Environmental Defense Fund

August 17, 2023

Ms. Liane Randolph
Chair, California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments on July 27 CARB workshop regarding updates to California's Cap-and-Trade Program

Dear Chair Randolph,

On behalf of Environmental Defense Fund (EDF), we appreciate the opportunity to provide comments on the July 27, 2023, workshop on updates to the California Cap-and-Trade Program. As always, EDF appreciates CARB's work on this program, and we look forward to ongoing engagement through the informal and formal processes. These comments respond to several of the proposals put forward in this second workshop, as well as considerations we recommend CARB take up at future workshops.

Avoiding the worst impacts of climate change will require securing as many reductions as possible as quickly as possible *in this decade* to stay within the carbon dioxide budgets identified by the Intergovernmental Panel on Climate Change (IPCC) to limit global warming to 1.5°C. To that end, EDF appreciates CARB's focus on near-term ambition and maximizing emission reductions by 2030, and specifically on the cumulative climate benefits accrued from near-term reductions. Reducing emissions of short-term gasses like methane is critical to slowing and limiting near-term warming, while reducing the total accumulation of long-lived gasses - like carbon dioxide, which can stay in the atmosphere for centuries - is critical for limiting overall warming. Curbing emissions as fast as possible is necessary for slowing the rate of warming and limiting cumulative emissions in the atmosphere.

The July 27 workshop recognized the critical opportunity for greater ambition in the cap-and-trade program specifically and acknowledged the importance of calibrating the emissions cap in the program to achieve California's emissions reduction goals. CARB must ensure that the emissions cap be calibrated to achieve at least a 48% reduction below 1990 emissions by 2030 that the Scoping Plan determines is necessary to be on track for net-zero by 2045. We also encourage CARB to model a cap adjustment that reflects the number of banked allowances, emissions included in the AB 32 inventory but outside the cap, and emission reductions achieved during the Covid-19 pandemic. EDF further recommends that when adjusting allowance budgets

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to align with this target, most if not all of that reduction should be reflected in the allowances allocated directly to covered entities and offered at auction.

Emissions cap must be aligned with 2030 emission reduction goal as modeled in the 2022 Scoping Plan to be the necessary backstop.

EDF supports CARB's plan to evaluate multiple allowance budget scenarios, including achieving an 85% emission reduction below 1990 by 2045. EDF appreciates CARB's foresight in planning out to 2045; even as we strive to maximize near-term emission reductions, it is important to provide direction about the future trajectory of the program to allow long-term planning for new investments in emission reduction strategies and technology.

Considering the forthcoming result of modeling, the emissions trajectory necessary in the Scoping Plan, and the urgency of near-term reductions, **EDF urges CARB to move forward in the formal rulemaking with a cap adjustment to achieve at least a 48% emission reduction by 2030**. To effectively minimize climate damages, California must rapidly cut climate pollution in this decade. The sooner California cuts emissions, the greater the cumulative reductions — and the easier it becomes to ensure California is on a reduction trajectory consistent with what climate science demands. EDF is enthusiastic that CARB is evaluating allowance budgets that could increase the program's near-term ambition by accelerating emissions cuts in this decade.

This increased ambition is especially important as the cap-and-trade program plays an important role in providing an emissions backstop to keep California on track to its climate goals. When well designed, a firm, declining cap on emissions provides the greatest possible certainty of meeting greenhouse gas reduction targets. This pollution limit, set by the emissions budget for covered sources, is the most essential feature of the cap-and-trade program. The 2022 Scoping Plan rightly considered the role of the cap-and-trade program as the tool to close the gap between expected abatement from sectoral policies and the emission cuts necessary to achieve reductions consistent with the state's goals. The relative role of the cap-and-trade program compared to sector-based policies as the "primary driver" for emission reductions is less important than the role the cap plays in ensuring that emissions do not exceed the allotted budget, and the stringency of the budget itself. If other programs or strategies help achieve greater reductions than expected, then there is less pressure on the cap; but if other programs or strategies deliver fewer reductions, the cap remains the state's "insurance policy" to make sure emissions continue to decline at the pace required.

This is especially important as CARB has raised concerns about the ability of California to deploy nascent technologies like green hydrogen and carbon capture on a meaningful scale by 2030. While these strategies are likely necessary to achieving California's climate goals, in the event that these technologies don't deliver the desired reductions in the near-term, California can rely on its emissions backstop to ensure the state still meets its 2030 goal. Uncertainty underscores the necessity of a firm emissions cap.

California's commitment to tightening its allowance budget is a significant advancement in climate ambition, and setting a more ambitious cap will accelerate near-term emission reductions in addition to facilitating the achievement of the state's long-term emission targets.

