IETA

Submitted to: New York Department of Environmental Conservation (DEC)

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IETA Comments on New York Cap and Invest Program Phase 2 Pre-Rulemaking Proposal

The **International Emissions Trading Association** (IETA) welcomes this opportunity to provide comments on New York's Phase 2 Pre-Rulemaking Proposal (Proposal) for the New York Cap-and-Invest (NYCI) program. For 25 years, IETA has been the leading global business voice on robust market solutions to tackle climate change while driving clean finance at scale. Our global non-profit organization represents over 300 member companies that support the use of Cap-and-Trade[1] (C&I) programs to address the climate crisis. IETA's expertise is regularly called upon to inform carbon market solutions that deliver measurable climate outcomes, address economic competitiveness and carbon leakage concerns, balance efficiencies with social equity, and support a just transition.

IETA has long been an ardent supporter of state-level C&I programs, and we are extremely encouraged that New York is clearly on the right path to implementing a robust market-based policy to achieve its ambitious emissions reduction targets. We would like to thank New York's Department of Environmental Conservation (DEC) and the state's Energy Research and Development Authority (NYSERDA) for all their hard work and dedication to date.

IETA's submission is organized into two parts: (1) The Reporting Rule; and (2) the Cap-and-Invest (C&I) Rule, reflecting the Proposal's composition.

Section 1 – IETA's Position on NYCI Reporting Rule

Reporting Requirements for Imported Electricity:

The Proposal would apply reporting requirements to electricity importers, citing California statute (**Cal. Code Regs. Tit. 17, § 95111**). However, there are various nuances that New York would need to consider to enable this reporting requirement. Specifically, New York will have to consider how to properly count unspecified power. California uses a default emissions limit of 0.428 metric tonnes of CO2e per MWh, and New York would need a similar figure to allow reporting to occur.

Given New York's location, the default emissions rate may differ depending on the importer's region. A broad emissions rate could undercount emissions from unspecified emissions, and depending on compliance obligations, it could create loopholes within the program. IETA suggests a regionally specific emissions rate as an alternative to a broad emissions rate, noting that a regional approach would more accurately represent the actual emissions occurring, at the slight cost of increased program complexity.

[1] For simplicity, IETA will abbreviate Cap-and-Trade and Cap-and-Invest as C&I to account for the use of different terminology in other jurisdictions.

Confidentiality Concerns:

While IETA Members recognize and support the need to collect information on fuels being sold in and into New York, we are concerned that much of the information being asked for, such as sales figures, volumes, supplier information, and counterparty information, is proprietary and confidential business information. Any rule that requires such information to be reported to the state should include clear authority for the agency receiving the information to keep it confidential.

Clarity on Scope of Emissions Required to be Reported:

DEC has suggested it will collect emissions scope information beyond the US Environmental Protection Agency (EPA) Greenhouse Gas Reporting Program (GHGRP), including upstream/out-of-state fossil fuel GHG emissions and biogenic combustion GHG emissions. If this is the case, IETA Members believe that DEC and NYSERDA need to make clear how those emissions should be measured and counted and what methods or emissions factors will be used to determine the level of emissions.

Reporting Timelines:

Because many entities in New York have not had to report this required information in the past, and those who don't have an obligation in the C&I program will be required to start reporting, it is important that all entities be given adequate time to collect and collate the information requested. For some entities, the reporting effort will likely be measured in months, not weeks.

Section 2 – IETA's Position on NYCI's Cap-and-Invest Rule

IETA's comments on the Cap-and-Invest rule are organized into two parts: (1) Overarching Positions Relevant Across the Whole Program; and (2) Specific Feedback on Elements Raised in the Proposal.

2.1) Overarching Positions Relevant Across the Whole Program:

Design the Program with Linkage in Mind:

IETA strongly holds that NYCI should be designed in a manner to best position the program for potential future linkage with the Quebec and California Western Climate Initiative Inc. (WCI) program (and potentially Washington, which is pursuing WCI linkage). As echoed numerous times by IETA, the benefits of cooperative approaches and regional linkages are clear. IETA believes that linked programs can expand abatement opportunities into the market, prompt technological innovation, improve liquidity, and ultimately result in greater emissions reductions, more cost effectively. Our view is that such market integration should aim to minimize distortive effects on the linked carbon market by harmonizing key design elements that are meant to increase flexibility and drive economic efficiency, price stability and market liquidity.

