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July 7, 2023

**To**:
Dr. Steven Cliff
Executive Officer
California Air Resources Board

Ms. Rajinder Sahota
Deputy Executive Officer
California Air Resources Board

**Re: <u>Comments on Potential Updates and Changes to the Cap-and-Trade Program</u>**

Dear Dr. Cliff and Ms. Sahota,

Thank you for the opportunity to submit comments on the status of the Cap-and-Trade Regulations (the "**Regulations**"), as well as the scope of potential updates and potential regulatory amendments to the cap-and-trade program (the "**Program**"), as presented in the workshop on June 14, 2023 (the "**Workshop**"). These comments are submitted on behalf of our client the Coalition for California Climate Ambition (the "**CCCA**").

The CCCA is an informal, unincorporated association of stakeholders supporting a continued role for the Program as the most efficient mechanism to achieve California's 2045 climate goals. The CCCA has members from key stakeholder groups, including industry participants, investors, and project developers. Members of the CCCA have made long-term investments worth hundreds of millions of dollars in multiple areas of the California economy, including in renewable power, energy transition, and infrastructure. CCCA members participate actively in the Program, including through participation in the California allowance auctions.

Section I of this letter contains a summary of these comments. Section II explains why the Program has been successful in assisting California with meeting its climate ambitions in a cost effective manner. Section III discusses why the current bank of allowances is the result of the Program working efficiently and is not evidence that the Program has failed as some critics of the Program suggest. Section IV presents findings from an academic study indicating that the Program is, in fact, effective in reducing greenhouse gas ("**GHG**") and local emissions. Section V outlines the policy recommendations we hope the California Air Resources Board ("**CARB**") will take into account during the upcoming rulemaking process.

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## I. SUMMARY

We would like to thank CARB staff for preparing and hosting the Workshop, which we found informative and productive, and CARB management for proceeding with the current update and review exercise with respect to the Program.

The comments of the CCCA may be summarized as follows:

- **It Is Imperative to Clarify Soon that the Program Will Continue Beyond 2030.** CCCA members strongly believe that the Program should continue beyond 2030, and that the Program extension should be confirmed and communicated to all relevant stakeholders sooner rather than later. Such extension is necessary to create a framework that will continue to incentivize CCCA members and other Program stakeholders to make long-term investments (often with return and exit horizons of more than 15 years) in California to decarbonize the economy in a durable and cost-efficient manner. Uncertainty over the Program's continuation and extension beyond 2030 today is starting to impact investment decisions and will have a cooling effect on certain investors if not addressed. The extension should be confirmed directly through amendments to the Regulations that would provide individual annual allowance caps through 2045 and may also require specific future legislation to reaffirm the agency's authority.

- **The Program Should Be the Workhorse of California's Climate Policies.** The Program should play a key role in California's fight against climate change and be utilized as the state's primary tool for driving reductions in GHG emissions. The Program can achieve GHG reductions faster and at a lower cost to the California economy than any other legislative or regulatory tool, making it a better option than traditional command-and-control approaches, which experience shows are both less effective and more expensive.

- **Increasing Price Certainty.** The CCCA is supportive of CARB's consideration of the various mechanisms that could increase price certainty, such as a revision to the allowance price containment reserve trigger prices.

- **The Program Is a Success.** CCCA members have extensive experience with climate programs globally and with the Program specifically since its inception. Based on their experience, CCCA members firmly believe that the Program is and has been a success as evidenced by its global recognition, its broad cross-sectorial reach, its near 100% compliance record, its generation of more than $23 billion in additional state revenues and, most importantly, by reducing GHG emissions significantly while the California economy experienced unprecedented economic growth.

- **The Bank of Allowances Reflects Overperformance, Not a Failure.** The existence of a bank of allowances is the result of the Program working efficiently and achieving reductions in GHG emissions earlier than anticipated. This is a sign of the success of the Program, not evidence of a failure, as some opponents of the Program incorrectly allege.

