

PROPOSED

State of California
AIR RESOURCES BOARD

Amendments to the California Cap-and-Trade Regulation

Resolution 13-44

October 25, 2013

Agenda Item No.: 13-9-9

WHEREAS, sections 39600 and 39601 of the Health and Safety Code authorize the Air Resources Board (ARB or Board) to adopt standards, rules, and regulations and to do such acts as may be necessary for the proper execution of the powers and duties granted to and imposed upon the Board by law;

WHEREAS, the California Global Warming Solutions Act of 2006 (AB 32; Chapter 488, Statutes of 2006; Health & Safety Code section 38500 et seq.) declares that global warming poses a serious threat to the economic well-being, public health, natural resources, and environment of California and creates a comprehensive multi-year program to reduce California's greenhouse gas (GHG) emissions to 1990 levels by 2020;

WHEREAS, AB 32 added section 38501 to the Health and Safety Code, which expresses the Legislature's intent that ARB coordinate with State agencies and consult with the environmental justice community, industry sectors, business groups, academic institutions, environmental organizations, and other stakeholders in implementing AB 32; and design emissions reduction measures to meet the statewide emissions limits for greenhouse gases in a manner that minimizes costs and maximizes benefits for California's economy, maximizes additional environmental and economic co-benefits for California, and complements the State's efforts to improve air quality;

WHEREAS, section 38501(d) of the Health and Safety Code confirms that national and international actions are necessary to fully address the issue of global warming, but action taken by California to reduce GHG emissions will have far reaching effects by encouraging other states, the federal government, and other countries to act;

WHEREAS, section 38510 of the Health and Safety Code designates ARB as the State agency charged with monitoring and regulating sources of GHG emissions to reduce these emissions;

WHEREAS, section 38560 of the Health and Safety Code directs ARB to adopt rules and regulations in an open public process to achieve the maximum technologically feasible and cost-effective GHG emissions reductions from sources or categories of sources;

WHEREAS, in Resolutions 11-32 and 12-33, the Board directed staff to continue to work with stakeholders on several topics related to implementation of the Cap-and-Trade program, including reconsidering leakage risk determinations, the allowance allocation approach for California industries including refineries, and product benchmarks, as necessary;

WHEREAS, in Resolutions 12-51 and 12-33, the Board directed staff to analyze and, if necessary, propose amendments relating to resource shuffling, legacy contracts, combined heat and power, emissions leakage, allowance allocation to universities, cost containment, product-based benchmarks, and waste-to-energy facilities, as necessary;

WHEREAS, pursuant to Resolution 10-42, the Board directed the Executive Officer to initiate a public process for the review of additional compliance offset protocols for the purpose of bringing additional protocols to the Board for consideration; and ARB staff has proposed a new Compliance Offset Protocol Mine Methane Capture (MMC) Protocol as part of this rulemaking;

WHEREAS, staff has proposed amendments to the Cap-and-Trade Regulation that include the following elements:

- The provision of allowance allocation for additional sectors and the modification of allocation for sectors based on new information;

- The inclusion of an additional cost containment mechanism;

- The identification of new covered entities and exempt sectors where direct regulation best meets the goals of AB 32;

- The exemption of certain emissions from incurring a compliance obligation under the program for the first compliance period;

- The provision of additional clarity regarding resource shuffling;

- The inclusion of a new offset protocol and clarification and addition of processes for the implementation of the compliance offset program;

- The addition and modification of market rules for auctions and transfers in the tracking system; and

- The inclusion of additional provisions to enhance market security.

WHEREAS, ARB has inter-agency agreements for leakage studies related to several industrial sectors receiving free allowances, which will be completed before the beginning of the second compliance period;

WHEREAS, the proposed cost containment mechanism ensures environmental integrity, but only addresses near-term needs and more long-term certainty is needed;

WHEREAS, staff prepared a document entitled “Staff Report: Initial Statement of Reasons for the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms” (ISOR), which presents the rationale and basis for the proposed regulation and identified the data, reports and information relied on;

WHEREAS, the California Environmental Quality Act (CEQA) requires that a public agency not approve a project as proposed if there are feasible alternatives or feasible mitigation measures available which would substantially lessen the significant environmental impacts of such a project; In the event that specific economic, social, or other conditions make infeasible the alternatives or mitigation measures, the project may be approved if it is determined that any remaining unavoidable significant impacts are acceptable due to overriding considerations;

WHEREAS, Public Resources Code section 21080.5 allows public agencies with regulatory programs to prepare a plan or other written document in lieu of an environmental impact report or negative declaration once the Secretary of the Resources Agency has certified the regulatory program;

WHEREAS, that portion of the ARB’s regulatory program that involves the adoption, approval, amendment, or repeal of standards, rules, regulations, or plans has been certified by the Secretary of Resources Agency (CEQA Guidelines, section 15251(d));