It is important to emphasize that program alignment does not need to be perfect, nor do individual programs need to be identical, to facilitate successful future linkage. In no way will linkage (or should linkage) remove New York's autonomy to cater its C&I program to the specific needs, goals, and political realities of the state. Regardless of New York's initial perspective on linkage, designing the program to be "linkage-ready" would reduce administrative burden and the market impacts in the future if the state decides to pursue linkage. IETA remains open and available to educate DEC on the benefits of linkage and the necessary steps to ensure NYCI is best designed to be "linkage-ready."

We would like to highlight a seminal report[2] on linkage published by the academic nonprofit Resources for the Future, which showcases that incremental alignment of program elements captures immediate benefits for C&I programs while paving the road for eventual formal linkage. Given the short program implementation timeline, leaning into existing and proven infrastructure from Quebec and California would reduce administrative burden and eliminate unnecessary work for the state while better positioning the state for future linkage opportunities.

Importance of Adaptive Policy:

IETA has worked with carbon pricing regulators all over the world, and we recognize that adaptive program management is necessary for the success of carbon pricing programs. DEC needs to be comfortable amending the program on an "as-needed basis" when there is a purpose and should not be averse to program changes when warranted. However, program changes must follow a robust public engagement process, be transparent, clearly defined and broadly communicated well in advance of implementation to avoid perverse market impacts.

Washington's recently implemented C&I program provides numerous examples highlighting the need for adaptive policy and the benefits of program transparency. For example, Washington's regulators have made numerous adjustments to the program in its first year aimed at cost containment. When the regulators provided clear timelines for these changes, the market reacted positively, and the amendments achieved the regulators' goals. Washington's implementation also highlights both the importance of and the caution that regulators must take to ensure market participants have adequate time to adjust to upcoming program changes. Most prominently, in the instances where Washington failed to provide transparent, clear timelines for program changes (occurring early in the program), participants were caught off guard, and the resulting unintentional uncertainty negatively impacted the market and confidence in the program.

While adaptation may be needed in the future, New York regulators should seek to "get the regulation right the first time" and avoid changes to the program as much as possible. Government intervention, while necessary at times, inherently distorts the market's ability to price the marginal cost of abatement. To be clear, IETA supports government intervention when necessary to ensure or improve the robustness and integrity of markets (for example, California's ongoing program review to increase program stringency), but regulators must exercise caution to design a program that doesn't require frequent intervention to maintain.

2.2) Specific Feedback on Elements Raised in the Proposal:

Compliance Periods and Deadline:

New York's Proposal suggests a compliance deadline of June 30 of the subsequent year after the emissions year. This timing would not align with either RGGI or the California-Quebec program, potentially creating some future issues.

If New York is exploring to link with the California-Quebec program, which IETA highly recommends, it would make more sense to adopt a Nov. 1 compliance deadline. This would remove an obstacle for future linkage while having little impact on the program as a whole. Importantly, this decision would not require New York to link, but it would keep that option open if the state decides to pursue linkage in the future. Furthermore, the November deadline provides covered entities with more flexibility than a June deadline, as they have additional time to procure allowances should they need it.

[2] Linking by Degrees: Incremental Alignment of Cap-and-Trade Markets – Burtraw et al., 2013 (**Link**)

Regarding compliance period length, IETA members support a 2- or 3-years compliance period, with preference for the 3-years option to better align with California and Washington. Multi-year compliance periods, which are common in C&I programs, allow flexibility for both compliance entities and general market participants to participate in the market when they see the right conditions, it is a way to maximize the market's ability to help with lower-cost GHG reductions, price discovery and liquidity.

If the compliance period is lengthened to 3 years, IETA recommends an annual retirement obligation of 30% rather than 50% to not only align with potential economy-wide linkage partners but to provide additional compliance flexibility. The reduced percentage still has the effect of ensuring entities are on track to comply with their obligation while protecting against the risk of non-compliance from potential bankruptcy.

