

# Cap-and-Trade Program Stakeholder Engagement and Market Monitoring

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# History of Engaging Stakeholders

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- From the beginning, it is important to establish clear communications between the regulator, regulated entities, and the public
- What are the goals of the program?
  - Assess statutory mandates and goals
  - Specific program goals
  - Program design
- Public process to designing an emissions trading system and encouraging investments in clean, low carbon solutions that support the environment and economy
- Adoption of the California Cap-and-Trade Regulation and subsequent amendments

# Public Rulemaking Process

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- Assessing statutory mandates and goals
- Held hundreds of individual and public meetings
  - Took lessons from international and domestic experiences (EU ETS, Western Climate Initiative, RGGI)
  - Met with California stakeholders (industry, environmental groups, air districts, market participants, voluntary offset programs)
  - Established technical expert committees to advise on program design
- Held workshops and technical working groups to inform Program design
- Released multiple drafts of the Regulation for stakeholder comments
- Multi-year public workshops and rulemaking process

# Identifying Regulated Entities

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- California's Cap-and-Trade Regulation takes an economy-wide approach to covering greenhouse gas emissions
  - Industrial sources
  - Generators and importers of electricity
  - Transportation fuel and natural gas suppliers
- As of 2020, there are over 700 registered market participants
  - 45% are covered and opt-in covered entities
  - 55% are voluntary market participants

# Providing Stakeholder Support

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- Multiple public email accounts to provide assistance and interface with stakeholders
  - CACITSSRegistrar@arb.ca.gov – entity questions about compliance, program requirements, market data and trading
  - CACITSSUserManagement@arb.ca.gov – user registration questions
  - CACITSSHelpDesk@arb.ca.gov – general tracking system questions
  - Cap-and-Trade Hotline: (916) 322-2037; any program questions; auction support
- List of Staff Contacts: staff experts available for specific topic areas, including by industrial sector
  - Covers electricity, fuel sector, change of ownerships, allowance allocation for industrial assistance, benchmarking, compliance offsets, tracking system (CITSS), and auction

# Communication Policies and Strategies

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- Public agency responsible for actions to protect public health from effects of air pollution and lead efforts to address global climate change
  - Market Operator and Regulator
- Hold public meetings and schedule in-person or phone appointments to discuss public and entity-specific questions and concerns
- Handle confidential and market-sensitive data appropriately and securely
  - Public Records Act Request
  - Confidential Business Information
  - Market-sensitive data
  - Accurate program information
  - Timely release of market information
- Communicate early and regularly

# User Friendly Forms and Guidance

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- We provide forms to individuals and entities to help meet program requirements and compliance obligations
  - User Registration
  - Account Application
  - Account Management: adding account representatives, changing facility ownership, filing corporate associations and structure updates
- Program guidance, factsheets, and FAQ documents that help explain requirements
  - Preparing for Annual or Full Compliance Period Compliance
  - Registering for a CITSS account
  - Guidance for Offset Project Operators
- [Cap-and-Trade Program Guidance and Forms](#)

# Compliance Flexibility and Market Integrity

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- Compliance Flexibility
  - Allowances & Offset Credits
  - Banking subject to holding limits
  - Multi-year compliance periods
- Market Integrity
  - Purchase and holding limits to prevent market manipulation
  - Corporate associations and structure disclosures to prevent collusion
  - Registration in the Cap-and-Trade tracking system
  - Financial penalties
  - Coordination with U.S. Commodity Futures Trading Commission (CFTC), Federal Energy Regulatory Commission (FERC), and California Department of Justice



# Independent Third-Party Monitor

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- California utilizes in-house expertise and an independent, external market monitor
- CA maintains full authority to conduct program monitoring and provide oversight, and we employ an independent monitor through a contract managed by WCI, Inc.
- Independent Market Monitor that provides:
  - Behind-the-scenes analysis
  - An additional level of confidence in program integrity
  - Advice to California and Quebec monitoring staff/management
  - External contractor may not communicate with entities; only the regulating authority can do this

# Compliance Assistance and Outreach

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- Provide supplemental materials
  - Help entities understand the program requirements and how to meet compliance obligations
  - Guidance documents and video modules on Cap-and-Trade Program website
- Proactive outreach to entities
  - Before auctions and during summer leading up to a Nov 1st compliance deadline
  - Actively reach out to entities with a compliance obligation to make sure they are registered in the program
  - Monitor account holdings to identify entities that are short of allowances leading up to a compliance deadline and conduct outreach

