May 10, 2018

Rajinder Sahota – Assistant Division Chief, Industrial Strategies Division
Jason Gray – Branch Chief, Cap-and-Trade Program
California Air Resources Board
1001 I Street
Sacramento, California 95814

RE: Comments on the April 26th Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation

Dear Rajinder and Jason,

The organizations listed below respectfully submit the following comments in response to the April 26th Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation (Cap-and-Trade).

<u>Our organizations continue to support a well-designed cap-and-trade program as the most cost-effective method for achieving GHG emissions reductions while limiting the impact to California's economy</u>. Enabling companies to choose the most economical method for reducing emissions and maintaining a stable, liquid market will limit the negative effects of imposing the compliance costs on California manufacturers and other complying businesses when no other competitively-sized markets also imposes such costs on their manufacturers.

The central message of these comments is "cost containment". Cost containment, including maintenance of assistance factors during Compliance Period 3 (CP3), a low price ceiling paired with appropriately placed 'speed bumps', and the continuation of allowances currently or projected to be available.

Maintain Assistance Factors at 100 Percent in CP3

We agree with the ARB staff recommendation to maintain assistance factors (AFs) at 100 percent for all covered entities in CP3 as it will meet the objective of minimizing emissions leakage that results from a growing disparity in production costs between California manufacturers and entities in other jurisdictions that do not impose such costs.

<u>Why is it appropriate that ARB revisit the issue of AFs now?</u>

When California embarked on this mission to reduce GHG emissions, it was promised and expected that competing jurisdictions would join the state in its effort to impose a cost on carbon. However, as we have seen over the intervening years, that has not happened in a meaningful way and California manufacturing growth continues to lag that of other states as evidenced by the state's paltry 4.5 percent share of new manufacturing investments. This indicates a potential for net higher emissions as operations expand in jurisdictions that do not control GHG emissions and comes at the detriment of California industry and jobs.

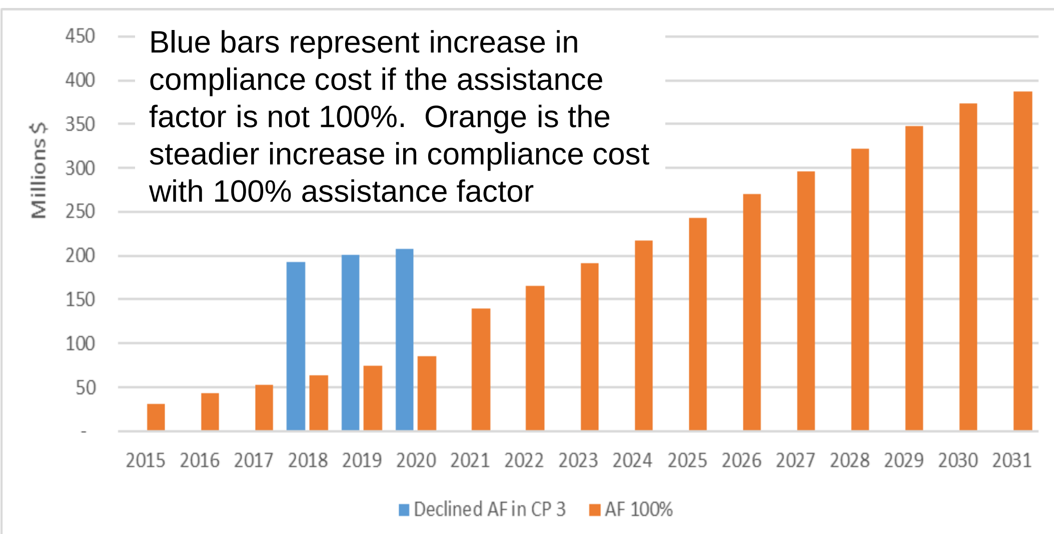
Additionally, programs that do exist in other jurisdictions generally focus on electric sector emissions, and only tangentially cover industrial entities that are energy intensive and typically consume higher density/intensity fuels. Where such industrial entities are included in these programs, carbon price impacts intentionally limited in order to protect their domestic industry.

