

August 11, 2011



The Honorable Mary Nichols  
Chair, California Air Resources Board  
1001 I Street  
Sacramento, CA 95814

Subject: **CalChamber's Comments on the California Air Resources Board's  
Cap-and-Trade 15-Day Rulemaking Package**

Dear Chairwoman Nichols:

The California Chamber of Commerce (CalChamber) appreciates the opportunity to comment on the California Air Resources Board (CARB) Cap-and-Trade 15-Day Rulemaking Package as released July 25, 2011.

The CalChamber is the largest broad-based business advocate in the state, representing the interests of nearly 15,000 California businesses, both large and small. Many of CalChamber's larger members will be directly covered by the cap-and-trade regulation, while many other smaller members will likely experience indirect impacts in the form of new costs passed down from upstream fuel and energy providers.

CalChamber strives to remain a constructive voice throughout the AB 32 implementation process in order to advance the greenhouse gas (GHG) emission reduction goals in a cost-effective manner while protecting California businesses and allowing for economic growth. We have long maintained that if designed appropriately, a market-based mechanism has the ability to garner significant GHG reductions in a cost-effective manner. Key features of such a program would necessarily include free allowance allocation, a broad use of offsets, and linkage to the federal or a regional program.

We are committed to ensuring GHG reductions are achieved while maintaining the competitiveness of California businesses and the health of the economy. CalChamber supports CARB's decision to implement a 'soft start' to the cap-and-trade program, adjusting the start date to 2013. We support this adjustment and believe it is important that CARB takes this time to ensure that the program is ready, functional and efficacious. As long maintained, with so much at stake and with the world watching, the importance of a well designed program is crucial in helping meet our AB 32 implementation goals, which is why a soft start to the cap-and-trade program is appropriate.

While there are some positive changes to the previous cap-and-trade regulation, the following comments focus on areas of concerns with the proposed 15-day rulemaking package of the cap-and-trade regulation which we believe will hinder the State's ability to achieve the required reductions in a cost-effective manner.

#### **Allowances**

While the regulation proposes to freely allocate most allowances, primarily to mitigate emissions and economic leakage, we have concerns that this approach does not guarantee 100% allowance allocation fairly amongst industry sectors. While it's important to aid highly energy intensive trade exposed entities through the free allocation of allowances, requiring medium or low leakage prone industries to purchase allowances in the second and third compliance period will unnecessarily increase the cost of compliance for businesses, expanding these costs across to other California businesses and consumers. As long as California moves forward by itself in a cap-and-trade program, the risk of economic leakage will remain high. CARB should take every step possible to avoid this scenario.

### *Benchmarks*

CalChamber understands CARB's difficulty and challenge in establishing the industry benchmarks. The valid purpose of distribution benchmarks is to establish equitable bases for distribution of free allowances within industries, taking into account the complexity and existing energy efficiency of California facilities. Appropriate calculation of benchmarks is essential so that industry sectors know the anticipated cost of compliance, and can plan for future operations, projects, expansion, etc. We agree with a benchmarking system that rewards those facilities that are more energy efficient so long as the benchmarks are set correctly.

CARB should not use benchmarking methodology to serve unrelated goals and thus undercut the basic principle of free allocation of allowances to prevent leakage of emissions and economic activity of energy intensive trade exposed industries. Benchmarks that penalize the superior efficiency of California industries relative to competitors in other states or that distort the distribution of allowances among industry members without regard to energy efficiency could result in significant allowance shortages for industry members relative to their in-state competitors. This will result in large allowance shortages for many facilities, with significant adverse impacts on California businesses and their workers.

### *Allowance Reserve*

CalChamber agrees that an allowance reserve is necessary, especially if intended as a cost-containment mechanism to moderate allowance prices. The allowance price reserve however is set too high. CARB is proposing to sell allowances through a Reserve Tier system where beginning 2013, allowances from the first tier will be sold at \$40/metric ton, allowances from the second tier will be sold at \$45/metric ton, and allowances from the third tier will be sold at \$50/metric ton. The tier reserve system along with the escalating cost of the reserve throughout the compliance years negates the overall purpose of the reserve, which is to serve as a cost-containment mechanism. We are concerned about the potentially high cost of allowances under this reserve system. We are also concerned about the manner in which CARB intends to fill the reserve by taking from the industry allowances. These are allowances that covered entities should receive freely in order to minimize economic leakage, but instead will be used to fill the price containment reserve at excessively high prices, negating the leakage issue and the overall point of a cost containment reserve.

### *Multi-year Allowance Allocation*

Under the current revision, CARB proposes to issue allowances on a one year forward basis and not multiple years. Choosing annual allocations over multi-year allowance allocations creates uncertainty for entities in terms of financial and capital planning purposes. It is not feasible for a facility to responsibly plan an expansion or retrofit for future years without knowing how it will obtain allowances to cover facility emissions in future years of the project.

### *Allowance Auction Revenue – Nexus*

CARB's proposal to raise funds via an auction for reasons outside of administrative fee purposes is beyond CARB's regulatory authority. CARB justifies an auction system as a means of lowering GHG emissions and satisfying requirements under AB 32. CARB proposes that revenues from an auction be appropriated to fund programs such as a community benefits fund, green collar employment training, and a low carbon investment fund. These and other proposed programs are outside the scope of administrative fees. We ask CARB to keep in mind that fees must be closely tied to the regulatory programs serving the fee payers, otherwise, these fees are actually taxes and are subject to a two-thirds vote of the legislature. Without a legitimate nexus, the above mentioned auction revenue proposals will likely be challenged as they are contrary to the legislative intent of AB 32.