# Robust Program Design

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- Program has strong incentives to meet compliance on time without resorting to application of financial penalties
- What if an entity fails to surrender the full number of credits by the November 1 compliance deadline?
  - Section 95857 “The entity’s compliance obligation for untimely surrender is calculated as four times the entity’s excess emissions.”
  - This is not considered to be a penalty, nor does it constitute a violation of the regulation. No application of financial penalties
  - If the entity fails to surrender this “untimely emissions obligation,” they are then considered to be in violation of the regulation and will be subject to enforcement and penalties as well
- Requirements are enforced fairly, and enforcement process is transparent

# How Is Non-Compliance Addressed?

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- Investigate to confirm actions taken by the entity constitute violations of the regulation
  - Collect and evaluate evidence
  - Determine regulatory authority
  - Work with CARB's management and legal team to confirm regulatory authority and to determine appropriate action against the entity
- Administrative or financial penalties
  - Administrative – suspending and/or permanently revoking an entity's account
  - Financial penalties assessed through mutual settlement agreements
  - Litigation

# Industrial Facilities in the California Cap-and-Trade Program

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DAVID ALLGOOD

OCTOBER 21, 2021

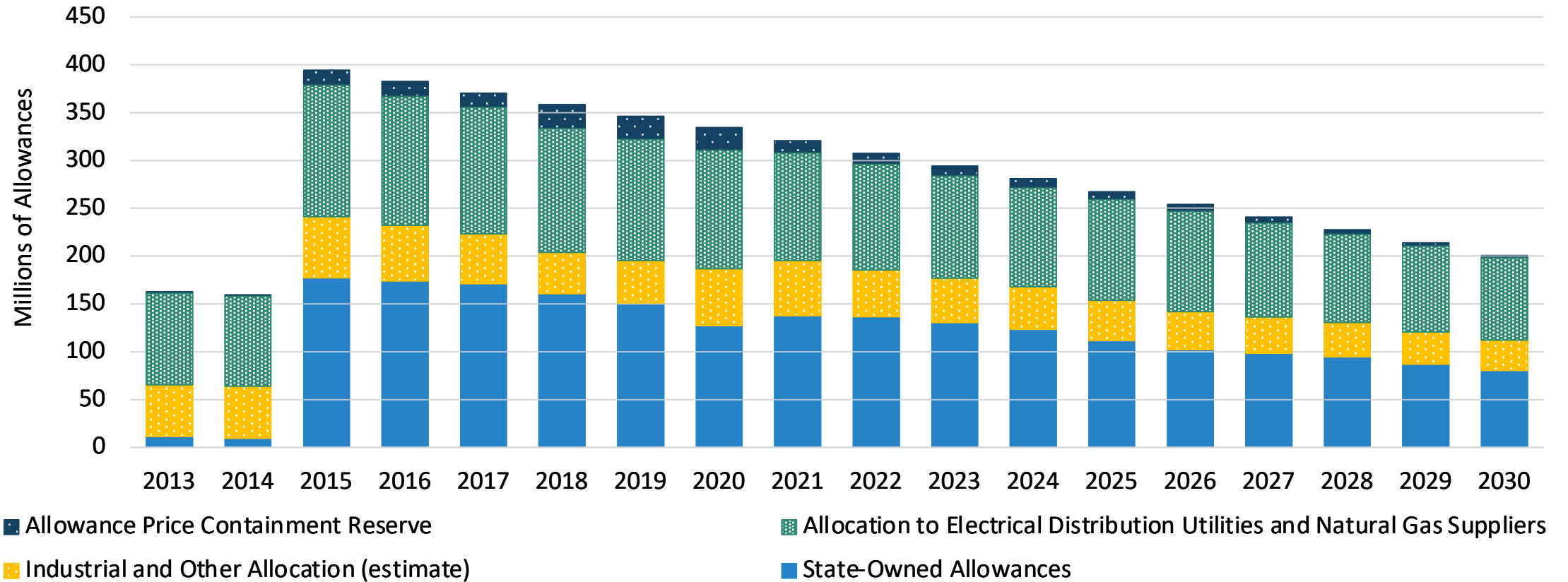


# Overview: Industrial Facilities in the Cap-and-Trade Program

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- Covered industrial facilities must meet all requirements of the Mandatory Reporting Regulation (MRR) and Cap-and-Trade Program (C&T)
  - Reporting and verification of emissions and production (MRR)
  - Annual and triennial compliance obligation (C&T)
- Most covered industrial facilities are eligible free allocation
- Key activities to support implementing industrial allocation
  - Leakage risk assessment for each covered industrial sector
  - GHG intensity benchmarks for key products
  - Annual distribution of allowance allocation

