



AB 32 Implementation Group

Working Toward Greenhouse Gas Emission Reductions
And Enhancing California's Competitiveness

To: Steve Cliff, Chief – Climate Change Markets Branch
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FR: AB 32 Implementation Group

RE: Regulation for Linking California's and Quebec's Cap-and-Trade Programs –
February 3, 2012 Workshop

Date: February 17, 2012

Submitted Electronically: <http://www.arb.ca.gov/cc/capandtrade/comments.htm>

The AB 32 Implementation Group is a coalition of employers and taxpayer groups advocating for policies to achieve greenhouse gas emission reductions in a manner that will protect jobs and the economy.

Status of the Western Climate Initiative

The purpose of linkage is to provide a broad and liquid market that includes all of the competitors in the marketplace to minimize emissions leakage and thus effectively reduce global greenhouse gas emissions. Failing to achieve linkage with regional jurisdictions that includes a substantial number of the covered entities in a competitive marketplace will only create incentives for business expansion and location outside of the regulated area. We agree with the Legislative Analyst's Office (LAO) that linking with other jurisdictions could serve to contain aggregate program compliance costs by providing more opportunities for low-cost emission reductions. (Evaluating the Policy Trade-offs in ARB's Cap-and-Trade Program, LAO, February 9, 2012). However, the number, size and location of compliance entities covered must be sufficient to provide sufficient market liquidity and protect against economic dislocation.

When CARB began developing the cap-and-trade regulation most stakeholders expected that all of California's neighboring states and provinces originally members of the Western Climate Initiative would participate and support a robust and effective market. We are disappointed that we are close to the program launch date and not a single US State is following our lead with only Quebec, with its very limited compliance

market, preparing to participate. This lack of participation creates and magnifies many risks associated with AB 32 implementation, including emissions leakage and economic dislocation. To make matters worse, there is little time to analyze and address these risks as they relate to linking with Quebec and how other features of the cap-and-trade rule should be adjusted. CARB does not plan to even begin a review of how to analyze the leakage risks for cap and trade until the third quarter of 2012, yet the need for this analysis is critical given that no other western state will be participating in the program. It is illogical and contrary to AB 32 that CARB will likely hold at least two auctions prior to having established the rules for how leakage and economic dislocation will be evaluated.

CARB should immediately re-analyze the risks associated with the cap-and-trade program to include the latest data and assumptions about market participation, and make changes as necessary to avoid unintended consequences, such as job loss and emissions leakage.

Economic analysis of linking with Quebec

CARB must include an economic impact analysis in its initial statement of reasons for formal rulemaking on linking and we agree with the LAO that the Legislature should evaluate the analysis to ensure that linking with Quebec is in the state's best interest.

An acceptable economic analysis depends on successful harmonization of the two programs. The LAO states that California's rules must be harmonized with the rules of Quebec to ensure that both jurisdictions are subject to equally stringent rules for compliance. If not harmonized, the ability of offsets to serve as a cost-containment mechanism for the program may be diluted and emission reductions for offset projects may be less certain. In addition, given the limited market and the extent that Quebec's cap on its covered entities is more stringent than California's, this may increase the scarcity of allowances, which would serve to increase overall allowance prices for all covered entities and potentially increase the compliance cost for California's covered entities.

Important design elements to be harmonized between Quebec and California

CARB acknowledges the need to harmonize Quebec and California's programs with regard to conducting the auctions, who can participate in reserve sales, purchase and holding limits, how corporate associations are defined for purposes of holding limits, reporting of emissions between 10,000 and 25,000 tons/CO₂e. We agree. In addition,

we urge CARB to review holding limits for both jurisdictions to ensure that covered entities are able to purchase and hold sufficient allowances to cover their emissions in a manner that doesn't reduce market liquidity. However, CARB must balance any relaxation of limits against the ability of the many medium and small companies competing against large stakeholders for the ever-decreasing pool of allowances. Also, Quebec has not yet adopted any or all of the offset protocols included in the California program, and does not plan to do so until spring or summer. As noted by the LAO above, unless and until Quebec adopts offset protocols, the supply of compliance instruments will be constrained and the costs for all market participants in both Quebec and California will rise.

Role of the WCI, Inc.

CARB has created the WCI, Inc. to perform administrative and technical services to support the market, including market monitoring of allowance auctions and market trading of compliance instruments. We are concerned that WCI, Inc. is assuming important market oversight responsibilities yet its function might not be subject to important requirements that apply to governmental organizations such as open meeting laws, accounting for use of funds, public participation, oversight by California entities including the Legislature, Attorney General, Bureau of State Audits, etc. The LAO notes that effective oversight of carbon markets will be important, however it could also be a "challenging and potentially expensive" effort (*page 22*). Will administrative fees paid by regulated entities in California be used to support the WCI, Inc.? We need to understand much more about the function, funding, and role of the WCI, Inc. to ensure it is complying with all appropriate legal requirements and that there is full public accountability of their activities.

Should you have any questions regarding our concerns, please contact Shelly Sullivan at (916) 858-8686.