Non-Obligated Adjustment Uncertainty:

New York has sought to use an emissions cap that would encompass obligated and non-obligated sectors, with the agency establishing the allowance budget by removing non-obligated sectors from the emissions cap.

This approach would automatically create uncertainty about the future cap supply. This uncertainty could be relatively minor depending on the size of the non-obligated sector, or fairly large if significant sectors – such as power – are non-obligated.

While New York has suggested that the proportion of obligated vs. non-obligated emissions would remain fairly constant, California has shown that non-obligated sectors may not retain a consistent percentage of total emissions. California data has shown that capped sector emissions have declined more quickly than non-obligated sectors over the life of its C&I program. The uncertainty generated by this discrepancy would be significant if projected emissions for non-obligated sectors differ substantially from actuals. If non-obligated sectors are unable to reduce emissions as quickly as anticipated (due to their exemption from the C&I program, a potential lack of robust complementary policies addressing them, economic factors, etc.), market participants may face unexpected supply constraints, leading to unforeseen higher prices and subsequently, a potentially larger cost impact on end consumers.

Determination of Initial Emissions Cap:

IETA strongly holds that New York should not rely entirely on historical data to set the initial cap, as this could create a fundamental balance that is overly tight in the initial years that could result in unnecessarily high allowance prices.

We note that Washington has experienced this firsthand as the Department of Ecology used historical data to set caps to align with the 2030 emissions target, and as a result, the program has remained tethered to the allowance price containment reserve. Another driving factor in Washington's tight market is that initial auction volumes were insufficient to cover forward hedging demand by compliance entities.

New York can learn from Washington's experience and should consider bringing forward allowances from future years to sell via auction either at launch or very early in the program's lifespan to ensure forward hedging demand can be adequately met. These brought-forward allowances should be from the normal auction pool and in addition to the front-loaded cost containment reserve allowances. NYCI should also consider front-loading allowance sales within the first year, for example, by selling more than 25% of the annual auction volume in the first quarterly auction and less than 25% in subsequent auctions. NYCI will be better served by a less volatile price signal based on longer-term equilibrium than one based on more volatile short-term supply/demand imbalances. We note that none of these benefits

will be realized if allowances from the first compliance period are unable to be banked for future periods, a point further elaborated below.

Additionally, New York would benefit from having an initial cap that does not have an aggressive cap decline and allows market participants to get familiar with the newly established scheme. This approach is especially true given the uncertainties in some abatement opportunities and no use of offsets or other flexibility mechanisms.

Program Stability Measures and Cost Containment:

The Proposal suggests that the cost containment reserve (CCR) price over the first compliance period – 2025-2026 – would be set at the 2025 trigger price. The 2027-2030 would be set at the 2027 CCR trigger price. New York appears to be contemplating a similar approach for the price ceiling. This approach would mean the price floor, CCR and price ceiling levels would compress before widening. This would provide no benefit to the state and could potentially depress carbon abatement investments. The price floor, emissions containment reserve (ECR) and CCR should all be parallel lines. This would make more carbon abatement opportunities financially attractive.

The price floor, CCR and ECR price levels should rise by a set percentage plus annual inflation. In addition to enabling more financially attractive abatement opportunities, this would provide clear guardrails for emitters to anticipate future price levels and align to the existing economy-wide programs in California Quebec, and Washington. This approach also creates an inflation-adjusted product that may not be impacted by future changes to inflation levels.

By adopting the California-Quebec approach, New York would more easily be able to link in the future. Without this alignment, it could force a future change by New York, with the potential to create an arbitrage opportunity within either market that would provide no benefit to the states.

New York should consider adopting the “24-month unsold rule” from California’s regulation to respond to periods of low demand. That rule transfers state-owned allowances that remain unsold at auctions for more than 24 months to a price containment mechanism. This rule has proven to be effective in appropriately responding to periods of low demand in California. In NYCI, these allowances could be transferred to the CCR or ECR.

