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July 13, 2007

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

Re: CAPCOA Comments on the June 30, 2007 Market Advisory Committee Report: Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California

Dear Ms. Nichols:

The California Air Pollution Control Officers Association (CAPCOA) welcomes you as the Chair of the California Air Resources Board and looks forward to working with you. We appreciate the opportunity to offer comments regarding the Market Advisory Committee Report (Report) on "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California." CAPCOA is an Association of Air Pollution Control Officers representing all thirty-five local air quality agencies throughout California. CAPCOA has been in existence since 1975, and is dedicated to protecting public health and providing clean air for all residents and visitors to breathe. Climate protection issues are important to CAPCOA, which strives to assist in efforts to reduce greenhouse gases while making sure that criteria and toxic pollutant reduction programs are enhanced by this effort.

CAPCOA would like to commend the Market Advisory Committee for an excellent report that comprehensively addresses many very complex issues. CAPCOA concurs with many of the recommendations. We have the following suggestions for ARB's consideration. Many of these comments were submitted previously to the Market Advisory Committee (June 15th letter to Ms. Eileen Wenger Tutt). The comments are organized with general remarks first, then comments follow the general outline of the report. The suggestions are made to help make sure any greenhouse gas cap-and-trade program established in California is robust, can deliver needed emission reductions, and enhance other air quality objectives. In addition to the suggestions below, CAPCOA strongly recommends that an Enforcement Working Group be formed as ARB staff develops rules for a greenhouse gas cap-and-trade program. CAPCOA members would be pleased to participate in this effort. Such a working group will help focus on the critical need to have a solid program with enforceable, verifiable emission reductions.

General Comments

Addressing Environmental Justice Issues, Hot Spots, and Potential Backsliding of Other Programs
The Report does an excellent job articulating the concerns and desire that a cap-and-trade program to reduce greenhouse gases should not create such problems. However, the recommendation to use auction revenues to fund projects in environmental justice areas and that the program be monitored to see if any hot spots or backsliding occurs does not go far enough to prevent potential problems. The revised report added a recommendation that ARB exercise its authority under Health and Safety Code (H&SC) §41503.2 to review and revise a district's plan to prevent any backsliding. This process is too lengthy and cumbersome to be a meaningful way to prevent or address environmental justice issues. This Health and Safety provision requires ARB to review district plans within 12 months of their submittal to determine if they are adequate to meet state ambient air quality standards, and if not, to send the plan back to the district for revision and re-submittal. If a district and ARB disagree as to the ARB findings, H&SC §41503.2 invokes a conflict resolution process, which, only if unsuccessful, then authorizes ARB to conduct public hearings and revise a plan. This process could take years. Since the major contributors to greenhouse gas and criteria pollutants are mobile sources, revisions may require changes to state and federal sources. Any slowing of progress is an issue, not just backsliding that affects attainment. CAPCOA would like to work with ARB to develop proactive ways to ensure that greenhouse gas reduction programs, such as cap-and-trade, accelerate progress in other important air quality programs and do not detract from their outcomes.

Allowances Should Not be Property Rights
It is very important that the program rules clearly establish that allowances are not a property right. Inadvertently creating any kind of property right would prevent ARB from amending the rules, reducing allowances, or suspending or terminating offsets or allowances. Unforeseen circumstances may require adjusting the 2020 or 2050 targets or otherwise altering the value of allowances. The Acid Rain Program and RECLAIM both contain specific rule language to address this issue. ARB staff should include such language in the program rules to make sure that this design aspect is included.

Add Periodic Program Reviews, Including Trade Information
CAPCOA recommends that periodic program reviews be undertaken and that the results be reviewed by ARB and Cal EPA and shared freely with the pubic and program participants. This is one of the most effective ways to closely monitor progress in a variety of areas and to try to anticipate difficulties. Part of this review should include trading information, such as volume and price. CAPCOA does not agree with the recommendation that ARB not collect or track price information. It is very important that this type of information be readily available and transparent to ensure less price volatility or market manipulation.

Recommendation to Consider a Centralized Market
In the design phase of the regulations to implement a cap-and-trade program for greenhouse gases, ARB should consider whether to designate a centralized market for allowance trading. Benefits of a centralized market include one clearing price for trades, better price and volume information, efficiency, and easier administration for recording trades. In a decentralized market, where several businesses offer trading services, it is more difficult for facilities to get a good sense of allowance availability and a strong price signal. For example, before RECLAM rule amendments to correct the problems that occurred during the 2000/2001 power crisis, one company inquired with three different brokers about the availability of a very large amount of credits. This was misinterpreted in the market as three times the demand needed, which caused further confusion and stress to the market.