# Cap-and-Trade Allowance Budgets



Source: CARB, 2018

# Allocation Versus Auctioning

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## Allocation

- Direct value to specific entities or purposes
- Expedient method to protect against emissions leakage
- May dampen the price signal under certain circumstances

## Auction

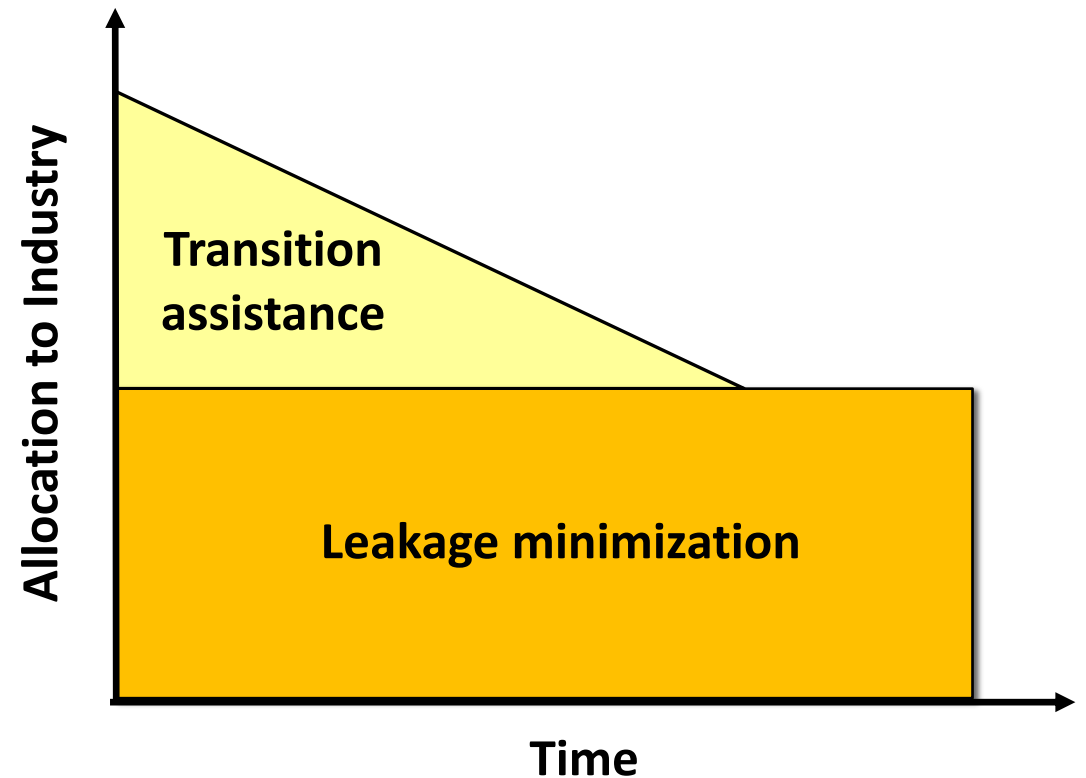
- Transparent, easily understood distribution of allowance value
- Facilitates price discovery of emissions abatement
- Yields proceeds that can:
  - Finance decarbonization efforts
  - Be returned to households/entities or be used to replace some existing taxes