ARB recognized these facts in part when they approved keeping the AFs at 100 percent for CP2 and the Legislature continued that recognition by providing statutory direction to maintain AFs at 100 percent for the Post-2020 period. Now that we have a 2030 emissions reduction goal it is also appropriate to look at how best to mitigate the impacts to instate industry through higher level AFs that will help limit compliance costs while meeting environmental goals of Cap-and-Trade.

In the April 26th informal workshop, ARB staff presented information indicating a major spike in compliance costs should the CP3 AFs not be maintained at 100 percent (Chart 1). The picture is very clear that compliance costs for covered entities in the medium and low leakage risk categories will face higher compliance for CP3 that equate to more than double those under a CP3 100 percent AF scenario. ARB staff are correct in seeking to smooth the transition from the AB 32 (2006) regime to that of SB 32 (2016) and AB 398 (2017) as it will have a positive effect on the certainty issues facing entities looking at their future in California.

<u>Chart 1</u>

Estimated Compliance Cost for Sectors in Medium and Low Leakage Risk Categories



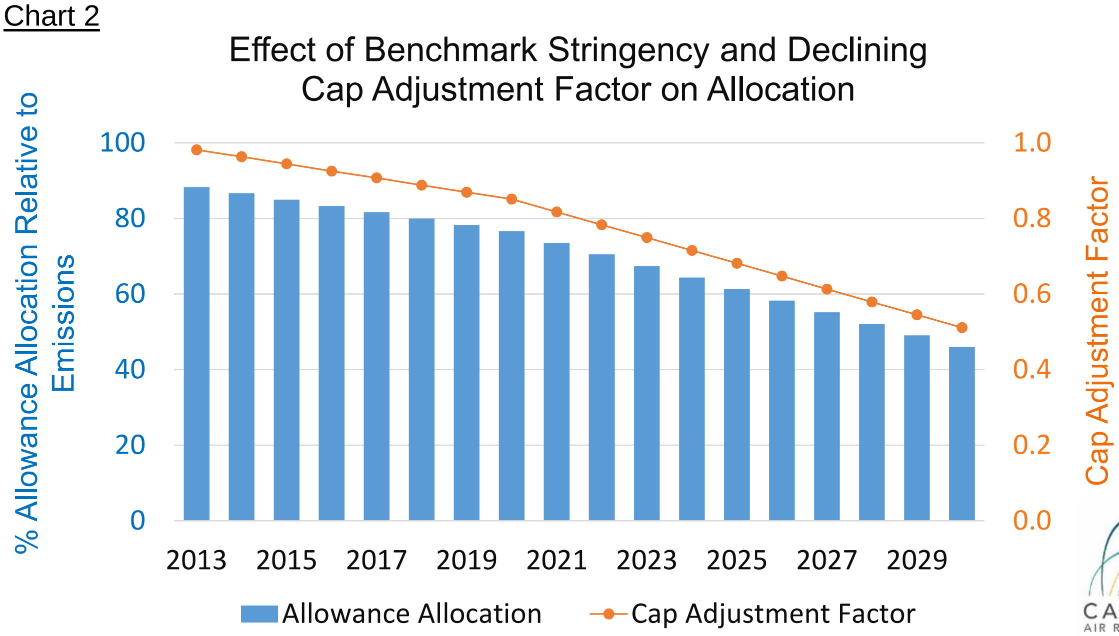
- Assumes $15 allowance value for 2015 – 2020 and $20 for 2021 – 2023
- Uses 2016 emissions as a proxy for emissions in 2017 and beyond

CALIFORNIA AIR RESOURCES BOARD

Some commenters on prior informal discussion workshops falsely claimed that maintaining AFs at 100 percent will “let polluters off the hook”, result in windfall profits or delay investments in reducing GHG emissions. This represents a fundamental misunderstanding of how large financial investments are made by corporate entities that look five to ten years out when projecting capital expenditures.

Also, many of those same commenters imply that covered entities are getting a “free ride” under 100 percent AFs. However, the 10-percent ‘haircut’ and annual cap adjustment factors ensure that this is not the case and ARB projections (Chart 2) clearly show that by 2030 most covered entities will receive 50 percent or less of their compliance need through allowance allocations. The resulting increase in compliance costs (Chart 1) will continue to challenge California manufacturers as we approach the midpoint of the 2020s through the end of the decade.