As aforementioned in this submission, DEC should seek to be as transparent as possible and to give market participants ample time to make decisions on how to best procure allowances. Therefore, IETA does not support the provision in the pre-proposal that states, “The number of CCR Allowances made available in each specific auction would be at NYSERDA’s discretion within these rules and would be announced in the auction notice issued before each auction.” It is crucial that market participants know exactly how and when volume in price containment mechanisms will be available from the onset of the program. Determining the specific amount shortly before they will be offered would generate unintentional uncertainty.

Initial Price Ceiling Level:

The Proposal includes a hard price ceiling; IETA Members believe the price ceiling, as proposed at $23, seems completely incompatible with a link to any program with a higher price than $23. For example, linking with California will not make any sense if their price is at, say, $88.22 (as is the case for 2024) and New York has infinite non-tradeable price ceiling units (PCUs) at $23. Program participants would have no motivation to link. IETA Members don’t have a concern with the concept of PCUs, but if linkage is

something New York wants to do – and IETA supports linkage – the price of the PCUs needs to be set higher.

IETA also expresses concern that the $23 dollar price ceiling will not send the price signal necessary to drive investments in abatement technologies in an economy-wide program, particularly in carbon-intensive sectors. It is not safe to assume that the marginal cost of abatement in NYCI is the same in a sector-specific C&I program like RGGI. Without emissions reductions in sectors outside of power, New York is at risk of missing their GHG reduction and climate goals. If the marginal cost of abatement is, in fact, higher than the price ceiling, the price ceiling will be quickly reached and sustained. If the price ceiling is sustained, the program will be a de facto carbon tax, providing infinite units at a specific price. These impacts are evident in the state's modelling results, which showed very little difference in emissions between the three presented scenarios. To ensure NYCI achieves the state's desired goals, the program needs to allow prices to rise to marginal abatement costs. NYCI should explore increased price ceiling scenarios to determine additional emissions reductions that could be unlocked with a price more aligned to the state's marginal abatement costs. For reference, California's 2024 price ceiling is $88.22, and Washington's is $88.15. Understanding that these price ceiling levels are likely the result of affordability concerns, IETA believes that New York regulators need to more carefully balance the concerns over affordability and meeting the reduction goals of the program.

Allowance Banking:

Banking is proposed to be allowed without restriction, with the exception that first compliance period allowances (2025-2026) are unable to be carried over to future compliance periods.

IETA members do not believe it is appropriate, or good policy, to restrict 2025 and 2026 compliance period allowances from being bankable into subsequent periods. Compliance entities require a reliable, long-term price signal that represents the marginal cost of abatement to make investments in decarbonization. Given the first compliance period will have different fundamentals and period-specific factors, the price signal in the earliest years of the program will not be representative of longer-term costs. As a result, entities may wait for the long-term price signal in 2027, delaying crucial decarbonization efforts necessary for the state to achieve its 2030 GHG target. While the prices may be low in the earliest years of the program, future years would likely see unnecessarily high prices as the price signal would need to be higher to drive emissions reductions in a shorter timeframe. Additionally, as mentioned earlier, the market stability benefits of frontloading during early compliance periods would be completely nullified if these allowances are not able to be banked for future use.

We would point out that in the EU ETS Phase I, the price fell to zero because supply exceeded first-period demand, and allowances couldn't be banked into the second phase. This is something that must be avoided for NYCI to be successful. The clearest remedy would be to remove the first compliance period banking restriction.

Additionally, IETA does not support bank adjustments as part NYCI. Allowance banking does not directly represent or imply oversupply in the market. Rather, it is the result of entities buying allowances in advance of future compliance obligations to minimize their costs down the road. Hedging decisions are often based on exposures contracted years in the future. Adjusting for banked volumes disregards this fact and punishes entities' proactivity.

Allowance Holding Limits & Time Requirements:

IETA Members believe it is unnecessary, and likely counterproductive, to have minimum hold times. This design feature is not included in any other existing carbon pricing program. We do not know of many, if

any, cases where carbon allowances are being 'flipped' in such a short time. If these transactions were to happen, we believe they would most likely be related to specific business needs (like allowing compliance entities' abilities to properly hedge their exposures) in isolated cases and would not have a meaningful impact on the market. A minimum holding time could add unnecessary complexity and more transactional costs which could have a dampening effect on liquidity and market activity. DEC should not deter secondary market participation or activity in any way to ensure that the market functions as efficiently as possible.

