Comments on ARB's June 13, 2011 Supplement to the AB 32 Scoping Plan Functional Equivalent Document

Submitted by Kenneth C. Johnson on July 5, 2011

The California Superior Court has found that "ARB abused its discretion in certifying the FED as complete," in part because "the Scoping Plan fails to provide meaningful information or discussion about the carbon fee (or carbon tax) alternative in the scant two paragraphs devoted to this important alternative." But the plan – and ARB's June 13, 2011 supplemental FED – gives even less attention to an equally important policy alternative, a price floor operating in the context of cap-and-trade.

Plaintiffs in the court action have argued that a carbon fee could be more effective than cap-and-trade at complying with the maximum-reduction mandate of Health and Safety Code § 38560. But cap-and-trade operating with a price floor would be expected to achieve emission reductions *no less* than that of a similarly-administered carbon fee.

ARB's original FED rejected the carbon fee alternative primarily because "a carbon fee does not provide certainty in terms of the amount of emission reductions that will be achieved," whereas cap-and-trade would provide such certainty. But cap-and-trade operating with a price floor would achieve emission reductions *no less* than that of cap-and-trade without a price floor.

Thus, a price floor deserves special attention because it could resolve concerns relating to environmental stringency and statutory compliance that have been raised by both the plaintiffs and ARB. The supplemental FED makes mention of a 2008 CBO study that includes a price floor among the policy alternatives considered, and which "explores ways in which policymakers could preserve the structure of a cap-and-trade program, but still achieve some of the advantages of a tax." (See supplemental FED, page 39.) It also discusses one existing program, RGGI, which employs a price floor. (See pages 42-43.) But ARB fails to include a price floor in its Range of Alternatives (pages 17-19).

In the context of RGGI, a price floor has been instrumental in keeping allowance prices from falling below the floor level, which is currently set a $1.89 per CO_2 allowance. (See http://rggi.org/market/co2_auctions/results.) California's program, as currently constructed, would not prevent prices from falling substantially below $1.89.

In 2008 ARB had estimated that cap-and-trade would achieve 34.4 MMT of the requisite emission reductions necessary to reduce emissions from a 596 MMT BAU projection in 2020 to the 427 MMT target. But the BAU projection has been revised downward to 507 MMT, an 89 MMT difference; thus the prospect of a long-term collapse of emission prices is a credible and realistic possibility. (It is notable that in the RGGI's June 2011 auction less than one-third of the available allowances were sold, even at the floor price of $1.89.)

If California achieves the 2020 cap with emission allowances selling well below $1.89, would its program be considered to have complied with ARB's mandate under Health and Safety Code § 38560 to "… achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions …"? According to ARB's current interpretation, yes. ARB recognizes the statutory requirement to at least achieve the 427 MMT target in 2020, and to do so in a manner that favors low-cost reduction strategies. But it does not recognize any statutory requirement to seek emission reductions beyond the minimum required to achieve the 2020 target even if such further reductions would be feasible and cost-effective.

While ARB has broad discretionary authority in interpreting the statute, it should not adopt an interpretation that renders a core statutory requirement of AB 32 meaningless and ineffectual. The qualifier "maximum" in § 38560, which applies to "emission reductions," is clearly intended to have meaning. § 38560 is clearly intended to at least potentially influence emission levels achieved under AB 32, but it would not under ARB's current cap-and-trade-based approach. A price floor, which is based on a cost-effectiveness threshold that is consistent with the legislative policy objectives of AB 32, would reasonably incentivize further emission reductions to the extent that such reductions are feasible and cost-effective according to § 38560.

The Scoping Plan employs one mechanism, banking, that could motivate at least short-term emission reductions beyond the declining cap limit in the event that allowance prices are low. However, banking is no substitute for a price floor because market traders will not generally act to seek maximum emission reductions according to § 38560. They will only act to hold unused allowances, and prevent price collapse, if high prices are anticipated in the near future. In the face of long-term, systemically low emission prices, banking will not operate to prevent price collapse.

The legislature intended that ARB implement the AB-32 legislation "in a manner that minimizes costs and maximizes benefits for California's economy" (HSC § 38501(h)), but there is no requirement that costs and benefits be optimized according to the myopic, short-term valuation standard of arbitrage traders. Considering that the 2020 emission target was based on a 550-ppm atmospheric CO_2 stabilization target[1] (compared to the 350 ppm requisite limit indicated by more recent climate science[2]), a policy that achieves only minimal emission reductions rather than the maximum reductions required by § 38560 will only achieve short-term economic gains at the expense of much greater long-term costs and forfeiture of long-term economic benefits.

[1] Climate Action Team Report to Governor Schwarzenegger and the Legislature (March 2006), pages 37-38. http://www.climatechange.ca.gov/climate_action_team/reports/2006report/2006-04-03_FINAL_CAT_REPORT.PDF

[2] "Target atmospheric CO2: Where should humanity aim?" Hansen et al. (2008) http://arxiv.org/abs/0804.1126v3