Chart 2



We support the ARB staff recommendation to maintain AFs at 100 percent in CP3 as consistent with the purpose of industry assistance in preventing leakage, the Board direction imparted in Board Resolution 17-21 (page 14) and the intent of AB 398 in the post-2020 period.

Price Ceiling is Cost Containment

While ARB staff are on track with their recommendation on AFs in CP3, serious issues remain regarding the direction price ceiling discussions. The price ceiling is the final word on cost containment in the cap-and-trade program, thus setting an appropriate price ceiling will help ensure stability and certainty for covered entities.

It is also important to note what the price ceiling is and what it is not. The price ceiling is the upper bound of the cost of a carbon allowance under Cap-and-Trade; it does not represent the overall cost of carbon in California. The cost of carbon is more accurately described as an aggregate of several other complementary measures, including the Low Carbon Fuel Standard (LCFS), Renewable Portfolio Standard (RPS) and Cap-and-Trade.

Cap-and-trade by in large provides pressure relief to the overall GHG emission reduction regime, and an appropriate price ceiling protects the integrity of this core function. Contrary to numbers presented by ARB staff, Cap-and-Trade requires a lower price ceiling and failure to do so risks letting these allowances become as expensive as those in other programs such as LCFS.

Research conducted by NERA Economic Consulting on behalf of the California Manufacturers & Technology Association (CMTA) clearly indicates that higher price ceiling levels result in larger reductions in the household income of Californians (See Attachment 1). Consequently, an appropriate price ceiling also limits the impact to businesses and consumers that face higher costs for the energy they consume, fuel they use in their vehicles and goods they purchase.

Considering the significant impact that a higher price ceiling would have on the California economy, ARB should propose a lower price ceiling. If they choose to pursue a higher price ceiling level, ARB must be prepared to justify that choice by analyzing different ceiling levels options, including the impact of different ceiling prices on industry and jobs in California.

Speed Bumps Help Control Run-Away Prices

The price ceiling sets the upper bound of the allowance costs under Cap-and-Trade, but the Price Containment Points (aka 'speed bumps') provide a check on the system and opportunity for ARB and the Legislature to review market conditions that contribute to rapidly increasing prices. Out of control allowance price increases threaten the political support for Cap-and-Trade as well as the interest to demonstrate the success of the California model to other jurisdictions.

The NERA research mentioned above also looked at the issue of speed bumps that help moderate allowance price increases and delay the year in which the market reaches the price ceiling. This provides for a smoother escalation in prices, a key element of the program, and greater certainty. Conversely, high speed bump levels effectively take those allowances out of the market and permit the price to approach the ceiling much sooner.

Unsold Allowances Represent Progress, Not a Problem

The current availability of unsold, or unused, allowances is both an indication that the Cap-and-Trade program is working as well as an additional protection against the prospect of scarcity in the future driving up allowance prices today. ARB staff correctly point to this fact in their April 26th PowerPoint presentation indicating that it is, "not simply supply vs. demand" and that restricting allowances penalizes covered entities that undertook early actions.

Additionally, given that the last few auctions have been fully subscribed, it is time to revisit the 25 percent rule that limits the addition unsold allowance to the market and either remove or revise the rule in order provide an adequate allowance supply post-2020.

Conclusion

The organizations listed below urge ARB to carefully consider these comments and focus on the cost containment and leakage prevention aspects of these reforms as that is what will provide for a stable, replicable system that achieves the environmental goals of the GHG emissions reduction program and mitigate the negative impacts to the California, the fifth largest economy in the world.

Please contact Michael Shaw, Vice President of Government Relations, California Manufacturers & Technology Association (CMTA) at (916) 498-3328 or mshaw@cmta.net if you have any questions regarding these comments.

Sincerely,

Michael Shaw
California Manufacturers & Technology Association (CMTA)

On Behalf of the following organizations:

Agricultural Council of California
California Chamber of Commerce
California Dairies, Inc.
California Farm Bureau Federation
California League of Food Producers
Climate Change Policy Coalition
Glass Packaging Institute
Western States Petroleum Association