Holding limits align with best practices in other economy-wide C&I programs. However, DEC should offer a limited exemption (as seen in other programs) for large compliance entities to ensure that they have the ability to hold and forward hedge what they need for compliance.

General Market Participants:

IETA notes that the Proposal would prevent general market participants from placing bids in auctions at or above the CCR price for that year. It is not clear if this will have a meaningful impact, given that general market participants will still be able to acquire allowances via secondary markets and potentially via auction clearing price futures. NYCI should consider removing this restriction. At the very least, they should revise it such that it does not apply if there are no CCR allowances available in the auction. For example, the CCR for a given year could be exhausted in the first auction of that year. In this case, there would be no CCR allowances available in that year's remaining auctions, so general market participants should not be restricted from bidding above the CCR trigger price in those subsequent auctions.

Potential Problematic Inconsistencies for Electricity Sector Obligations:

The Proposal appears to inconsistently place compliance obligations on power suppliers, with some, but not all, expected to be covered under the program. This inconsistency potentially creates regulatory and legal concerns. New York would place obligations on stationary sources above 25,000 metric tonnes of CO2e, and this group could include "non-Regional Greenhouse Gas Initiative (RGGI) electricity generation sources." This would appear to cover generators that are below the 15 MWh threshold within the RGGI rule.

At the same time, New York has not yet made a decision about whether large power entities that have RGGI obligations would have obligations under NYCI. In addition to potentially duplicating obligations, this could effectively create two different carbon prices within the power sector, and those price implications could skew generation (and emissions) based purely on that differential. This could create advantages and disadvantages for some generators while providing little environmental benefit.

IETA strongly holds that New York should seek to minimize the overlap of electric generators' obligations under RGGI and apply a uniform price across the electricity sector to ensure emissions reductions are incentivized equally. To be clear, IETA fully supports New York's continued participation in the RGGI program. We urge the regulators to take caution in ensuring that the treatment of RGGI facilities does not result in unbalanced incentives, which could provide an unfair advantage for some facilities facing compliance.

Electricity Utility Consignment:

The Proposal considers a consignment option for electricity utilities that would allocate allowances consigned to quarterly auctions with revenue returned to ratepayers. This model is similar to the California electrical distribution utilities (EDU) allocation. It is unclear exactly how this approach would work as the Proposal suggests revenues would accrue in an unknown location. The Proposal also seems to contemplate allocations based on load share basis rather than forecasted emissions. IETA

recommends that allocations to the power sector – if implemented – should be based on estimated emissions for those specific utilities. This would incentivize emissions reductions to occur more quickly than the forecasts as the utilities could monetize the allowances for future carbon abatement or ratepayer relief.

Another potential approach could see allowances allocated to achieve the Climate Leadership and Community Protection Act (CLCPA) power sector goals to fixed-priced auctions at the applicable floor price that would be available only to the power sector. These auctions could rebate or refund RGGI costs to applicable emitters based on the most recent RGGI quarterly auction, creating a uniform price. These allowances would be deposited into compliance accounts to prevent manipulation. If the sector falls behind the allocated volume, it would be exposed to quarterly auctions that would provide a carbon signal to cut emissions. All proceeds from those fixed-priced sales could be returned to ratepayers via utilities to ensure affordability. This approach would minimize some administrative work to state agencies, properly account for RGGI costs, and minimize impact to end consumers. A fixed-priced auction would also provide a clear signal to the power sector to remain on track to hit CLCPA goals.

Auctions, Pre-Compliance & Future Vintages:

Regarding the facilitation of auctions and allowance transactions, it is critical that New York develops digital infrastructure that is interoperable with infrastructure in existing markets and adheres to industry's best practices for IT and data security. Existing North American C&I programs provide an excellent framework that New York should heavily lean into when determining how to best facilitate NYCI auctions.