- **The Program Reduces GHG and Local Air Emissions.** Contrary to the claims of some critics, causal scientific analysis does not support the contention that the Program allowed GHG emitters to increase their emissions of GHGs and hazardous air pollutants, and that such increases disproportionally impact disadvantage communities. In fact, a recent study contends that the Program reversed a pre-2012 trend where disadvantaged communities experienced increasingly disproportionate levels of local air emissions and narrowed this gap between 2012 and 2017.

## II. THE PROGRAM IS UNQUESTIONABLY A SUCCESS

The CCCA members firmly believe that the Program is and has been a success for several reasons, including those discussed below. The CCCA views are consistent with the views of the vast majority of other Program participants (which as indicated below cover 85% of the state's emissions), including those from investor, labor and industry groups.

### 1. The Program Has a Broader Reach than Any Other Policy

The Program operates on an economy-wide scale, covering emitters in most sectors that produce more than 25,000 tons of cumulative emissions annually. This is unlike other well-known programs like the EU Emissions Trading Scheme ("**EU ETS**"), which covers only the power sector, manufacturing industry, and airlines operating between program countries,[1] and the Regional Greenhouse Gas Initiative ("**RGGI**"), which covers only the power sector. As a result of this broad scope, the Program covers 80% of California's GHG emissions,[2] compared to the 40% coverage of EU ETS[3] and the even lower coverage of RGGI.[4] The Program's broad reach across various sectors has the potential to make a stronger impact on emissions reductions.

### 2. Cap-and-Trade Has Helped California Reduce Emissions at a Time When the California Economy Grew at Unprecedented Rates

As indicated in the recent Legislative Analyst's Office ("**LAO**") report, cap-and-trade programs have been found to be the most cost effective approaches to reducing GHG emissions.[5] This is evidenced by the fact that California met its 2020 emissions reduction target four years early in 2016. At the same time, the economy boomed: from 2012 (the outset of the Program) to

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[1] European Commission's Climate Action, "EU Emissions Trading System (EU ETS)," available at https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en.
[2] California Air Resources Board, "FAQ Cap and Trade Program," available at https://ww2.arb.ca.gov/resources/documents/faq-cap-and-trade-program.
[3] European Commission's Climate Action, "EU Emissions Trading System (EU ETS)," available at https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en.
[4] International Carbon Action Partnership, "USA – Regional Greenhouse Gas Initiative (RGGI)," available at https://icapcarbonaction.com/system/files/ets_pdfs/icap-etsmap-factsheet-50.pdf.
[5] Legislative Analyst's Office, "Assessing California's Climate Policies: The 2022 Scoping Plan Update," available at https://lao.ca.gov/Publications/Report/4656.

2017, California's GDP grew from a 12.8% to a 14.2% share of the US economy.[6] The cost effective and technologically agnostic nature of the Program has allowed it to bolster California's economic growth while reducing emissions. Some have suggested that the innovations and investments driven or required by the Program have actually contributed to economic growth.

### 3. Other Policy Options Available to CARB Will Result in Higher Costs to California's Economy Without Creating Additional GHG Reductions or Environmental Benefits

Research and experience show that cap-and-trade programs are the most effective tool to reduce GHG emissions on an economy wide basis and at the lowest cost, while other policy options, such as command-and-control measures, do not guarantee outcomes and are more expensive. Traditional command-and-control regulation typically offers little flexibility to companies with respect to how and where to reduce emissions and it furthermore fails to take advantage of the fact that some polluters can reduce emissions more cheaply than others. Echoing the points made by the International Emissions Trading Association ("**IETA**") in its comment letter, utilizing the Program as a workhorse would be more cost effective when compared to command-and-control policies or government subsidies, which can cost between $60 and $80,000 per ton.[7]

### 4. The Cap-and-Trade Program Shows California's Leadership Globally

The Program is recognized globally as one of the most successful and ambitious policies for emissions reduction. As CARB and political and industry representatives who participate in the international United Nations climate conferences annually will confirm, the Program is considered a blueprint by many other jurisdictions looking to California for climate leadership. California inspired Quebec to pursue and achieve linkage in 2014,[8] and recently California received indications of interest from Washington State.[9] Linkage has numerous notable benefits that drive emissions reductions.[10]

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[6] Los Angeles Times, "California is now the world's fifth-largest economy, surpassing United Kingdom," available at https://www.latimes.com/business/la-fi-california-economy-gdp-20180504-story.html.