Resources Needed for a Cap-and-Trade Program

The June 1, 2007 draft report stated that cap-and-trade programs are easier to manage than traditional programs. CAPCOA disagrees strongly with this statement. Cap-and-trade programs fundamentally change the way compliance and enforcement is done. Instantaneous checks to determine if a concentration limit is being met are replaced by annual (or longer as recommended in the Report) compliance periods. Detailed accounting of mass emissions is required which takes very different methods to verify and enforce.

The June 30, 2007 report states that only 50 people are needed to run the federal Acid Raid Program. Acid Rain deals only with one industry and all emissions are monitored with Continuous Emissions Monitors, or CEMS. The program is implemented through Title V permits, which are issued by local air districts in California and the appropriate state agencies outside of California. The program started initially with 110 electric utility plants. AB32 may start with 450 facilities initially from many different industries. It will be more complex to monitor and enforce than the Acid Rain Program because there will be many more types of equipment involved. Extensive field enforcement resources will be needed to ensure that emissions reported and reductions are real and verifiable.

Staff spoke to the Deputy Director of Acid Rain for EPA, who has been with the Acid Rain program since its inception. It took three years to develop the regulations and software, and there were 73 people at EPA initially dedicated to the program. In 1995, there were 110 facilities and 263 units. Currently there are 1,226 facilities and 3,560 units. Once the program was established, EPA was able to reduce the amount of staff dedicated to the current 50 people because there is a central data base and automated emission determination. If there are no CEMS, or a variety of industries to monitor, additional resources would be needed. In addition, EPA does only minimal work on permits for Acid Rain. The permits are handled through Title V which is done by local air districts in California and other agencies outside of California, and contain a one-page summary of the allowances for each unit.

Of the 50 staff people, 11 work in regional offices primarily doing field support, and auditing CEMS. Additional EPA resources that are not in this division work on enforcement cases. Approximately 14 to 15 staff members do data quality assurance and audits of CEMS data. Seven to eight staff are responsible for program assessment, evaluation, and communication, such as the annual reports and web site information. Four staff members handle the allowance accounting activity, four maintain the air monitoring network, in coordination with other agencies, and two are administrative. Five software staff maintain and upgrade the computer system. This number would be much higher for initial program development, even if contractors write much of the code.

This emphasizes that the Acid Rain Program is not a good model relative to resource needs. The greenhouse gas cap-and-trade program for California will be much less straight forward to monitor, include many different types of equipment at many different industries, and have significantly more resource needs for permitting, enforcement, verification, and monitoring.

Program Scope

CAPCOA supports the Committee recommendation to begin with large point sources, as described in Program 1, and to add the transportation sector emissions (Program 2) and upstream small industrial, commercial, and residential emissions (Program 3) as the tools to incorporate those sectors are available. We believe it is important to have a rigorous market program in place soon, and the data and tools are available today to begin with Program 1. Local air districts currently collect the process and emissions data needed to quantify CO2 emissions from the affected facilities, including, if necessary, establishing historical emissions baselines. All of these sources are currently subject to permitting and reporting

requirements, and were inspected a collective 6,995 times in 2004-2006. While the market program may not ultimately rely completely on this existing infrastructure, using it at the outset will speed the deployment of the market system and will ensure early verification and enforceability with a team of over 400 experienced field inspectors. We suggest when ARB adopts the phased in program design, it also approve a schedule for the phasing, to allow for better management of the cap and certainty for covered entities.

CAPCOA is concerned with the proposal to exclude fugitive emissions from the program. Some fugitive emissions can be quantified and should be included. Large landfills currently have landfill gas collection systems and ARB will regulate smaller landfills as an early action measure. Most landfills flare their emissions. Some collect the methane and compress it and then use it either to generate electricity or to power vehicles. Although there are ultimately combustion emissions associated with all three treatment options, two of them produce useful work, where as flaring is purely waste. We believe these emissions can be readily and accurately quantified and a market-based program could effectively incentivize capture and use of the methane. Fugitive emissions from some industrial processes can also be quantified well enough to be included in a market program. For example fugitive emissions from natural gas distribution could be quantified in the same way that emissions at refineries are.

Design Issues

Length of Compliance Period

The Report recommends that the compliance period be longer than one year, and suggests that a 3-year interval may be appropriate for ARB to consider as they develop these concepts into a regulatory program. CAPCOA has concerns that such a long compliance period could result in complacency by sources in the program that may count on purchasing allowances during a reconciliation period under the assumption that there will be an ample, affordable supply. A 3-year compliance period can lead to a lack of market signals relative to price, as seen in the European Union market after the first compliance period. Without more frequent price information, it is more likely that the program, as a whole, will either be long with excess unused allowances, or worse, could be short with not enough allowances to cover emissions. A one-year compliance period is recommended to help avoid this problem and to ensure that companies manage their emissions more closely. A one-year period is consistent with the committee's first design principle of environmental integrity.

Banking

Unlimited banking is also counter to the design principle of environmental integrity unless there is a mechanism to reduce the value of banked allowances as the 2020 or 2050 compliance deadlines approach. Otherwise, there could be the effect of unused allowances from earlier years causing emissions to swell in later years, making the emissions targets harder to achieve.