WHEREAS, in accordance with ARB’s certified regulatory program at title 17, CCR, section 60005 (b), and the policy and substantive requirements of CEQA, as part of the Staff Report, ARB staff has prepared an assessment of the potential for significant adverse and beneficial environmental impacts associated with the proposed amendments and a succinct analysis of those impacts;

WHEREAS, the ISOR, including the environmental analyses, was circulated for a 45-day written public comment period from September 9, 2013 until October 23, 2013; and

WHEREAS, the draft update to the AB 32 Scoping Plan recommends the development of post-2020 emissions reduction targets, and that sending a signal that Cap-and-Trade will continue beyond 2020 is critical to fully realizing the benefits of the program;

NOW, THEREFORE, BE IT RESOLVED that the Board hereby directs the Executive Officer to take the following actions:

1. Consider the topics set forth in Attachment A, with such other additional conforming modifications as may be appropriate and any additional supporting documents and information available to the public for a period of 15 days, provided that the Executive Officer shall consider such written comments as

may be submitted during this period, shall make such further modifications as may be appropriate in light of the comments received, and shall present the proposed regulations to the Board for further consideration;

2. Evaluate all comments received during the public comment periods, including comments raising significant environmental issues, and prepare written responses to such comments as required by ARB's CEQA certified regulations at title 17, CCR, section 60007 and Government Code section 11346.9(a);
3. If appropriate, prepare and circulate any further environmental analysis to the extent required by ARB's regulations at title 17, California Code of Regulations, sections 60001-60007 and incorporate all feasible mitigation or alternatives that could eliminate or substantially lessen any significant adverse environmental impacts identified; and
4. Present at a subsequently scheduled Board hearing, the Board with staff's written responses to comments raising significant environmental issues, along with the environmental analysis, for consideration for approval, and the Final Regulation order for consideration for adoption.

BE IT FURTHER RESOLVED that the Executive Officer review the findings of the leakage studies and, in response, propose any modifications to the allocation assistance factors, as necessary, prior to the start of the third compliance period.

BE IT FURTHER RESOLVED that pursuant to the draft update to the AB 32 Scoping Plan, the Board directs the Executive Officer to develop a plan for a post-2020 Cap-and-Trade Program, including cost containment, before the beginning of its third compliance period to provide market certainty and address a potential 2030 emissions target.

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October 25, 2013

Identification of Attachment to the Board Resolution

Attachment A: Staff's Proposed Topics of 15-day Changes
(Distributed at the October 25, 2013 ARB hearing)

ATTACHMENT A TO RESOLUTION 13-44
Cap-and-Trade Regulation
Topics Subject to Potential 15-day Changes

Introduction

This document presents an overview of the main topics ARB staff is proposing for further public consideration as part of a subsequent 15-day comment period. This list is not exhaustive and does not include minor technical changes that may be proposed. Staff will continue to coordinate with stakeholders in the development of the regulatory text. This list in no way limits ARB's authority to make other changes to the proposed regulatory amendments, consistent with the requirements of California law.

Legacy Contracts

The modified staff proposal is to extend transition assistance for legacy contracts through the second compliance period instead of ending after 2014. This is consistent with the staff proposal to extend industry transition assistance for the first compliance period through the second compliance period. A more detailed discussion is available at: <http://www.arb.ca.gov/cc/capandtrade/legacy-contract-proposal.pdf>

New 15-day Proposed Changes and Modified Product Benchmarks and Allowance Allocation

The current regulation includes 28 product benchmarks in 18 different industries. The proposed changes include modifications to product benchmarks in seven sectors, not including refinery products, and additional benchmarks for 17 industries. Many of these benchmarks are still in development awaiting additional industry data. Sectors that will have modifications during the 15-day rulemaking are tomato, chicken, dehydrated flavors, dairy, pistachio, almond, snack chips, juice and spirits, lead, and aluminum manufacturing.

In the 15-day proposal, staff will also make clarifications in the event of a negative true-up during allowance allocation. This event occurs when a covered entity that is eligible to receive true-up allowances decreases their production substantially in a very short period of time such that the true-up allocation would exceed the amount of allowances for which it was eligible.

Refinery Allocation Methodology

In the 15-day changes, staff will propose the following:

CWT to CWB: ARB staff will propose to change the unit for refinery allowance allocation under the cap-and-trade regulation from carbon dioxide weighted tonnes (CWT) to complexity-weighted barrels (CWB). The benchmark for CWB would be

calculated using survey data for 2008 and 2010 CWB and MRR data for 2008 and 2010 refinery emissions.

Electricity and Steam: ARB staff proposes no regulatory changes relating to the use of electricity and steam at refineries. However, when calculating the benchmarks, staff proposes to consider electricity and steam use in a way similar to other sectors. That is, greenhouse gas emissions from electricity sold or purchased by refineries will no longer be included in the benchmark, and emissions from net steam consumption would be included in the benchmark. Staff considered an alternative method proposed by industry stakeholders but found it unnecessarily complex and inconsistent with the approach used in other sectors.