IETA supports the idea of simplified bids for smaller entities. The market will work best when all obligated entities have access to a program that is as simple and cost-effective as possible. DEC must ensure that the cut-off level to be eligible to use the simplified bid process is appropriately designated.

IETA believes that DEC and NYSERDA should offer compliance entities an opportunity to hedge their anticipated carbon exposure before their obligation starts accruing. Successful C&I programs (California, Quebec, and RGGI) have all held pre-compliance auctions that have allowed for price discovery ahead of the compliance state date. New York regulators should do the same by holding a pre-compliance auction, ideally in Q4 2024.

Additionally, DEC/NYSERDA should offer future vintage allowances in an advance auction, similar to other economy-wide cap-and-invest programs. This provides another opportunity for compliance entities to hedge their future carbon exposures.

Exclusion of Offsets:

Offsets are an important cost-containment mechanism within cap-and-trade programs and provide numerous co-benefits**.** In the California context and across other similar carbon pricing programs, offsets serve as an important cost-containment measure, offering a percentage of an emitter’s compliance obligation to be met with credits that are typically priced slightly lower than the cost of buying carbon allowances at state-run auctions. In many cases, the projects deliver multiple benefits even beyond the carbon reductions they generate. For example, carbon dioxide removal (CDR) projects can extract preexisting CO2 from the atmosphere. A well-designed offset program can help drive advances in CDR technology, which, when paired with robust C&I programs, can lead to net negative emissions. This is true not only for California but also for other states as well, as the offsets component of the C&I program has driven climate action in numerous states across the country. Subject to strict usage limits, these

offsets represent real climate benefits and provide cost-savings for California companies and have the potential to do the same under NYCI.

DEC has consistently said that offsets would not be included in the NYCI program, citing administrative burden and limitations in the CLCPA, as well as concerns related to the impact on disadvantaged communities. In light of the significance of the New York program across the region and the likelihood that other states may look to NYCI as a model in the future, IETA thinks DEC should reconsider this position.

Regarding administrative burden, New York regulators can reduce the administrative burden of offset implementation by using or adapting compliance protocols from California and Washington. This is a well-accepted common practice amongst emerging C&I programs, seen most recently with Washington adopting several California protocols for its program. Addressing CLCPA limitation concerns, IETA believes that the geographic restrictions in the CLCPA – i.e., same county, within 25 linear miles – would not extend to mobile source emissions (a majority of emissions expected to be covered in NYCI) and therefore, could be of great interest and an important flexibility and cost containment mechanism for entities with mobile sources emissions.

Concerning the impacts on disadvantaged communities, we would point to California to illustrate how offsets represent real climate benefits and are an important cost-containment mechanism within C&I programs, as well as to dispel the myth[3] that the use of offsets within C&I programs adversely impacts disadvantaged communities.

Independent of NYCI, and in addition to compliance with federal regulations, New York is well placed to provide safeguards to ensure absolute point source emissions don't increase beyond allowable thresholds or pose a threat to disadvantaged communities through the Statewide Community Air Monitoring Initiative, adoption of relevant California standards e.g. the California Heavy-Duty Low NOx Omnibus and California Phase 2 Greenhouse Gas Standards regulations, Zero Emission Vehicle standards etc. **Taking these measures into account would significantly address disproportional impacts on disadvantaged communities, safely enabling offsets to provide much-needed cost-containment for compliance entities.**

At the minimum, before completely writing off the possibility of compliance offsets, IETA urges DEC and NYSERDA to assess within the written record the potential benefits of including compliance offsets in the NYCI program.

Conclusion:

IETA appreciates the opportunity to provide feedback on New York's Phase 2 Pre-Rulemaking Proposal for the New York Cap-and-Invest. We are encouraged by the progress that the state has made to date and look forward to additional engagement opportunities as the program continues to be developed. For additional information or questions, contact IETA analyst **Joey Hoekstra**.

[3] See CARB's C&I FAQ on Environmental Justice Communities and Local Air Pollution for detailed evidence defending C&I and offset usage against concerns related to disadvantaged communities (**Link**)