenarios B and C unnecessarily increases allowance price volatility and risks price spikes that exceed APCR Tier prices. For the avoidance of doubt, the analysis regarding environmental ambition applied to the APCR tiers above also holds true for removing allowances from the price ceiling.

Finally, whether AB 398 imposes limitations on how many allowances can be removed from the APCR is also worth considering, as AB 398 could be read to require that 81.2 million allowances be kept in these tiers. In addition, the CCMC notes that only 31.1 million allowances are assigned to the APCR from the 2025-2030 budgets, which CARB has identified as the relevant timeframe for the contemplated allowance removals.

For all of the above reasons, the CCMC reiterates that removing allowances from auction and allocation offers the greatest possible certainty for achieving the GHG reductions in line with the 2022 Scoping Plan.

2. **If CARB seeks to address the “potential discontinuity” between 2030 and 2031 annual budgets, the CCMC offers three potential options for consideration that would maintain or increase environmental ambition.**

CARB’s 23 April 2024 workshop identified a potential “discontinuity” in caps between 2030 and 2031 that could impact cap adjustment factors, allocations, holding limits, and funds to the greenhouse gas reduction fund (depicted on Slide 11 of the 23 April 2024 workshop).

As CARB considers whether, how, and/or when to address the discontinuity, the CCMC emphasizes that CARB’s ultimate approach should not come at the expense of achieving the 48% emission reduction target identified in the 2022 Scoping Plan Update and the SRIA Proposed Scenario, which requires removing 265 million allowances from the 2025-2030 budgets.

The CCMC outlines three potential options for addressing the discontinuity without expressing a preference for any particular option. The CCMC’s intent is that these potential options facilitate robust consideration of a wide array of approaches.

While there are tradeoffs with each potential option that the CCMC is actively analyzing, the potential options identified below either maintain or increase environmental ambition for the C&T program.

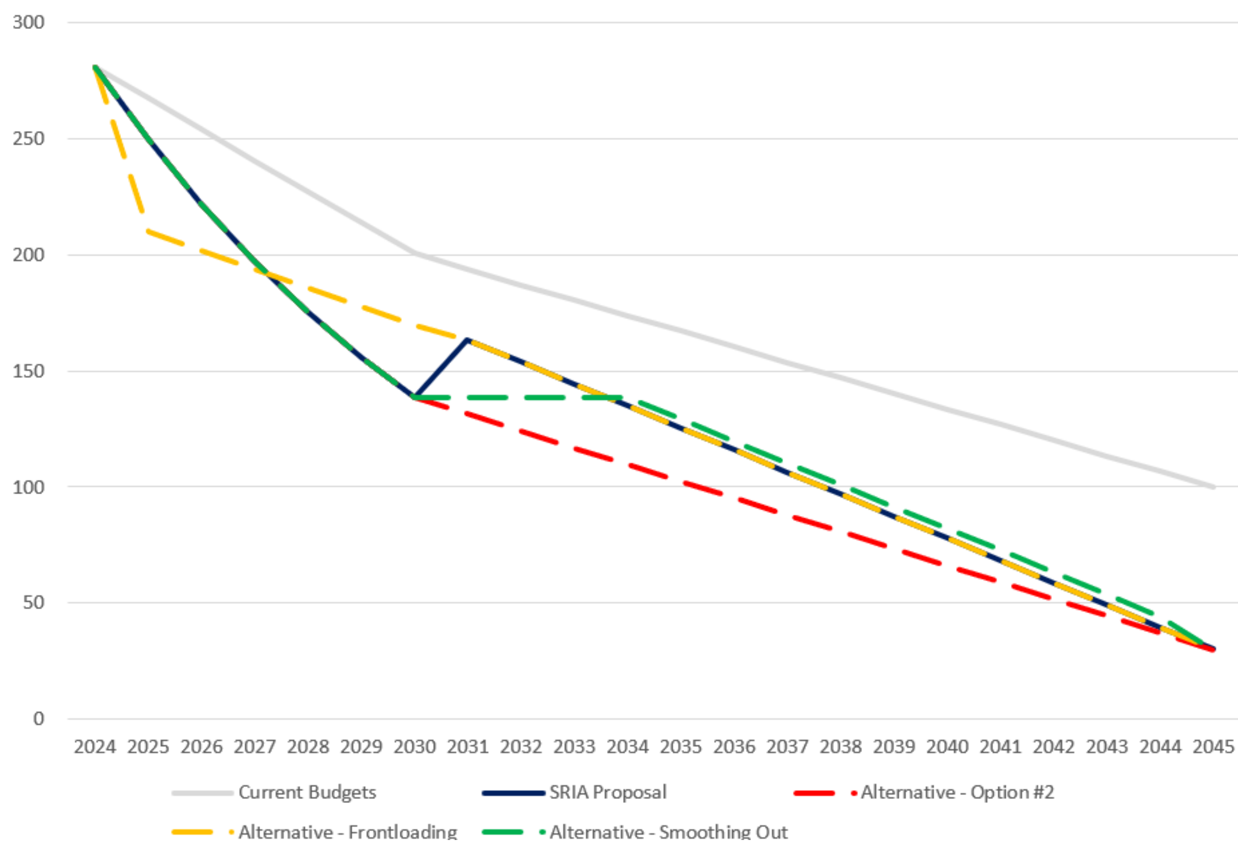
- Option #2 Approach: CARB could start the 2031 annual budget from the 2030 allowance budget (139 MMTCO2e) and set subsequent annual budgets to decline linearly from that start point, consistent with the solid yellow line on Slide 35 of the 5 October 2023 workshop and referred to as “Option #2” at the same workshop. This approach would increase the ambition of the C&T Program by removing an additional 235 million tons of allowances from 2031-2045 caps. This approach better positions the C&T Program as a backstop if complementary policies underperform. See the red dashed line in Figure 1 below.
- Smoothing Out Approach: CARB could start the 2031 annual budget from the 2030 allowance budget (139 MMTCO2e) instead of the 2030 Scoping Plan emission reduction target (173 MMTCO2e). CARB could then distribute the allowances that would have comprised the discontinuity across future budget years. The green dashed line in Figure

