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RE: Comments on 2024 Independent Emissions Market Advisory Committee Report

## **Introduction**

K29 Advisors appreciates the opportunity to provide these comments on the Independent Emissions Market Advisory Committee’s (“IEMAC”) draft 2024 Annual Report (“Draft Report”). We very much appreciate that the Draft Report highlights the importance of addressing the affordability challenges so many consumers are facing. In these comments, we provide the following clarifications and corrections we hope the IEMAC will consider:

- Policymakers Must Prioritize Affordability
- California Cannot Solve the Climate Crisis Alone
- Must Consider the Impact of Unpriced Climate Policies
- The California Cap-and-Trade is Working as Intended

### **I. Policymakers Must Prioritize Affordability**

The concerns about cost and economic impacts expressed in the Draft Report are appropriate, particularly given the need for continued public support for California’s climate policy. With retail electric rates increasing by as much as 110% over the past decade, voters and elected officials are looking for ways to curb the increasing prices of energy in California.<sup>1</sup> Long ago, the California legislature recognized the need to minimize cost impacts. For example, Assembly Bill (“AB”) 32 (Nunez, Chapter 488, Statutes 2006) states:

*“It is the intent of the Legislature that the State Air Resources Board design emissions reduction measures to meet the statewide emissions limits for greenhouse gases established pursuant to this division in a manner that minimizes costs and maximizes benefits for California’s economy,”*

The state assembly reiterated this core principle when reauthorizing the Cap-and-Trade program in 2017. As stated in AB 398 (E. Garcia, Chapter 135, Statutes 2017):

*“It is the intent of the Legislature that the State Air Resources Board extend the market based compliance mechanism adopted pursuant to subdivision (c) of Section 38562 from January 1, 2021, to December 31, 2030, inclusive, in a manner that effectively reduces greenhouse gas*

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<sup>1</sup> The Public Advocates Office (2024). 2024 Q2 Electric Rates Report. Retrieved on January 28, 2025, from <https://www.publicadvocates.cpuc.ca.gov/press-room/reports-and-analyses/2024-q2-electric-rates-report>.

*emissions; minimizes any adverse impacts on state consumers, businesses, and the economy; and continues elements of the current program that protect state utility ratepayers.”*

Because the retail electric rates are already well above social marginal costs, the Draft Report encourages CARB to consider an approach to reduce volumetric electricity prices. We agree with this fundamental suggestion. While the Draft Report encourages CARB to consider an alternative climate rebate design, we suggest that the IEMAC consider additional regulatory design changes to address this challenge. Currently the Cap-and-Trade regulation prohibits any electrical distribution utility (“EDU”) from:

- Using allocated allowances to meet compliance obligations for electricity sold into the California Independent System Operator (“CAISO”) markets,
- Using allocated allowance auction proceeds to pay for the costs of complying with the Cap-and-Trade regulation,<sup>2</sup> or,
- Returning allocated allowance auction proceeds to ratepayers in a volumetric manner.<sup>3</sup>

Permitting EDUs to apply allocated allowances or value of allocated allowances sold in auction directly to compliance costs, or to be returned to ratepayers in a volumetric manner, would have the effect of reducing the retail price of electricity, addressing at least part of the inefficiency referenced in the Draft Report.

## **II. California Cannot Solve the Climate Crisis Alone**

California has long been viewed as a leader in developing policies to protect the environment. However, as large as California’s economy is, its greenhouse gas (“GHG”) emissions are a drop in the bucket as compared to total global GHG emissions. California’s 2022 GHG emissions were 371.1 million metric tons (“MMT”).<sup>4</sup> In 2022 global GHG emissions were 57.1 billion metric tons.<sup>5</sup> As such, California’s GHG emissions are slightly over one-half of one percent of global emissions. Were California to eliminate its GHG emissions, the climate crisis would continue unabated. As important as it is for California to address its GHG emissions, the greatest contribution the state can make to addressing global climate change is to demonstrate climate policies in such a way as to compel other jurisdictions to advance similar policies.