[7] According to UC Berkeley and the LAO. See Meredith Fowlie. 2022. "What's the Plan for Carbon Pricing in California? Energy Institute Blog; Legislative Analyst's Office." 2022. The 2022-2023 Budget: Zero-Emissions Vehicle Package.

[8] California Air Resources Board, "Cap-and-Trade Program Linkage," available at https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/program-linkage.

[9] Washington State Department of Ecology, "Climate Commitment Act," available at https://ecology.wa.gov/Air-Climate/Climate-Commitment-Act.

[10] California Air Resources Board, "Net Flow of Compliance Instruments," available at https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/program-linkage/net-flow-compliance-instruments; Office of Governor of California, "Proposed Linkage of California's Cap-and-Trade Program With the Canadian Province of Québec's Cap-and-Trade Program," available at https://www.ca.gov/archive/gov39/wp-content/uploads/2017/09/Draft_Linkage_Comment_Response-Attachment_3-02-22-2013.pdf.

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### 5. The Program Has Generated $23.2 Billion for the Greenhouse Gas Reduction Fund

The Greenhouse Gas Reduction Fund ("**GGRF**") is a groundbreaking national initiative aimed at tackling climate change by supporting projects and programs that reduce GHG emissions. The GGRF is closely linked to the Program, as it receives a portion of the revenues generated from the allowance auctions and utilizes these funds to finance various projects and initiatives to reduce GHG emissions in California. Of implemented GGRF investment projects, 73% or $6.7 billion benefits priority populations.[11] More broadly, of the $23.3 billion generated by the Program, $22.6 billion has been provided to 23 state agencies to support a diverse set of 75 programs that facilitate GHG emissions reductions.[12] These headline-grabbing programs, such as low carbon transportation programs like Zero Emission Vehicles ("**ZEVs**") receive a significant portion of their funding from the Program. A cap-and-trade investment plan is submitted to the legislature every three years to identify priority investments using allowance proceeds.[13] The most recent Fourth Investment Plan for Fiscal Years 2022-23 through 2024-25 recommends continued funding for programs like ZEVs, renewable energy, nature-based solutions and many other projects, some specifically designed to benefit disadvantaged communities.[14]

### 6. The Program Has Achieved High Compliance Rates

In addition, as CARB indicated, the businesses covered by the Program have achieved near 100% compliance rates at each compliance period.[15] This high level of compliance with the Regulations demonstrates the continued rigor of the Program and the important role it is playing in California meeting its emissions reduction targets.

## III. THE BANK OF ALLOWANCES REFLECTS PROGRAM OVER-PERFORMANCE

Despite strong evidence that the Program has been a success as discussed above, some have suggested that the existing bank of allowances in the Program is a design flaw. Such critics have suggested that this bank could result in the state failing to meet its climate objectives. Such assertions are not supported by the facts and ignore some fundamental market conditions that exist in the Program, as discussed below.

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[11] California Air Resources Board, "Annual Report to the Legislature on California Climate Investment Using Cap-and-Trade Auction Proceeds," p. 23, available at https://ww2.arb.ca.gov/sites/default/files/auction-proceeds/cci_annual_report_2023.pdf.

[12] *Id*, at 5.

[13] California Air Resources Board, "California Climate Investments Investment Plan," available at https://ww2.arb.ca.gov/resources/documents/california-climate-investments-investment-plan.