# Industrial Allocation Over Time

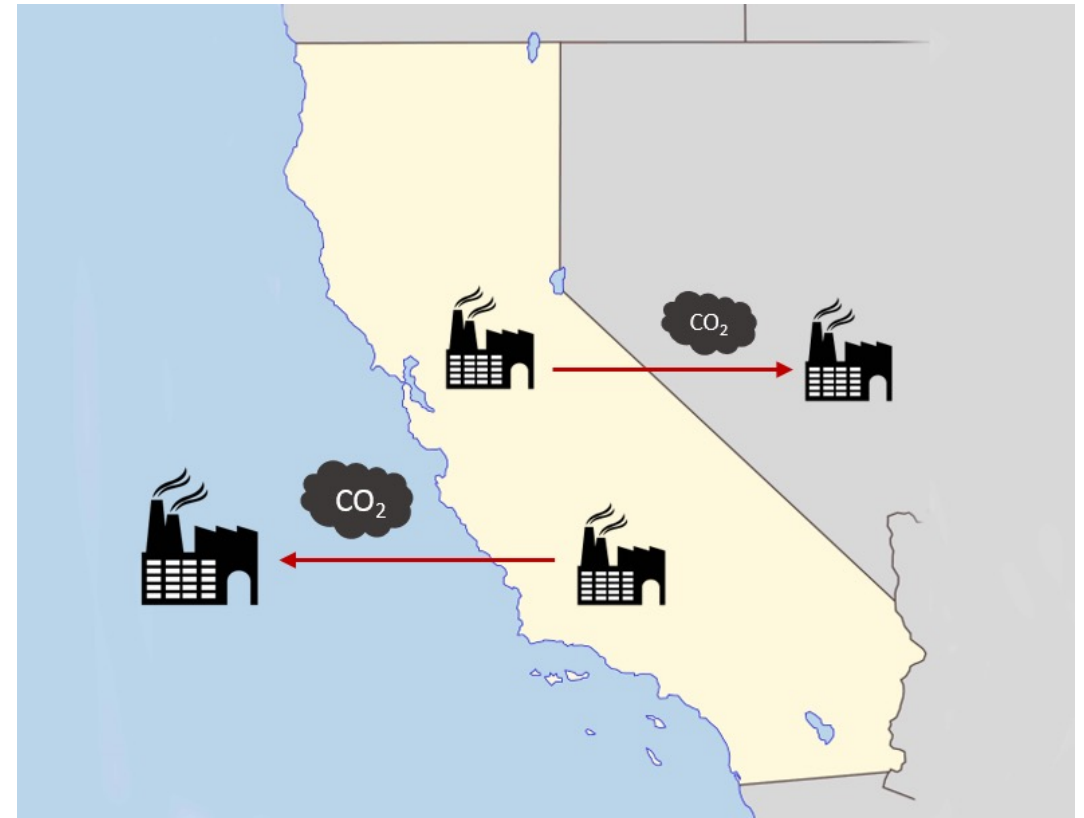
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- High initial levels of industrial allocation
  - Provide transition assistance to ensure a smooth program start
- Sustain free allocation as needed to minimize leakage
- Gradual transition to more auctioning