As CARB sets a more ambitious cap, it should pursue modeling to account for banked allowances, certain uncapped emissions, and reductions achieved during the Covid-19 pandemic.

To function effectively as the backstop, the emissions budget must be calibrated to ensure that cumulative emissions in California, at a minimum, do not exceed emissions allowed under a linear trajectory from 2020 to 2030 targets, factoring in any previously "banked" allowances that may be retired for compliance in the upcoming years. While the ability to bank allowances is an important strategy to encourage near-term emission reductions, those allowances also represent an opportunity to issue fewer allowances in future years. CARB has estimated that the private allowance banks represent 5% of all allowances. To that end, EDF recommends that at least some of that amount be reflected in the reduction of future allowances budgets.

When modeling emissions budgets, CARB should also consider the emissions from sources not covered by the program cap. For instance, modeling from Resources For the Future (RFF) in 2020 set a hypothetical emissions cap for Colorado such that the state achieves their yearly GHG targets while assuming BAU emissions in non-covered sectors. This is necessary to ensure that the allowance budget in the cap-and-trade program is stringent enough to compensate for potential growth in uncapped emissions from the AB 32 emissions inventory and still secure the cumulative reductions necessary. In other words, if an increase is projected from sources included in the AB 32 inventory but without a compliance obligation, even given any existing or likely future complementary policies, the budget in the out years should be reduced in order to ensure the capped sectors overperform and reduce additional emissions to accommodate a projected increase. To function effectively as the backstop, the emissions budget must be calibrated to ensure that California achieves at least a 48% economy-wide emission reduction by 2030.

CARB should also consider the extent to which a more ambitious cap could more accurately capture the emission reductions achieved during the Covid-19 pandemic, approximately 35 MMT. While these reductions are the result of unprecedented events, some of those reductions could be made permanent by a corresponding reduction in the emissions cap. While California and the world has seen a post-pandemic resurgence in greenhouse gas emissions, reducing the number of allowances issued in future years to reflect some if not all of the pandemic reductions would essentially "re-capture" those reductions.

Understanding the impact of these potential cap adjustments through modeling is a necessary next step to gain a more accurate picture of how the cap-and-trade program can be best optimized to achieve reductions. **CARB staff emphasized at the July 27 workshop that this program is about reductions, not prices, and EDF strongly agrees.** We therefore encourage CARB to examine all of the options for maximizing reductions while maintaining market stability, including modeling for a cap adjustment that accounts for banked allowances, emissions outside the cap, and emission reductions experienced during the pandemic.

A downward cap adjustment should be reflected in the number of allowances allocated directly to covered entities and offered at auction.

In order to ensure that any cap adjustment achieves actual reductions in the near-term, CARB should reduce the allowance pool for direct allocation and for allowance auctions. The other

options mentioned at the July 27 workshop, such as drawing from the Allowance Price Containment Reserve (APCR) or from already-banked allowances, would not be an effective way to achieve the goal of this program adjustment and would risk disincentivizing near-term reductions.

Reducing the number of allowances in the APCR would only serve to reduce the efficacy of an important cost containment feature of the program and would not ensure near-term reductions because the quantity of allowances available for auction or allocation would remain unchanged from the current cap trajectory. Reducing the quantity of already-banked allowances would be disadvantageous since it would send a signal that disincentivizes future banking. Banking is an important strategy for bringing emission reductions forward in time, and reducing confidence in the availability of future banked allowances would counteract this incentive.

Conclusion

EDF is deeply supportive of CARB's efforts to pursue a cap adjustment to put California on track to achieve at least 48% reduction in greenhouse gas emissions below the 1990 level by 2030 as laid out in the 2022 Scoping Plan. The cap is the most important part of the cap-and-trade program, and to effectively operate as a backstop it must be properly calibrated to the state's goals and reflect emissions outside of the cap. EDF also encourages CARB to bring about these proposed changes by reducing the allowance pool for direct allocation and auctions in order to truly ensure near-term emissions reductions.

Furthermore, as we have previously commented, EDF also encourages CARB to use these workshops and modeling efforts to explore other potential program updates, such as facility-level caps, bringing offsets under the cap, and implementing an emissions containment reserve (ECR). For more detail on these recommendations, please refer to our comments on the June 14 workshop.

EDF appreciates CARB's continued climate leadership to update the state's landmark cap-and-trade program. We look forward to working closely with staff and stakeholders to ensure the final product of this process is a program that maximizes climate ambition, supports local air quality improvements, continues to provide appropriate compliance flexibility and cost containment, and remains a model for other jurisdictions looking to accelerate their own climate leadership.

Sincerely,

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