Atypical and Typical Benchmarks: Staff proposes to consider typical and atypical refineries separately for the purposes of CWB benchmarking and CWB-based allowance allocation. That is, a benchmark of greenhouse gas emissions per CWB would be calculated for both typical and atypical refineries. "Atypical" refineries would be defined as those which have fewer than twelve process units under CWB definitions and less than 20 million barrels of crude throughput through their atmospheric distillers per year. All refineries which are not "atypical" are by definition "typical." For the purposes of these definitions, refinery facilities which operate jointly will be considered as a single "refinery" for use in determining the appropriate benchmark to be used for allocation.

Hydrogen: Staff proposes that hydrogen production will be considered separately from CWB. In order to provide consistent and equitable incentives for on and offsite hydrogen plants, one benchmark will be calculated for hydrogen production and used to allocate to all facilities which deliberately produce hydrogen, regardless of whether they are refineries or independent hydrogen producers. Current staff thinking is for this benchmark to be based on MRR data from merchant hydrogen plants, because it is the data source most reliably identifying both emissions and product data relating to hydrogen. Staff will continue to work with stakeholders on this issue.

Calcining: Staff propose to allocate allowances for on and offsite calciners using a benchmark calculated using ARB's standard methods and 2008, 2009 and 2010 data, rather than considering calcining within CWB. This benchmark is expected to be significantly higher than the current benchmark.

Additional Issues: Staff held a workshop on October 7, 2013 to discuss refinery allocation related to CWB and has received feedback on these proposals. Staff will continue to work with stakeholders to define jointly operated refineries, consider alternatives for hydrogen benchmarks that still create a level playing field for both on and off site hydrogen, and finalize benchmark values. More information on the refinery workshop is available at: <http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm>

Exemption for “But-for” CHP Facilities

The 45-day proposal currently exempts “but for” CHP facilities through 2014. Staff proposes to exempt “but-for” CHP facilities entirely and clarify that the compliance obligation for these entities will be accounted for upstream at the natural gas distribution utilities starting in 2015.

Public Wholesale Water Agencies

Staff proposes to evaluate additional data and adjust allocation related to direct emissions, as needed.

Local Distribution Companies

Staff proposes to make a minor modification to clarify that only emissions that occur along the natural gas transmission and distribution networks are exempt when calculating a local distribution company’s compliance obligation.

Reporting Requirements to Support Market Oversight

Staff proposed several amendments in the ISOR to better understand which individuals have access to carbon market related data within a registered entity or as a contractor, which registration data must remain static prior to an auction, and disclosures related to previous or ongoing investigation by a regulatory authority. Together, these amendments are intended to support market oversight and ensure ARB and the market monitor understand all points of potential information sharing that could result in collusion or market manipulation. The auction registration requirements are essential to implement a fair and competitive auction where all auction participants are known and company restructuring does not impact ARB’s ability to settle the auction. ARB will continue to work with stakeholders to refine the regulatory language in 15-day changes as described below.

Registered Entity Employees and Contractors: Staff will work with stakeholders to clearly define which company individuals must be disclosed as part of tracking system registration. Stakeholders have raised concerns related to how broadly this requirement could apply to employees within the registered entity. Staff will strive to limit the employee disclosure to only those individuals whose job duties require them to have access to tracking system account information, compliance instrument procurement, or emissions obligations.

Stakeholders have also expressed concern that the amendments related to contractor disclosure are too broad and may require disclosure of attorneys, which may require waiving attorney-client privilege. It is not staff’s intent to interfere in attorney-client privilege and staff will coordinate with stakeholders to craft regulatory language to limit this disclosure requirement to contractors that have access to tracking system account information, compliance instrument procurement, and emissions obligations.

Auction Registration Information: Stakeholders have expressed concerns related to the amount of registration information provided to ARB in the Compliance Instrument Tracking System Service (CITSS) that must remain static prior to and after each auction in order to be eligible to participate at auction. Staff will work with stakeholders, the market monitor, and the auction administrator to identify the subset of critical data that must remain constant from the time of auction registration until the auction is settled in order to ensure a fair and competitive auction for all participants. Staff will also make clarifications that any disclosure of previous or ongoing investigation by a regulatory agency does not in itself prohibit an entity from participating in the auction.

Market Rules: Staff proposed 45-day modifications to the information reporting requirements when compliance instruments (i.e., allowances and offsets) are transferred from one entity to another in CITSS. These requirements are necessary to monitor the secondary trading market and provide accurate information for public reports for program transparency. Stakeholders have expressed concerns that these amendments may unintentionally prohibit certain types of contracts that are commonly used in market trades. Staff will continue to work with stakeholders, the Commodities and Futures Trading Commission (CFTC), the State Attorney General's Office, the market monitor, and others as needed to ensure the regulatory requirements do not unnecessarily prohibit contracts such as forwards or other commonly used secondary market trades while ensuring sufficient information is provided to ARB for the purposes of market oversight.