However, residents of other states see Californians paying significantly higher prices for most goods, perhaps most notably energy. Retail electricity prices in California exceed the national average price by over 82%, with California retail electricity prices averaging \$0.2302 per

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<sup>2</sup> Publicly Owned Electric Utilities (“POUs”) are authorized to transfer allocated allowances to their compliance accounts, which will ultimately be retired for Cap-and-Trade compliance purposes, but like Investor-Owned Utilities (“IOUs”), POUs are prohibited from using auction proceeds from such allocations for Cap-and-Trade compliance.

<sup>3</sup> Title 17, CCR, Section 95892 (d)(7)(A), (B), (D).

<sup>4</sup> CARB (2024). Current California GHG Emission Inventory Data. Retrieved on January 28, 2025, from <https://ww2.arb.ca.gov/ghg-inventory-data>.

<sup>5</sup> United Nations Environment Programme (2023). Emissions Gap Report 2023. Retrieved on January 28, 2025, from <https://www.unep.org/interactives/emissions-gap-report/2023/>.

kilowatt hour (“kWh”), compared to the national average of \$0.1261 per kWh.<sup>6</sup> Similarly, California gasoline prices exceed the national average by over 43%, with California’s average gasoline prices at \$4.46 per gallon, compared to the national average price of \$3.11 per gallon.<sup>7</sup> Identifying the specific factors driving these cost disparities is a challenge. But the cost disparities themselves drive public support for, or opposition to, expanded climate action.

Climate change presents perhaps the quintessential commons problem. With an absence of meaningful national policy solutions, subnational approaches are going to be key to addressing this challenge. However, even if voters and policymakers from other jurisdictions share California’s vision, it is a challenge to export policy solutions that are seen to lead to such significantly higher consumer and producer costs. As such, we encourage the IEMAC and CARB to recognize that affordability must be paramount when considering potential changes to climate change policies.

### **III. Policymakers Must Consider the Impact of Unpriced Climate Policies**

The Draft Report correctly asserts that prescriptive policies can increase overall GHG abatement costs. In California, these unpriced climate policies include the Low Carbon Fuel Standard (“LCFS”), the Renewable Portfolio Standard (“RPS”), and Senate Bill (“SB”) 100, which requires that retail electric sales be supplied by 100% zero carbon resources by 2045.<sup>8</sup> Although a policy may be unpriced, it is not costless. And while the cost is not transparent, it is there, adding to the price consumers pay for energy.

As the name suggests, the costs of unpriced policies are not reflected in the price for allowances. Indeed, as indicated in the Draft Report, such direct policies cause the reverse, reducing the market clearing price for GHG allowances. However, some still consider the price of allowances to be too low and look for ways to increase allowance prices to better reflect the marginal social cost of carbon. As such, the cap-and-trade program receives criticism of incorrectly pricing emissions. While it does not correctly price emissions, it is important to recognize that, as stated in the Draft Report, it largely does so because additional policies reduce emissions without being priced. As a result, California consumers are paying much more than the cost of allowances to reduce GHG emissions. It is critical that California not impose prescriptive measures that come at a cost above the social cost of carbon. For example, as reported in the Draft Report<sup>9</sup>, many measures considered in the Scoping Plan update are forecast to come at a cost per ton of GHG avoided that is significantly higher than the social cost of carbon estimated by the U.S. Environmental Protection Agency.

The benefits of reducing GHG emissions are distributed globally. The location of GHG emission reduction is irrelevant to addressing climate change. Therefore, sector-specific or location-specific policies, which may be appropriate for criteria pollutants, are not relevant to global

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<sup>6</sup> EIA (2024). Electric Power Monthly. Retrieved on January 28, 2025, from [https://www.eia.gov/electricity/monthly/epm\\_table\\_grapher.php?t=epmt\\_5\\_6\\_a](https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=epmt_5_6_a).

<sup>7</sup> AAA (2025). State Gas Price Averages. Retrieved on January 29, 2025, from <https://gasprices.aaa.com/state-gas-price-averages/>.

<sup>8</sup> See [https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill\\_id=201720180SB100](https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180SB100).