### **Offsets**

CalChamber appreciates that the offset limit has been raised from 4% to 8% of a covered entity's compliance obligation. While we believe the extension of offset limitation is a step in the right direction, we believe that in order to reduce program costs, especially the high costs of a California-only program, a robust supply of offsets is required. Therefore, we encourage CARB to consider the inclusion of other offset protocols outside of the four protocols currently under consideration and to delegate authority for

offset approval to capable third parties. We believe that a broad qualitative use of offsets is an important cost-containment mechanism within the cap-and-trade program. Geographic limitations will result in unnecessarily high compliance costs. For that reason CalChamber urges CARB to consider the inclusion of other offset protocols with linkage to existing offset programs, near term linkage to regional programs such as the Western Climate Initiative (WCI), and future linkage to a possible EU offset program as well.

#### *Offset Buyer Liability*

The revision continues to propose that offset buyers be held liable in the event of offset reversals regardless of whether the reversal is intentional or unintentional. Failure to do so will constitute a violation resulting in CARB assessing penalties. CalChamber opposes buyer liability amongst the regulated entities and believes that enforcement of such liability ignores the purpose of approved offsets and a certification process supported by a third party verifier. Imposition of liability upon the buyer creates uncertainty that could raise transaction costs and suppress the market. It is reasonable to expect CARB, which approves every offset, to stand behind the offsets it approves, ensuring real, permanent and additional offsets without shifting any onerous liability burdens onto buyers.

#### *Unused Offset Forward Carry*

In an effort to provide flexibility and reduce compliance costs to regulated entities, CalChamber believes these entities should be allowed the flexibility of banking unused offsets on a year-to-year basis. Another mechanism that should be available to regulated entities is the ability to trade the balance of their remaining unused offsets to another company.

#### **Transportation Fuels**

CalChamber remains concerned about the impact of including transportation fuels under the cap beginning in 2015 and thus requests that the inclusion of these fuels be revisited. With no Western Climate Initiative (WCI) trading partners ready to link, California will be alone in the cap-and-trade program. A California-only fuels under the program should be further evaluated with all economic impacts taken into consideration – including cost and consideration for the fact that California is already implementing the Low Carbon Fuel Standard (LCFS). Given the importance of transportation on California's economy, and the significance of energy costs to nearly every resident and business in the state, it is imperative that CARB do a thorough analysis of the economic impact of CARB's current proposal to include fuels in a unilateral cap-and-trade program; making sure that costs are minimal and total benefits to California are maximized.

#### **Dispute Resolution Process**

Currently, CARB's Executive Officer (EO) retains sole authority of program implementation of both the cap-and-trade and the mandatory reporting regulations, including determining whether regulated parties have complied with regulations and setting the penalties for such program violations. These important decisions will be made unilaterally without a public process and will have an impact on California businesses. It is important for these regulated entities to have a fair and transparent process by which to appeal a decision.

CalChamber supports the adoption of a formal autonomous dispute resolution process that would enable facilities to challenge and resolve disagreements prior to potential enforcement actions through an equal process for all parties involved in any dispute. We believe this program should use an unbiased mechanism to resolve disputes, variances and penalty disagreements with the EO.

Without a fair, independent process, an entity's options are limited. Currently, an entity's only recourse is to challenge the decision in court, which requires significant resources and time. Lawsuits are not only costly but rarely solve the underlying problem. We are proponents of a transparent process that helps reduce money and time spent defending lawsuits so that regulated entities can instead focus their time and efforts on job creation and economic stimulation. Without a fair and transparent dispute resolution process, issues that could be resolved relatively quickly could become time-consuming litigation that could hinder the goals of AB 32.

**Monitoring and Review Process**

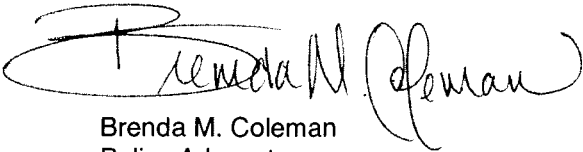
To ensure GHG reductions are achieved while maintaining the competitiveness of California businesses and the health of the economy, it is critical for CARB to monitor key indicators of not only the GHG reductions that are occurring but also indicators of the health of California's economy. We urge CARB to identify and monitor these key indicators, so that any inadvertent problems that may occur can be corrected before significant damage is done to California economy or environment.

We also urge CARB to include a periodic review process of the cap-and-trade program via a stakeholder advisory group to ensure emission reductions goals are being met in a manner that is both economically efficient and environmentally sound. Periodic reviews should include impact assessments of a California-only program to ensure that it meets the economic and emission reduction goals under AB 32. While ensuring GHG goals is important, it is equally important that consideration and oversight be given to any and all economic impacts, including those industries that would be both directly and indirectly impacted as a result of economic leakage. As CARB moves forward, we hope that these and other important issues are addressed with much diligence and oversight via an open forum that allows for public participation and comment in order to ensure transparency in the process and maintain integrity in the program.

Again, we appreciate your consideration and the opportunity to comment on the Cap-and-Trade 15-Day Rulemaking Package. We look forward to further communication as CARB continues to work on the important design elements of the program.

Should you have any questions, please feel free to contact me at (916) 444.6670.

Sincerely,

A handwritten signature in black ink, appearing to read "Brenda M. Coleman", written over a horizontal line.

Brenda M. Coleman  
Policy Advocate