

CALIFORNIA LEGISLATURE

STATE CAPITOL
SACRAMENTO, CALIFORNIA
95814

Friday, March 1, 2019

The Honorable Jared Blumenfeld, Secretary
California Environmental Protection Agency
1001 I Street
P.O. Box 2815
Sacramento, CA 95812

The Honorable Mary Nichols, Chair
California Air Resources Board
1001 I Street
P.O. Box 2815
Sacramento, CA 95812

Dr. Dallas Burtraw, Chair
Independent Emissions Market Advisory Committee
Resources for the Future
1616 P Street NW
Washington, DC 20036

Re: The role of California's cap-and-trade program in achieving the SB 32 target

Dear Secretary Blumenfeld, Chair Nichols, and Dr. Burtraw:

We write regarding California's cap-and-trade program and its role in achieving the 2030 statewide greenhouse gas emissions limit established by SB 32 (Pavley, Chapter 249, Statutes of 2016). According to the Air Resources Board (ARB) 2017 Scoping Plan, which lays out the state's official strategy for achieving the 2030 emissions limit, the cap-and-trade program is expected to play the single largest role in California's post-2020 climate strategy. Specifically, the 2017 Scoping Plan calls on cap-and-trade to deliver 38% of the cumulative emission reductions needed from 2021 through 2030 and 47% of the annual reductions needed in 2030.

As you know, AB 398 (E. Garcia, Chapter 135, Statutes of 2017) extended the cap-and-trade program through 2030 and required a number of program design changes. AB 398 also created

the Independent Emissions Market Advisory Committee (IEMAC), which is established within the California Environmental Protection Agency (CalEPA) and charged with providing analysis and advice to both ARB and the Legislature about the cap-and-trade program's design and performance.

Given its prominence in the 2017 Scoping Plan, an especially important and critical issue facing the cap-and-trade program is the overallocation of compliance instruments. According to the IEMAC, overallocation "refers to a market condition where the supply of compliance instruments persistently exceeds emissions." If the cap-and-trade program is overallocated, market participants may acquire excess allowances and hold (or "bank") them to allow for higher emissions in the future. Should this outcome manifest, the Legislative Analyst's Office has expressed concern that statewide emissions could exceed the SB 32 target.

AB 398 instructed ARB to "evaluate and address concerns related to overallocation" in its implementing regulations (see Health and Safety Code §38562(c)(2)(D)). ARB's response to this statutory direction has been criticized by independent experts, however, including a member of the IEMAC. Although the IEMAC did not evaluate ARB's analysis in its 2018 annual report, the IEMAC reviewed the underlying controversy and made several specific recommendations to improve data reporting in order to create a shared factual basis for evaluating programmatic outcomes. Our understanding is that ARB has not yet adopted these recommendations.

One of the IEMAC's recommendations was for ARB to adopt an annual banking metric that reports the number of excess allowances and offsets held in private accounts each year, calculated as holdings in excess of the compliance obligations regulated emitters accrued over the same period. The IEMAC also recommended ARB provide detailed data about the extent and type of allowance banking at the end of every multi-year compliance period.

These metrics are important because they allow policymakers to evaluate whether or not concerns about overallocation are manifesting in practice. As the IEMAC observed, a number of independent studies have concluded that private parties may acquire several hundred million excess allowances by the end of 2020. In contrast, ARB assumed that no more than 150 million allowances would be banked in private accounts at the end of 2020. The Senate's appointee to the IEMAC testified to the Senate Environmental Quality Committee that ARB's data now shows that more than 150 million excess allowances were already in private accounts by the end of 2018. This suggests the overallocation problem may be more significant than what ARB has so far acknowledged and indicates the need for further analysis.

Finally, we note that in adopting its cap-and-trade regulations last December, ARB agreed in Board Resolution 18-51 to take additional steps to address concerns related to overallocation:

BE IT FURTHER RESOLVED that the Board directs the Executive Officer to quantify and report to the Board, by no later than December 31, 2021, the volume of unused allowances from 2013 through 2020, including volumes held in private accounts, and the potential for unused allowances to hinder the ability of the program to help achieve the

SB 32 target. The Executive Officer shall hold a public workshop in 2019 to discuss potential methodologies to evaluate this topic.