Distributing Allowances

CAPCOA does not have any specific recommendations regarding the method to distribute allowances. Local air districts have collected combustion-related fuel usage and other information that would be helpful in determining facility-specific greenhouse gas emissions, if that would be needed for an allocation scheme.

Offsets

CAPCOA believes that regulatory standards have an important role in streamlining the review of offset credits, but that it should not supplant the case-by-case review of specific emission reduction projects. Case-by-case review is critical to ensure the reductions claimed are indeed real, permanent, quantifiable, verifiable, and additional to other requirements. This is especially true if offsets are to be generated from

outside the universe of facilities or entities covered by the market program. A regulatory standard may proscribe a technology change that could generate credits, but the case-by-case review is necessary to ensure that the assumptions made match the particular case, that baseline emissions did in fact occur, and that the change was implemented consistent with the standard. Finally, case-specific contracts or permit restrictions are necessary to ensure the permanence of the reductions over the term of the life of the credit.

Linkage to Other Programs

CAPCOA supports the goal of establishing broad linkages for the program, given the global nature of the climate change problem. The challenge will be to ensure the highest quality offsets and to prevent localized impacts when trades occur over increasing distances. We recommend specific protections be put in place for intra-state trading to prevent localized impacts from trades (see comments on ensuring environmental justice and protecting communities exposed to high levels of pollution). Trades involving offsets from outside of California present additional concerns. The report lists a set of criteria that ARB should consider in deciding which programs to link with, or whether to accept offsets generated in another jurisdiction. We believe offsets should only be accepted from programs that clearly demonstrate equivalent rigor. In order to prevent uncertainty and later disputes, and to ensure the integrity of trades, ARB should develop specific tests of stringency and equivalency in program elements and offset requirements that demonstrate the offsets are real, permanent, quantifiable, verifiable, enforceable, additional, and transparent. More specific information on the elements and requirements should minimally be included. Out of program offsets should not be accepted into the program until these tests are established in regulation.

A broader concern will be how to ensure that the AB 32 targets are met if reductions are made outside of California and are available as offsets to meet in-state allowance targets. If the 2020 cap is based on AB 32 targets, out-of-state offsets will prevent the market program from delivering the anticipated reductions and we will not meet the legislative targets. In order to address this, the in-program cap will have to be reviewed and adjusted over time.

Administrative Issues

Importance of These Issues

Chapter 7 of the Report is currently titled "Administrative Issues". There are many critical discussions here that are very important to the foundation of any cap-and-trade system. We suggest that the title be changed to "Operational Issues," and that the important concepts be included in the conclusions, recommendations, and key attributes in Chapter 8.

Role of Local Air Districts

In addition, CAPCOA would like to highlight previous recommendations that local air districts work in partnership with ARB in the many areas of program implementation that local air districts have decades of experience with. For example, the medium and large stationary sources that are likely to be included in a greenhouse gas cap-and-trade program are facilities that have been under local air district regulation for decades. These facilities have permits for equipment that emits or controls air pollution, are inspected periodically by district staff, are required to report annual emissions, such as combustion-related through put or via continuous emission monitors, and are subject to enforcement and auditing. It would be a more efficient program, at lower costs, if ARB took advantage of the expertise and existing infrastructure that local air districts are willing to provide.

Penalty Provisions Need to be Strengthened

The penalty recommendations are not sufficient in the Report. Up to the first ton of excess emissions is not considered a violation. Civil and criminal penalties would only apply to intentional violations.

Evidence of intentional regulatory violations will not be easy to document without case development, which will require significant staff and resources. At the very least, there should be provisions for evidentiary presumptions and burdens that would favor the government in establishing an intentional violation.

In addition, there are no penalties for allowance, monitoring, recordkeeping or reporting violations which can be caused by no fault or through negligence. In effect, this will lead to no penalty, and thus no enforcement, for any and all unintentional failures in these areas.

There should also be enforcement provisions for allowance violations that extend beyond compliance periods, for the enforcement lag inherent in compliance auditing of cap-and-trade programs, and for preventing or minimizing the effects of fraud. Provisions for chronic or repeat offenders should be added and CAPCOA recommends that penalties increase substantially for these cases.

Summary

Thank you for the opportunity to participate in this very important effort. These comments are provided in the spirit of developing a robust program to help ensure greenhouse gas and other air quality goals are met. CAPCOA is ready to work with ARB and others in development of the regulatory program to reduce greenhouse gases and would like to reiterate the recommendation that an Enforcement Working Group be formed. Please feel free to contact me at (805) 781-5912 if you have any questions or if CAPCOA can be of service.

Sincerely,

Larry R. Allen
President

cc: ARB Board Members
Tom Cackette, Acting Executive Officer