CMUA
CALIFORNIA MUNICIPAL UTILITIES ASSOCIATION

915 L Street., Suite 1210
Sacramento, CA 95814
(916) 326-5800
CMUA.org

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Independent Emissions Market Advisory Committee
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95812

RE: <u>Draft 2024 IEMAC Annual Report</u>

Dear Members of the IEMAC,

The California Municipal Utilities Association (CMUA) thanks the Independent Emissions Market Advisory Committee (IEMAC) for the opportunity to provide comments on the Draft 2024 IEMAC Annual Report. CMUA represents forty-two of California's publicly owned utilities (POUs), many of whom participate in California's Cap-and-Trade program. CMUA's member agencies are governed by locally elected boards and are committed to maintaining safe, reliable, and affordable electric service in a manner that supports the state's climate goals. POUs support these goals through investments in renewable and zero carbon generation as well as through programs that support energy efficiency, electrification of transportation and buildings, energy storage, and distributed generation.

CMUA thanks the members of the IEMAC for investing their time and efforts into developing the draft 2024 IEMAC Report. CMUA shares many of the concerns raised in the draft, including the impacts of high electric costs on ratepayers and the potential chilling effect high rates could have on transportation and building electrification. CMUA supports evaluating strategies to achieve California's environmental goals in an efficient and cost-effective manner. In these comments, CMUA recommends certain minor changes to the IEMAC Report to more accurately describe the requirements applicable to POUs and the roles POUs play in California's Cap-and-Trade market.

I. INTRODUCTION

Over the past decade, California's electricity sector, of which POUs serve about 25 percent of demand, has been the primary driver of the state's greenhouse gas (GHG) emissions reductions, due in large part to state policies, such as the Renewables Portfolio Standards (RPS), Senate Bill

100 (De Leon, 2018) (SB 100), and the Emissions Performance Standard (EPS). These policies result in costs paid for by POU customers stemming from significant additions of renewable energy resources, grid upgrades, increases in electricity demand, and the inclusion of new technologies. The Cap-and-Trade program currently allocates allowances to POUs to mitigate Cap-and-Trade compliance costs from being an additional expense passed down to customers. In addition to participating in the Cap-and-Trade program, POUs have invested in renewable and GHG-free generating resources to support the goals of the RPS and SB 100. Taking into account these investments, California has provided POUs with allocated allowances based on their respective anticipated Cap-and-Trade compliance burdens. Without these allowances, compliance with the Cap-and-Trade program could directly increase the cost of electricity for POU customers without commensurate climate benefits.

The Cap-and-Trade regulations also allow POUs to directly retire allocated allowances for compliance or consign allowances to the auction. This flexibility, particularly the ability to retire allowances for compliance, allows POUs to mitigate upward pressure on rates. Rather than having to increase rates to account for these compliance costs, and then attempting to mitigate these increased rates through providing customers with a climate credit, POUs can simply reduce the need for rate increases. This not only mitigates the economic burden on customers, but also incentivizes electrification and fuel switching. Affordable electric rates are key to ensuring that households and businesses can pay their electricity bills and incentivize them to make the investments necessary to transition to electric transportation and electrified buildings. In order to equitably and effectively advance the state's climate goals and reduce the potential erosion of public support, state policy must help mitigate future electric rate increases in California through programs, such as Cap-and-Trade.

As described further below, CMUA appreciates the draft 2024 IEMAC Report's emphasis on cost containment and agrees with the report's conclusions that more needs to be done to make electrification affordable for businesses and households. CMUA encourages the IEMAC to recognize the distinction between the state's investor owned utilities (IOUs) and POUs as it pertains to the use of allowance value. As discussed herein, the Cap-and-Trade regulation requires that allowance value be used for the benefit of electricity ratepayers, consistent with the applicable regulatory restrictions. The POUs currently utilize allowance and auction proceeds[1] to support many of the goals supported by the IEMAC.