1 illustrates one of many ways to distribute allowances across the 2031-2045 period. This approach would maintain the 2045 annual budget of 30.3 million allowances and the same 2031-2045 cumulative allowance budgets shown on Slide 34 of the 5 October 2023 workshop.

- Frontload Approach: CARB could "frontload" the allowance removals, which would result in lower caps in 2025-2026 and higher caps in 2029-2030 than currently contemplated on Slide 11 of the 23 April 2024 workshop. This approach would enable CARB to maintain the ambition outlined in the SRIA and start the post-2030 budget trajectory from the Scoping Plan target. See the yellow dashed line in Figure 1 below.

Figure 1 visualizes the concepts presented above compared to CARB's current budgets (light grey line) and proposed Scenario in the SRIA (dark blue line). The dashed lines represent each of the concepts discussed above.

Figure 1: Approaches for Addressing the Discontinuity



3. **The CCMC supports the continued use of the California Climate Credit and further targeting of that credit toward low-income and disadvantaged communities.**

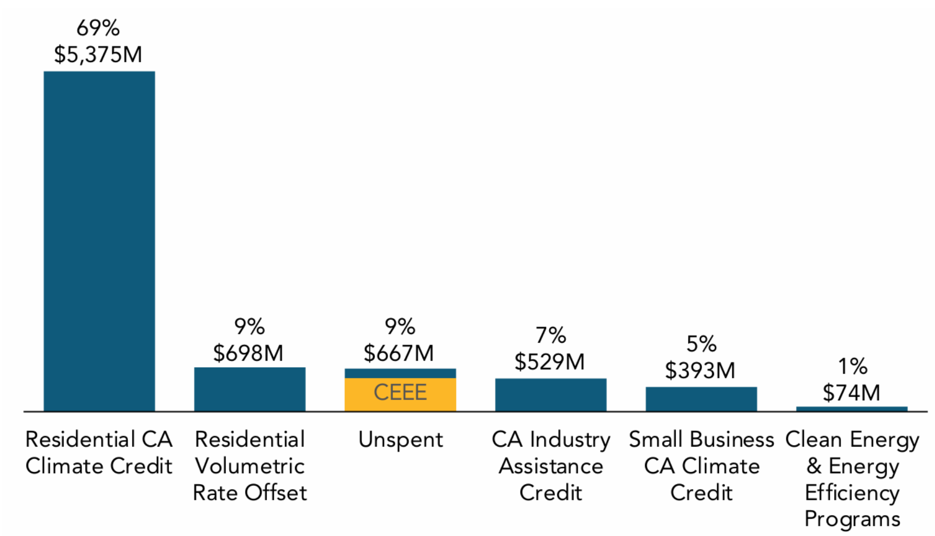
The 2022 Scoping Plan highlighted the importance of electrification in getting California to carbon neutrality by 2045. Dr. Meredith Fowlie's testimony to the Joint Legislative Climate Change Committee earlier this year highlighted how important electricity affordability is in driving electrification in the state. Recently, the Governor's Office issued a press release explaining the