<sup>9</sup> Draft Report, Table 3.-11, p. 5.

climate change. As asserted repeatedly in the Draft Report, the Cap-and-Trade program affords the most cost-effective approach to addressing climate change. Comparatively, policies that mandate climate reduction from specific industrial sectors or geographic locations increase the cost of GHG abatement over abatement actions that are undertaken pursuant to the Cap-and-Trade program. We encourage California policymakers to recognize this cost disparity when considering any sector-specific or direct measures.

#### **IV. The California Cap-and-Trade is Working as Intended**

As policymakers consider reauthorization of the Cap-and-Trade program, it is critical that all realize that the Cap-and-Trade program is working as intended. Unfortunately, the Draft Report asserts that the program is failing to work as intended and suggests several unneeded, and potentially harmful changes to the program.

##### *Banking Allowances Demonstrates the Strength of the Program*

The Draft Report expresses concern with the number of banked allowances. In permitting allowance banking, CARB recognized that such a policy would better facilitate a smoothly operating market, particularly in cases where demand is at least partially, a function of short-term weather patterns that are beyond the control of market participants.

While the Draft Report admits that there is little theory to describe the optimal number of banked allowances, the Draft Report indicates that a large bank conveys a sense that the allowance supply is too generous. However, the Draft Report, fleetingly, references what a bank may speak to regarding expectations of the market. We consider this question of expectations to be fundamental to this concern. While neither we, nor holders of banked allowances, possess perfect prescience regarding the future of the Cap-and-Trade market, it is unavoidable to consider private holding of compliance instruments to be anything but a positive sign regarding expectations of the strength of the market. Before suggesting fundamental changes to allowance supply, particularly changes that would increase compliance costs, we suggest that policymakers should develop a better understanding of why the allowances are being held.

##### *Concerns Regarding Undersubscribed Auctions Are Unreasonable*

The Draft Report restates concerns about the strength of the market for California allowances. As evidence to support such concerns, the IEMAC references auctions that were undersubscribed (meaning that demand fell below supply at the reservation price). The implication is clear, that there are fundamental flaws with the program and solutions should be developed.

We support ongoing evaluation of the Cap-and-Trade program, and particularly the market for compliance instruments. However, we suggest that the undersubscribed auctions were the result of external events, and not due to ongoing structural problems with the Cap-and-Trade program. Before seeking ‘solutions’, we encourage the IEMAC to better evaluate the cause of these events and assess whether such events can be reasonably expected to continue.

The five auctions between February 2016 and February 2017 were undersubscribed. However, as referenced in the Draft Report, these auctions being undersubscribed is widely recognized to be the result of concerns regarding the duration of the program. In addition to an outstanding lawsuit challenging the legality of the state auction, the legislature had not yet formally reauthorized the program to continue past 2020. As referenced elsewhere herein, in 2017 the legislature passed, and the governor signed AB 398 (E. Garcia, Chapter 135, Statutes 2017), reauthorizing the Cap-and-Trade program. That same year the California Supreme Court affirmed a lower court ruling that the auction did not violate Proposition 26. Even during this five-quarter period of uncertainty, the auction was only undersubscribed by more than 20 percent in three of the five auctions.

Similarly, the May 2020 and Auction 2020 auctions were undersubscribed. These auctions were held during the COVID-19 pandemic, where California, the United States, and most of the world were enduring significant and adverse economic effects due to the pandemic. While two auctions were undersubscribed during this time, only one showed demand falling below 85%.

The undersubscribed auctions referenced in the Draft Report were the result of external shocks to the market and are not evidentiary of any systematic or functional problem with the Cap-and-Trade market or the auction. The other 42 of 49 auctions held since November 2012 have cleared above the reservation price. Imposing changes to the auction process due to these external shocks is effectively suggesting a solution to a problem that does not exist.