II. COMMENTS ON THE DRAFT 2024 IEMAC REPORT

CMUA agrees with many of the conclusions in the Draft 2024 IEMAC Report and supports the further evaluation of these proposals as part of the California Air Resources Board's (ARB) upcoming rulemaking to the amend the Cap-and-Trade Regulation as well as potential legislation

[1] Title 17, CCR § 95892(d).

to reauthorize the Cap-and-Trade Program beyond 2030. In particular, CMUA agrees with the conclusion that:

> As the state moves forward with its climate change mitigation efforts, maintaining a focus on cost containment will be essential to ensuring that its clean energy transition remains both affordable and effective. In this respect, re-authorization of the cap-and-trade program has a critical role to play.[2]

Both the Legislature and ARB should ensure that affordability is a primary consideration in any changes to the existing Cap-and-Trade program. CMUA agrees with IEMAC observations that inefficiently high electricity prices can discourage electrification and is concerned that changes to the Cap-and-Trade program that reduce ratepayer protections, such as reduced allowance allocations or further restrictions on the use of allowance value, may erode public support for the program and slow the achievement of the state's broader climate goals. As the Draft 2024 IEMAC Report notes:

> . . . California's general climate policy portfolio [] hinges on expanding electrification of transportation, buildings, and industry. Inefficiently high retail electricity prices slows progress on electrification. Because retail electricity rates already reflect a sizable effective charge for costs that are not associated with the incremental use of energy, *the carbon price might be understood to push electricity prices in the wrong direction*.[3]

In this section, CMUA recommends certain changes to the IEMAC to fully recognize the role of the POUs in the Cap-and-Trade program.

A. **The IEMAC Report Should Recognize the Requirements Applicable to POUs and the Value of Preserving the Flexibility of POUs in the Use of Allowances Auction Proceeds.**

Throughout the Draft 2024 IEMAC Report, the authors discuss the electricity sector primarily in terms of the requirements for the IOUs, with less discussion of the significant differences between POUs and IOUs. For example, in its discussion regarding the free allocation of allowances to the IOUs, the draft report provides a detailed description of the consignment obligation of the IOUs and the process for issuing the on-bill California Climate Credit. However, the draft report then states that in contrast "[p]ublic electric utilities can use the

[2] IEMAC Discussion Draft, *Cap-and-Trade and Cost Containment in California*, January 2025, at 6.
[3] IEMAC Discussion Draft, *Assessing the Affordability Implications of California's GHG Cap and Trade Program*, January 2025, at 6.

allowances as they see fit."[4] This statement does not fully reflect the restrictions imposed on POUs' use of allowances. Unlike IOUs, POUs are not required to consign all allowances to auction. However, when they do consign allowances, POUs are subject to strict regulations on the use of allowance proceeds.

Pursuant to Section 95892 of the Cap-and-Trade Regulations,[5] POUs may either utilize directly allocated allowances for compliance with Cap-and-Trade[6] or monetize those allowances.[7] Any POU proceeds from monetizing auctioned allocated allowances "must be used for the primary benefit of retail electricity ratepayers" of that POU. Further, the proceeds "must be used to reduce greenhouse gas emissions or returned to ratepayers" through methods such as developing renewable generation or energy storage facilities, funding energy efficiency or fuel switching programs, or other programs that result in a demonstrable reduction in GHG emissions. The Cap-and-Trade regulations also specify uses of auction proceeds that are prohibited, such as paying for certain compliance costs, lobbying, and returning revenue to ratepayers in a volumetric manner.[8] Further, POUs must comply with strict reporting requirements which require the POU to demonstrate the expected GHG emission reductions associated with each use of allowance revenue.[9]

As such, a POU cannot "use allowances as they see fit" as set forth in the draft. Instead, POUs use their allowances in ways that directly reduce the economic burden of the Cap-and-Trade program on ratepayers, while supporting the state's GHG emission reduction goals:

- If a POU elects to use all or a portion of its allowances for compliance, that reduces the cost of the Cap-and-Trade program for that POU, by means of reducing the cost burdens of procuring allowances for compliance, which helps the POU avoid electric rate increases. Lower rates help incentivize electrification and fuel switching.