# Industrial Allocation: What is Leakage?

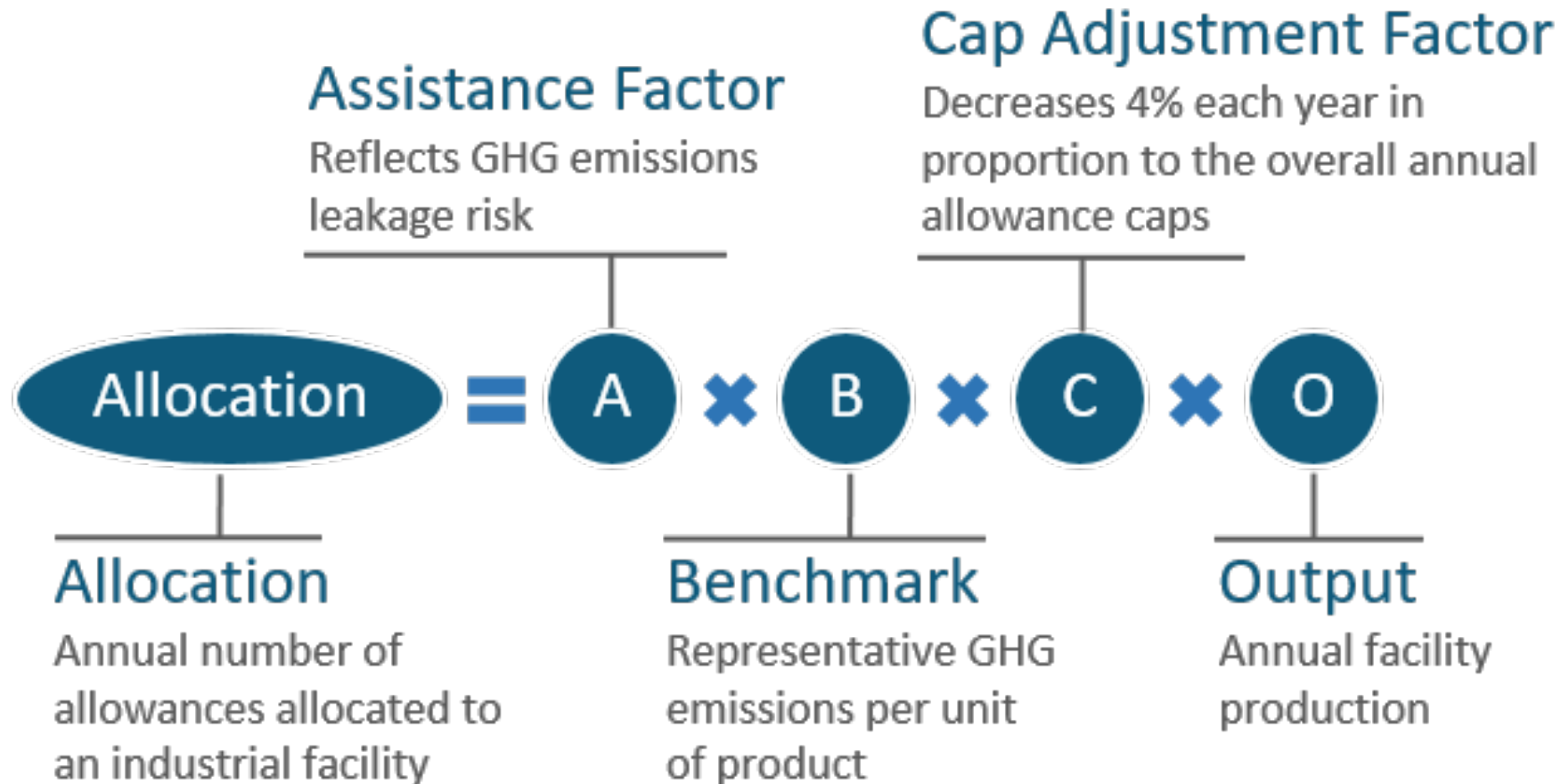
- Leakage is an emissions reduction within a jurisdiction with carbon pricing that is offset by an emissions increase outside the jurisdiction
- Industries at risk include those with high compliance costs and strong competition from jurisdictions without carbon pricing



# Industrial Allocation Methods

Output-Based Allocation	Energy-Based Allocation
CARB's preferred approach that preserves incentives for efficient in-state production	CARB's fallback approach where product-based approach is not feasible
Allocation is based on actual production of goods at the facility each year	Allocation is based on historic (2008-2010) fuel and steam consumption at the facility
Updating method – allocation scales up and down with changes in production each year	Non-updating method – allocation does not change with changes in production each year
Product benchmarks based on 90% of sector average emissions intensity or best-in-class	Fuel benchmark is natural gas and steam benchmark is set at a stringent 85% efficiency

# Industrial Allocation: Output-Based Allocation



# Industrial Allocation: Leakage Risk

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- Industrial sectors vulnerable to leakage risk
  - Sectors with high emissions-intensity (EI) have high compliance costs
  - Sectors with high trade-exposure (TE) are less able to pass through compliance cost
  - Sectors with high emissions intensity and intense trade exposure are described as emissions-intensive trade-exposed (EITE) industries
- CARB evaluates leakage risk for EITE sectors using two metrics:

$$EI = \frac{\text{sector GHG emissions}}{\text{\$million value added}}$$

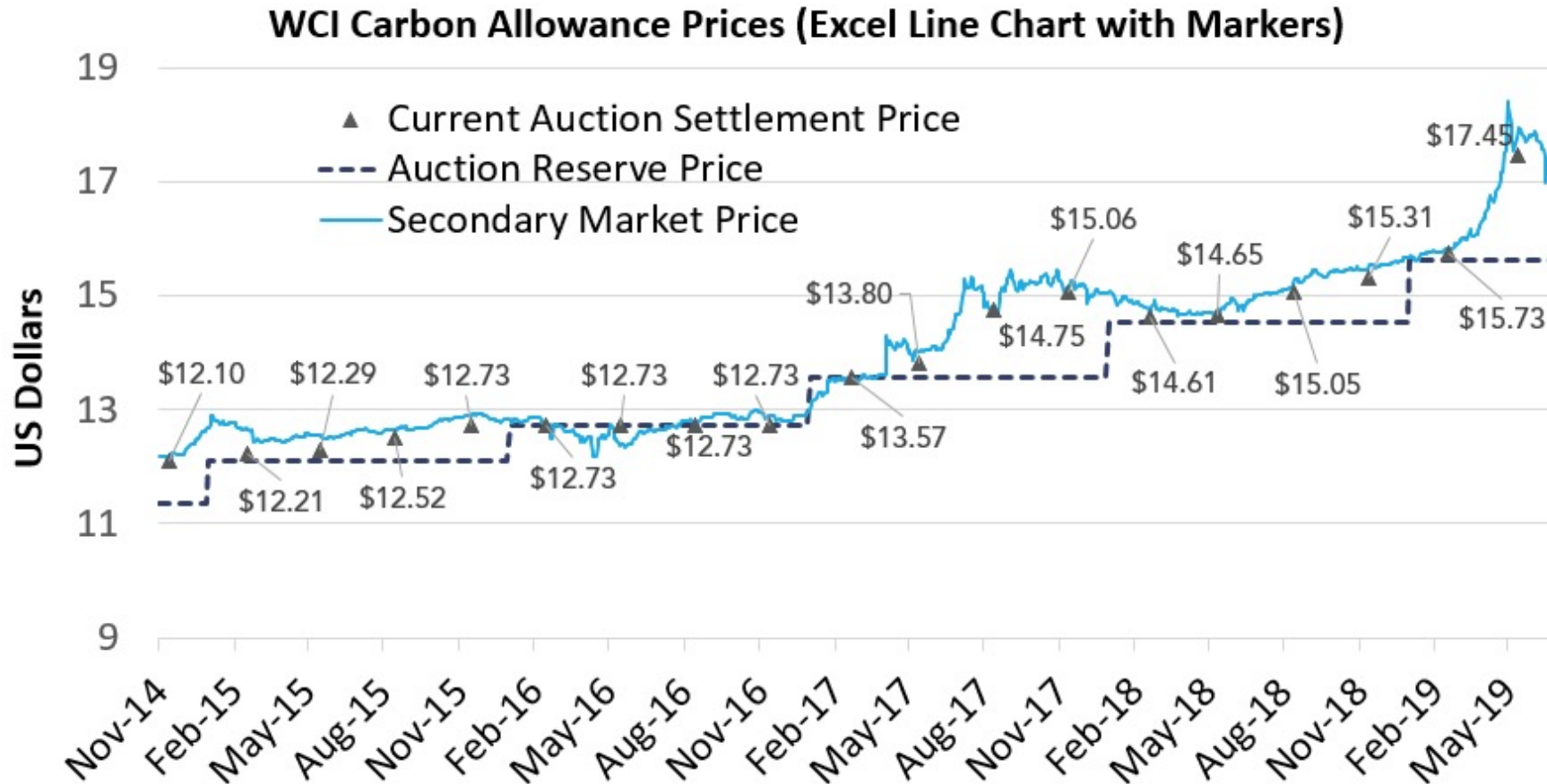
$$TE = \frac{(\text{value of imports} + \text{exports})}{(\text{value of imports} + \text{domestic shipments})}$$