[14] California Air Resources Board, "Cap-and-Trade Auction Proceeds Fourth Investment Plan: Fiscal Years 2022-23 Through 2024-25," pp. 12-13, available at https://ww2.arb.ca.gov/sites/default/files/auction-proceeds/Cap-and-Trade%20Auction%20Proceeds%20Fourth%20Investment%20Plan_FINAL.pdf.

[15] California Air Resources Board, "FAQ Cap and Trade Program," available at https://ww2.arb.ca.gov/resources/documents/faq-cap-and-trade-program.

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### 1. The Allowance Bank Reflects Overperformance, Not Weakness or Failure

California met AB 32's goal of a return to 1990 emissions in 2016, significantly ahead of projections when the Program was designed and when the first Scoping Plan was adopted in 2008. This achievement is a strong indication that the Program is a success. The natural consequence of this overperformance, however, was that allowances sold at auctions have been held by various Program participants in their CARB accounts for potential future use. However, this is a good outcome, not a bad outcome, because it means that the Program achieved reductions early, with the accompanying climate benefits. It is therefore disingenuous to argue that the Program is failing because it succeeded in reducing emissions rapidly. Moreover, banking of allowances is a necessary market design feature that serves as a "shock absorber" in situations where economic activity accelerates and there is a delay in the necessary technology deployment or if the costs of reductions increase more rapidly than expected.

### 2. The Focus on Emissions in Individual Years, Including 2030, Is Misplaced

Critics of the Program argue that AB 32, as amended, requires CARB to design a program that will result in GHG emission reductions that essentially follow a linear decline over time and that the Program cannot and should not experience variation year on year above that linear decline curve. While AB 32 does require a steady and permanent decarbonization of the state's economy, AB 32 also recognizes that reality and economic conditions dictate that there will be natural fluctuations in the levels of emissions reduced each year. Such linear regression is legally permissible under AB 32 and CARB has discretion to allow for these annual variances, provided that the Program is designed so that the total GHG emission reductions achieved over the duration of the Program is consistent. Allowing for annual variances supports the policy goal of promoting higher levels of emission reductions in the initial years of the Program, thereby compounding the environmental benefits of such reductions, and to limit the impacts on economic growth of achieving these cumulative reductions. Thus, the real test under AB 32 is whether CARB has designed a program that is reasonably expected to gradually reduce statewide emissions, and to achieve carbon neutrality in 2045 through the declining caps, using the interim dates as checkpoints to ensure consistency in total emission reductions over time. Clearly, CARB has met this test and, accordingly, the Regulations comply with California law.

### 3. The Program Will Continue After 2030

Notwithstanding the discussion in the preceding section, the argument that the entire remaining bank of allowances will be used in 2030 to exceed the statewide goals rests on the false assumption that the Program is discontinued in 2030 and that the entities in the market will somehow use all of the banked allowances in 2030. If the Program continues through 2045, entities subject to the Program will have every reason to continue holding allowances for the future when the Program will become increasingly stringent and when prices are projected to increase based on the declining allowance supply.

### 4. New Climate Goals Already Require an Adjustment to Allowance Budgets

CARB has already signaled that it will lower the Program's annual emissions caps in its upcoming rulemaking. Under the 2022 Scoping Plan, CARB has set a target to achieve a 48% reduction in GHG emissions from 1990 levels by 2030, and a linear adjustment to ensure that this target is met would remove significant supply from the Program's future emissions caps. This would set California up for success in meeting post-2030 targets on its way to carbon neutrality in 2045.

## IV. THE PROGRAM REDUCES GHG AND LOCAL AIR EMISSIONS

One criticism of the Program is that the Program has enabled large emitters to increase their emissions of GHG and hazardous air pollutants, and that those emissions historically and currently disproportionally impact disadvantaged communities.