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[4] IEMAC Discussion Draft, *Allowance allocations and financial flows*, January 2025, at *3. ("**Free allocations to utilities.** About 23–30% of allowances are given to electric utilities and 11–12% of allowances are freely given to gas utilities, in both cases for the purpose of benefiting utility ratepayers. Investor-owned electric utilities (IOUs) are required to "consign" their allowances to quarterly auctions and purchase the number they need at auction. Because many IOUs receive more allowances than they need for compliance purposes, they are also required to use any surplus funds collected from the sale of their consignment allowances to benefit their customers, primarily through the on-bill California Climate Credit that all private utility ratepayers receive twice a year. Public electric utilities can use the allowances as they see fit. Gas utilities are also required to use their allowances to benefit ratepayers, including by consigning a growing share of their allowances to auction. The impact of these ratepayer benefits is further described in Chapter [X].")

[5] Title 17, CCR § 95892.

[6] Title 17, CCR § 95892(b)(2).

[7] Title 17, CCR § 95892(c).

[8] Title 17, CCR § 95892(d)(7).

[9] Title 17, CCR § 95892(e).

- If a POU monetizes its allowances and uses the allowance proceeds for renewable procurement, then that reduces the POU's emissions profile, which lowers the POU's Cap-and-Trade obligation and further mitigates customer rate impacts.

- If the POU utilizes its allowance proceeds for energy efficiency, fuel switching, or other GHG reducing programs, this provides direct benefits to the POU's community and ratepayers without the need to increase rates to fund these programs.

Moreover, because POUs' allowance allocations are based on forecasted emissions and fixed in the Cap-and-Trade regulations,[10] POUs are further encouraged to aggressively reduce emissions. The greater the progress a POU makes toward GHG emissions reductions, the lower the POU's compliance obligation will be. As its compliance obligation decreases, the POU will need to retire fewer allocated allowances for compliance. Retiring fewer allocated allowances for compliance means the POU will have more allocated allowances available to consign to auction, and thus more allowance proceeds to reinvest in clean energy and other GHG-reducing activities in its local community. This cycle results in even more funds that can be returned to ratepayers and even greater GHG emissions reductions than would be achieved absent such an allocation. In short, the regulatory structure applicable to POUs, complete with both incentives and sufficient guardrails, effectively encourages POUs to undertake early action and accelerate GHG emissions reductions.

Relatedly, because POU allocations were forecasted and memorialized in the Cap-and-Trade regulations through 2030, POUs have made long term planning decisions and investments based on the expectation of receiving these allowances. Any disruption to the current structure would threaten these investments and could require POUs to raise rates to account for shortfalls in allowances, while also penalizing POUs who have made early actions to decrease their GHG emissions.

Finally, giving POUs the flexibility to optimize use of allowance value allows POUs to be efficient and responsive to the specific needs of their communities, which vary significantly across the diverse regions of the state. Preserving this structure is vital to containing the costs of the Cap-and-Trade program and limiting its burdens on ratepayers. CMUA urges the IEMAC to amend the draft report to clarify that POUs are subject to the restrictions described in this section and to recognize the benefits of preserving the flexibility that POUs have in the use of their allowance allocation and allowance proceeds.

[10] Title 17, CCR § 95892, Table 9-4.

B. <u>The IEMAC Report Should Include an Expanded Analysis of the Cost Impacts of Carbon Prices.</u>

The Draft 2024 IEMAC Report determines that the cost impact of carbon prices increased electric rates by less than 5 percent in 2023.[11] To reach this conclusion, the draft report looks only at the impacts of carbon prices on Pacific Gas and Electric Company (PG&E). PG&E is one of the largest electric utilities in the country and has some of the highest electric rates. Utilities vary considerably across the state with vastly different customer bases, resource portfolios, and rates. It is likely that a small utility with much lower rates would be impacted by carbon prices differently than PG&E. Based on the feedback that CMUA has received from its members, CMUA expects that the rate impacts to many POUs would be much greater than 5 percent. CMUA recommends that the IEMAC acknowledge in this analysis that extrapolating conclusions to utilities other than PG&E, including POUs, may not be appropriate.

III. CONCLUSION

CMUA thanks the IEMAC for their consideration of these comments.

Sincerely,

Derek Dolfie

Derek Dolfie
Director of Energy
California Municipal Utilities Association

[11] IEMAC Discussion Draft, *Assessing the Affordability Implications of California's GHG Cap and Trade Program*, January 2025, at 15.