# Industrial Allocation: Product Benchmarks

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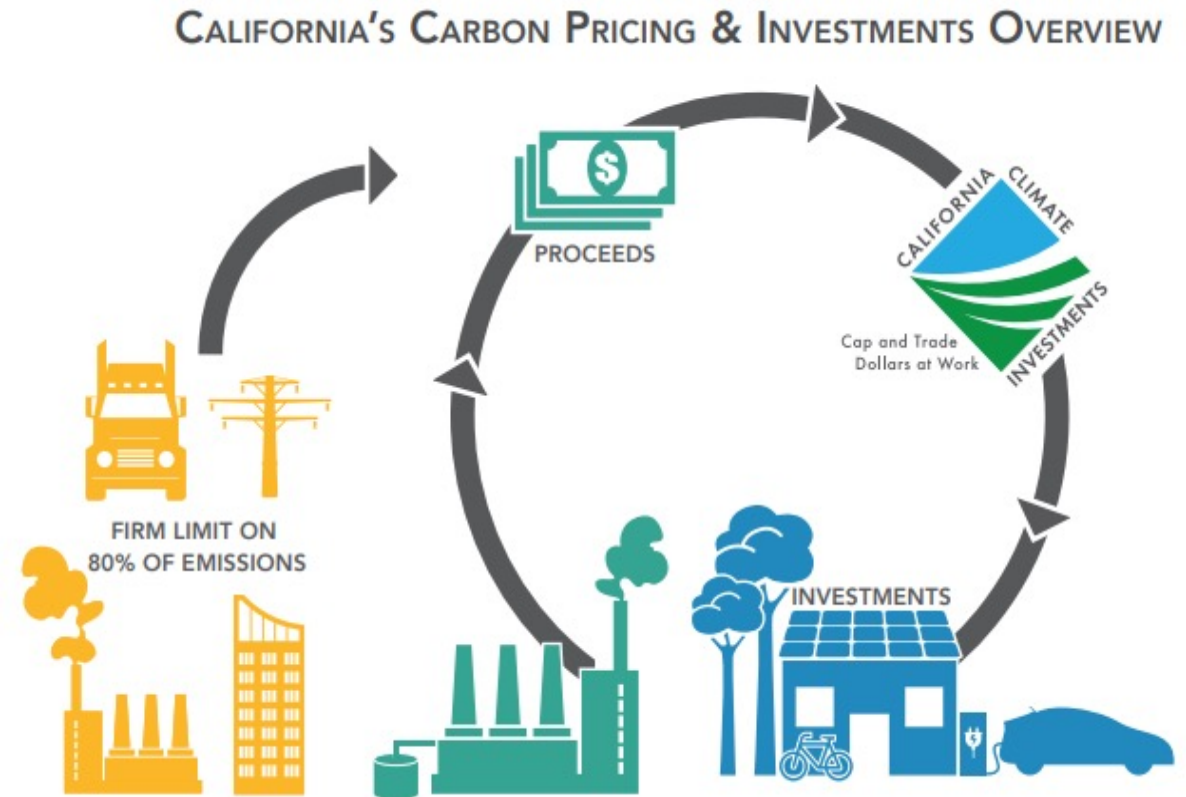
- Benchmarks represent the sector-wide emissions efficiency per unit of production
- Benchmarks are set to reward highly-efficient, low-emitting facilities within each sector
- Benchmarks are set at either 90% of average efficiency or the “best-in-class” facility (e.g., the most efficient facility in the sector)
  - Ensures that at least one facility in each sector achieves the benchmark

# Auction and Secondary Market Prices



# Using Auction Proceeds

- \$14.9 billion in auction proceeds to reduce GHG emissions, improve public health, and strengthen the economy
  - Food Processor Incentive Fund
  - Zero-emissions vehicle rebates
  - Public transportation
- Spending is focused on vulnerable populations and disadvantaged communities





# Funding Example: Food Processor Incentive Program

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- The Food Production Investment Program (FPIP) funds drop-in and emerging energy technologies at food production facilities with the goal of reducing greenhouse gas emissions.
- FPIP initially received funding through AB 109, the Budget Act of 2017 (\$60M). Additional funds were allocated the following year through SB 856, the Budget Act of 2018 (\$64M).
- To date, FPIP has invested \$111 million across 45 projects.
- FPIP uses a scoring criteria that includes technical merit, benefits, market potential and information sharing, as well as affecting priority populations and using California-based vendors.

# Summary

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- There are tradeoffs between free allocation and auctioning
  - A jurisdiction must understand its goals so provisions can be designed to support those goals
- Output-based industrial allocation can minimize leakage and preserve incentives to maintain efficient production
- Use of action proceeds can work to reduce greenhouse gas emissions, strengthen the economy and improve public health and the environment

# Questions

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- Cap-and-Trade Program Website:

<https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program>

- Mandatory Reporting Regulation Website:

<https://ww2.arb.ca.gov/our-work/programs/mandatory-greenhouse-gas-emissions-reporting>