These developments are welcome, but it is unnecessary and potentially counterproductive to wait until 2021 to improve program reporting about conditions that could manifest in the interim. In light of the concerns discussed above and the opportunity to create a common factual understanding of program performance in 2019, we ask that:

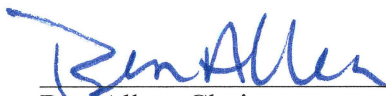
- 1) ARB provide additional information about the timing and agenda for the 2019 workshop identified in Board Resolution 18-51 as soon as is practicable.
- 2) ARB adopt the reporting requirements recommended by the IEMAC's 2018 Annual Report, in consultation with the IEMAC (as appropriate), including:
 - a) An annual banking metric that calculates the number of allowances and offsets held in private accounts above and beyond the unsatisfied compliance obligations regulated parties have incurred; and
 - b) A detailed report of the number, vintage, and jurisdictional origin of all allowances and offsets banked from the second compliance period (2015-2017) to the third compliance period (2018-2020), in both private and government accounts. This report should separately address each of the different accounts tracked in ARB's quarterly Compliance Instrument Reports, calculated across holdings in the entire Western Climate Initiative program, *with data sufficient to complete the table provided in Attachment A to this letter.*
- 3) ARB consult with the IEMAC at the 2019 workshop identified in Board Resolution 18-51 and in any follow-up engagement the Board deems relevant.
- 4) The IEMAC include in its 2019 Annual Report:
 - a) An assessment of ARB's response to AB 398's instruction to "evaluate and address concerns related to overallocation";
 - b) An independent calculation of the annual and multi-year compliance period banking metrics described above; and
 - c) A discussion and associated analysis of key issues raised in ARB's 2019 workshop, including those that relate to overallocation, potential policy reforms to address overallocation, and the impacts of any such reforms.

Developing a shared factual basis for program design and evaluation will offer policymakers in both the administration and the Legislature the opportunity to make careful program design choices should the need for reforms become apparent. Finally, we note that these actions would

not prejudice any particular policy outcome and therefore can be pursued no matter one's views about the adequacy of current policy.

Thank you for your continued leadership on climate policy and your diligence to ensure that California achieves the 2030 SB 32 target for greenhouse gas emission reductions. We look forward to working together in the coming months and years. Please contact David Ernest García, consultant to the Senate Environmental Quality Committee, at (916) 651-4108 should you have any questions or need any clarification about the information we have requested.

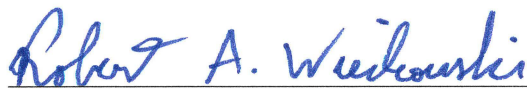
Sincerely,



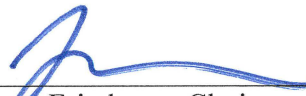
Ben Allen, Chair
Senate Environmental Quality Committee



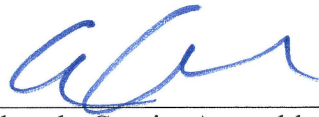
William W. Monning, Senator
ARB Ex Officio Member



Bob Wieckowski, Chair
Senate Budget and Fiscal Review
Subcommittee #2



Laura Friedman, Chair
Assembly Natural Resources Committee



Eduardo Garcia, Assemblymember
ARB Ex Officio Member



Cristina Garcia, Chair
Joint Legislative Committee on Climate
Change Policies

cc: Ashley Conrad-Saydah, *Deputy Secretary for Climate Policy*, CalEPA
Rachel Wagoner, *Deputy Legislative Secretary*, Governor's Office of Legislative Affairs
ARB Board Members
IEMAC Members

Attachment A

Template for ARB to use when providing WCI-wide reporting metrics at the end of California's second multi-year compliance period (2015-2017). This table should be completed for each of the nine categories of accounts tracked in ARB's quarterly Compliance Instrument Report:

Private entity accounts

1. General
2. Compliance
3. Limited Holding Use Account (CA)

Jurisdictional Accounts

4. Voluntary Renewable Electricity (CA)
5. Auction + Issuance + Allocation
6. Retirement
7. Invalidation
8. Reserve
9. Environmental Integrity (QC)

This information could be disclosed in the form of a new Compliance Instrument Report that distinguishes between the jurisdictional origin of all compliance instruments and measures allowance and offset holdings in the Compliance Instrument Tracking System Service (CITSS) immediately following each multi-year compliance event. For example, such a report issued immediately after the November 2018 California compliance event would provide sufficient information to determine the bank of allowances and offsets carried from the second compliance period (2015-17) into the third compliance period (2018-2020).

Template for compliance instrument reporting table

WCI-wide holdings as of the end of Compliance Period 2 (2015-17)

Type	Issuing Jurisdiction			Total
	California	Quebec	Ontario	
Allowances, Vintage 2013				
Allowances, Vintage 2014				
Allowances, Vintage 2015				
Allowances, Vintage 2016				
Allowances, Vintage 2017				
Non-Vintage Quebec Early Action Allowances				
Non-Vintage Price Containment Reserve Allowances				
Subtotal, Allowances				
Offset credits				
Total Compliance Instruments				