California Climate Credit and expected rebates based on electricity providers. The CCMC welcomes these contributions and makes the following additional points:

- Electric investor-owned utilities (IOUs) are required to annually consign all of their allocated allowances for the benefit of ratepayers consistent with the goals of AB 32.
- The majority of the IOU allowance value is returned to electricity ratepayers as California Climate Credits (rebates), with the remaining value used for renewable energy, energy efficiency, and transportation electrification projects.
- From 2013-2021, the total allocated allowance value was $7.74 billion, of which $5.38 billion (69%) went directly to California residences (see Figure 2 below).

The detailed presentation by Kevin Hamilton on behalf of the AB 32 Environmental Justice Advisory Committee (EJAC) at the 23 April 2024 workshop also highlighted the importance of rebates to support low-income households. The CCMC notes that these rebates are made possible through the continued use of free allocations to utilities. As noted in the CCMC's 26 October 2023 public comment letter, this rebate framework could be updated to increasingly target lump-sum distributions to low-income and/or disadvantaged ratepayers to further channel revenue toward progressive outcomes. The CCMC also supports CARB's inclusion of environmental justice perspectives at the workshop.

Figure 2: IOU Use of Allocated Allowance Value in 2013-2021



Source: Cap-and-Trade Program Summary of 2013-2021 Electrical Distribution Utility Use of Allocated Allowance Value https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/allowanceallocation/edu_2013to2021useofvaluereport.pdf

4. **The CCMC notes that periodic updates are an important element of ensuring offset protocol designs reflect implementation experience and best practice.**

The CCMC welcomes continual updates and improvements to the Compliance Offset Protocols, including those contemplated as part of this rulemaking. The CCMC notes the unique role of carbon offsets in leveraging private investment to help achieve in-state reductions in sectors not covered by the C&T program. Protocols such as the Ozone Depleting Substances Protocol have helped the state achieve significant in-state reductions of local air emissions and the CCMC welcomes the protocol's continued use and improvement. In addition, the Urban Forestry Protocol possesses significant potential to generate emissions reductions as well as local air quality improvements in urban areas, and the CCMC would support protocol updates that catalyze its utilization. Other protocols, such as Improved Forest Management, are strongly supported by certain California tribes as important sources of income generation, and the CCMC supports improvements to this protocol.

5. **The CCMC highlights key considerations when evaluating updates to Corporate Association Group (CAG) rules and holding limit rules in order to protect environmental ambition.**

The CCMC does not have enough information at this time to make a recommendation on the proposed CAG rules, except that the CCMC agrees with CARB's view that implementing the rules immediately (instead of one or more years after the rulemaking) could lead to unnecessary price volatility and a phased in approach is prudent.

CARB's 23 April 2024 workshop also estimated that over 20 million allowances could be released into the market as a result of holding limit reductions alongside annual budget reductions. The CCMC notes that holding limits are closely entwined with allowance banking. At the 16 November 2024 workshop, CARB indicated that its current banking rules help to (1) reduce compliance costs and mitigate concerns about price volatility, (2) create compliance flexibility, (3) incentivize early emission reductions, and (4) encourage a long-term commitment from market participants.

To the extent CARB is evaluating potential changes to the holding limit to avoid disrupting banking or to address fluctuations to the holding limit caused by the 2030-2031 discontinuity, the CCMC offers two potential options. First, CARB could update the holding limit through 2030 to reflect the existing annual allowance budgets rather than the revised annual allowance budgets. Second, CARB could change the holding limit formula in a way that would "decouple" it from the annual allowance budget by removing the annual allowance budget as a variable and replacing it with a more gradual decline approach.

Sincerely,

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