### *Offsets Serve to Expand California's Climate Policy*

Since the first Cap-and-Trade regulation was drafted 15 years ago, the issue of compliance offsets has been challenging. Many regulated entities have supported offset eligibility for compliance as a critical cost-containment measure. Additionally, because offset eligibility allows California to support GHG abatement from areas where California has no legal authority to mandate GHG emissions reductions, compliance offset eligibility provides a means to support GHG emission abatement which would not otherwise occur. Alternatively, opponents to offset use have expressed multiple concerns regarding their use. The IEMAC has repeatedly expressed concern with offset use. The 2024 Draft Report expresses multiple concerns related to offset policy, including:

- Offsets do not necessarily reduce California emissions,
- Offsets are not sufficiently permanent or additional,
- Offsets Allow GHG Emissions from Covered Sectors to Increase

As is well known to the IEMAC, and stated above, the earth's atmosphere does not react differently to GHG emission abatement based on the source of the GHG emission abatement. Although, as noted in the Draft Report, AB 398 (E. Garcia, Chapter 135, Statutes 2017) imposed further restrictions on the geographic source of offsets, the global atmosphere knows no difference. As such, GHG abatement from within California or from beyond California has the same impact. One could make a logical argument that by spreading GHG abatement to geographic or industrial sectors that are not subject to climate policies, offset eligibility can result in an increase in GHG abatement, as compared to a scenario in which no such compliance offsets

are permitted. For example, as referenced in the Draft Report, the current compliance offset eligibility supports GHG emissions abatement from projects in Tribal Lands which are not subject to the Cap-and-Trade program. These GHG emissions reductions would not occur but for the eligibility of compliance offsets and the value they create for the project owners.

The Draft Report also cites studies that question the permanence or additionality of compliance offsets. To provide global GHG benefits, an offset project must create GHG emissions reductions that would not otherwise occur but for the eligibility of the offset project. However, such concerns should be balanced against the stringency of the offset protocols developed by CARB. Indeed, CARB has demonstrated its ability to reverse offsets in cases where the protocols were not ultimately satisfied. Instead of referencing general research, we encourage CARB, the IEMAC, or any other concerned stakeholders to evaluate specific offset projects used for compliance within the Cap-and-Trade program. As stated, CARB's offset protocol is very strict, and allows for reversals when the requirements of the protocol are not fully satisfied.

The Draft Report expresses concern that compliance offsets allow GHG emissions from covered sectors to increase as compared to a circumstance in which compliance offsets were prohibited. While the fundamental arithmetic of such an assertion is plain enough, CARB recognized the impact of offsets on the emissions budget when the Cap-and-Trade regulation was initially developed. CARB showed that the total GHG emission reductions would be the same in a scenario with no offsets, as compared to a scenario with offsets.<sup>10</sup> The Draft Report suggests an alternative wherein compliance offsets would put 'under the cap', asserting two effects, as follows:

- First, regulated parties would then only use an offset credit if the cost of the offset were less than the cost of an allowance.
- Additionally, because such a policy would effectively reduce the number of available compliance instruments, such a change would increase the allowance price. This would increase the revenues available in the Greenhouse Gas Reduction Fund.

The first effect reasonably raises a question of which regulated entities are currently using offsets that cost more than do allowances. However, the second effect should be opposed to anyone who is concerned about affordability and the cost impact of California's climate policy. For many reasons referenced herein, it is critical that California place cost and affordability paramount. We encourage the IEMAC to focus on policy approaches that are consistent with such affordability concerns.

The Draft Report claims several problems with the Cap-and-Trade program and then suggests policy solutions. However, because the problems that are claimed are not actual, these policy solutions are unneeded. CARB and the IEMAC should recognize that these policy solutions will only exacerbate the affordability concerns with the program, and risk reducing public support for California's climate goals.

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<sup>10</sup> CARB (2010). Appendix E Setting the Program Emissions Cap. Retrieved on January 30, 2025, from <https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2010/capandtrade10/capv3appe.pdf>.

## Conclusion

Ongoing evaluation of the Cap-and-Trade market is important to help maintain the success of the program going forward. We support the IEMAC's efforts and appreciate the opportunity to submit these comments on the Draft Report. We very much appreciate that the Draft Report highlights the importance of addressing the affordability challenges so many consumers are facing. It is clear to us that the Cap-and-Trade market is working as intended, consistent with California's climate goals. While the Draft Report raised concerns about some elements, we encourage further, more detailed research, before suggesting significant changes to the program.

Respectfully submitted,

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/s/

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