The CCCA agrees that CARB should continue to monitor closely the environmental impacts of various economic activities in the state on different communities, especially disadvantaged communities, for the purpose of identifying and addressing issues. However, the criticism is not supported by facts. As indicated in previous public comments made to the Joint Legislative Committee on Climate Change Policies by IETA, a recent academic study published in the Journal of Public Economics[16] argues that the Program reversed a pre-2012 trend where disadvantaged communities experienced increasingly disproportionate levels of local air emissions and narrowed this gap between 2012 and 2017. This study, conducted by Dr. Danae Hernandez-Cortes from Arizona State University and Dr. Kyle Meng from UC Santa Barbara, researched the impact of the Program on emissions between 2012 and 2017, a time period during which allowance prices were $15 or less compared to today's allowance prices that exceed $30. The authors found that the Program reduced emissions annually at their sample of industrial facilities by 9% for GHGs, 5% for PM2.5, 4% for PM10, and 3% for NOx.

It is important to mention that this study performed a causal analysis rather than a correlational analysis as performed by many previous studies on this topic which may have led some to view the Program unfavorably. Based on the foregoing, the argument that the Program has allowed GHG emitters to increase their emissions of GHGs and hazardous air pollutants, and that such increases disproportionally impact disadvantage communities is not supported by the scientific literature.

## V. POLICY RECOMMENDATIONS

The CCCA urges CARB to consider the following recommendations as CARB continues to work on potential updates and regulatory amendments to the Program.

### 1. It Is Imperative to Clarify Soon that the Program Will Continue Through 2045.

[16] Hernandez-Cortes, D. and K. C. Meng. 2023. "Do Environmental Markets Cause Environmental Injustice? Evidence from California's Carbon Market." Journal of Public Economics 217 104786.

a. The CCCA believes that the Program should be extended sooner rather than later for two primary reasons. First, uncertainty over the status of the Program after 2030 introduces unnecessary risk to investments in emission reduction projects which rely on private capital and an expected rate of return through the monetization of allowances (or the avoidance of needing to acquire allowances). This is particularly the case for larger infrastructure investments, which will likely not begin to operate until closer to 2030, given the lengthy permitting processes in California. The recent 2023 annual report by the Independent Emissions Market Advisory Committee echoes this point.[17] Second, extending the Program beyond 2030 would alleviate concerns around achieving California's 2030 climate target. The recent LAO report supports this view.[18]

b. The CCCA is of the view that CARB should set out annual emissions caps up to and including 2045 in the upcoming rulemaking process. The CCCA holds the position that such annual caps would ensure that California achieves the goals set out in AB 1279.

c. In addition, extension and continuation of the Program through 2045 should be done via legislation.

2. **The Program Should Be the Workhorse of California's Efforts to Address Climate Change, Not a Backstop**. Beyond the economic efficiencies identified in Section II, Paragraph 2, a workhorse role for the Program would send a strong, consistent carbon price signal throughout the California economy. Subsequently, the workhorse status will drive more revenue to the GGRF that can in turn be deployed to reduce emissions within the state. To achieve this goal, CARB may need to consider cost effective mechanisms to automatically adjust supply towards the 2045 carbon neutrality goal. Such a mechanism could account for uncertainty about near and long-term emission reductions, and it would remove the need for unilateral administrative adjustments that could be disruptive to the market. Automatic adjustments could help insulate the Program from legislative and external criticism by tighten supply if a set of objective criteria is met. We also support CARB's approach to consider design changes holistically, rather than adopting piecemeal elements.

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Thank you again for the opportunity to submit comments to you. We remain available to discuss these matters further at your convenience.

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[17] Independent Emissions Market Advisory Committee, "2022 Annual Report of the Independent Emissions Market Advisory Committee," available at https://calepa.ca.gov/wp-content/uploads/sites/6/2023/02/2022-ANNUAL-REPORT-OF-THE-INDEPENDENT-EMISSIONS-MARKET-ADVISORY-COMMITTEE-2.pdf.

[18] Legislative Analyst's Office, "Assessing California's Climate Policies: The 2022 Scoping Plan Update," available at https://lao.ca.gov/Publications/Report/4656.

Sincerely,

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