



September 27, 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 Second 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 **Second** 15-Day Rulemaking Package as released September 12, 2011.

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 a federal or regional program.

As CARB released its Second draft amendments to the Cap-and-Trade Regulation, CalChamber is disappointed to see that the Board addressed nearly none of the concerns raised in our previous comment letter dated August 11, 2011. The comments submitted expressed concern for the current design of the program and recommended modifications that are vital to ensuring an operable, cost-effective market designed to meet the GHG emission goals of AB 32. Without the recommended changes, the cap-and-trade regulation remains incomplete, and lacks the confidence and certainty needed toward successful implementation.

CalChamber provided comments on the following design elements and because these issues were not modified, we believe it is appropriate to *re-submit* our August 11th comment letter to you again as a supplement (Attachment 1) to our **Second** 15-Day Rulemaking commentary. Below is a summary of the issues raised by CalChamber in the August 11th letter:

- Allowances – The need to freely allocate allowances to mitigate emissions and economic leakage.
 - Benchmarks – Appropriate and equitable benchmark methodology is important as it serves the fundamental basis for the distribution of free allowances. CARB should not

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- 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.
- Allowance Reserve – Price containment in the proposed allowance reserve is necessary if the reserve is to be a true cost-containment mechanism.
- Multi-year Allowance Allocation – CARB's proposal to issue allowances on a one year forward only basis creates uncertainty for entities in terms of financial and capital planning purposes.
- Allowance Auction Reserve – Nexus - Raising funds via an auction for reasons outside of administrative fee purposes is beyond CARB's regulatory authority.
- Offsets - A robust supply of offsets is required in order to reduce program costs. Therefore, a consideration of offset protocols, outside the four currently under consideration, is encouraged.
 - Offset Buyer Liability – Opposition to buyer liability in the event of offset invalidation. Imposition of liability upon the buyer creates uncertainty that could raise transaction costs and suppress the market. *While CalChamber recognizes some positive changes were made in the Second-15 Day Rulemaking Package, these changes are not significant enough to relieve our concern that the buyer liability provision will prevent the creation of an adequate offsets market.*
 - Unused Offset Forward Carry – Regulated entities should be allowed the flexibility of banking unused offsets on a year-to-year basis.
- Transportation Fuels - The inclusion of transportation fuels under the cap beginning 2015 should be re-visited. The economic impacts of a California-only fuels under the program should be further evaluated – including cost and consideration for the fact that California is already implementing the Low Carbon Fuel Standard (LCFS).
- Dispute Resolution Process – 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.
- Monitoring & Review Process – A periodic review of the cap-and-trade program is critical to ensure GHG reductions are achieved while maintaining the competitiveness of California businesses and the health of the economy.

In addition to the above mentioned items – all of which we encourage you to consider modifying, the following elaborates on CARB's continued proposal to withhold allowances from regulated entities. We believe this is a tax that will hinder the State's ability to achieve the required GHG reductions in a cost-effective manner.

The 'Haircut'

The current cap-and-trade proposal continues to arbitrarily set the benchmark for industry sectors at 90% of the industry average, which would require regulated entities to purchase 10% of their allowances at the start of the program. CARB's proposal to withhold 10% of emission allowances (the 'haircut') is an unjustified tax on business that will lead to leakage of production and jobs while failing to reduce GHG emissions required under AB 32. The 10% haircut puts California companies at an immediate competitive disadvantage and runs contrary to CARB's recognition of a 'soft start' transition intended to mitigate economic and emissions leakage. So long as California continues to move forward by itself in a cap-and-trade program, the risk of economic leakage remains high; CARB must take every step to avoid this scenario. The best way to avoid these impacts and to mitigate risk to energy intensive trade exposed industries is through the free allocation of allowance. 100% allowance will provide the necessary

transition to a lower-carbon economy, and allows businesses to stay competitive and keep investments in the State.

Imposing a 10% tax on business via CARB's haircut proposal does nothing to 'maximize the environmental benefits' requirement under AB 32, and it is not needed to ensure the stringency of the overall cap – emission reductions will still be achieved by the 2020 goal. The tax proposed by CARB contradicts the AB 32 requirements of 'minimizing costs' and 'maximizing benefits' for California's economy in the design of emission reduction measures. The tax will negatively affect all California businesses, in addition to the anticipated fuel, energy and other cost increases that will be passed down to businesses from upstream providers. Ultimately, as California's economy suffers so too will employment, as an impact on business means an impact on jobs. Employers will be forced to reduce productions or lay off employees as the cost of compliance will make California less competitive with out-of-state businesses. With a 12% unemployment rate it is irresponsible to ignore the adverse economic impacts of the haircut by continuing to move forward with this egregious tax proposal.

CalChamber is concerned that CARB intends to fill the allowance reserve, which was intended to be a cost-containment mechanism, with allowances from the haircut. These are allowances that should otherwise be freely allocated in order to minimize emissions leakage. Instead, CARB is proposing to profit at industry's expense by selling the reserve allowances at arbitrarily high prices, a major concern for CalChamber (see Attachment 1, *Allowance Reserve*). This proposal negates the purpose of an allowance reserve as a cost-containment measure by increasing program cost with no overall program benefit.

CARB has estimated the sale of allowance proceeds to be about \$500 million in the first compliance period and up to \$2 billion in the second and third compliance periods. CalChamber has long maintained that CARB's proposal to raise funds via an auction for reasons outside of administrative fee purposes is beyond CARB's regulatory authority. And throughout the regulation process, CARB has publicly identified possible revenue uses from the sale of allowances, even directing CARB's Executive Officer to deposit a percentage of annual proceeds to fund programs that 'reduce GHG emissions or mitigate direct health impacts of climate change, and promote green collar employment opportunities in the most impacted and disadvantaged communities in California...' (*CARB Board Resolution 10-42*). We caution CARB that these and other spending proposals are clearly outside the scope of administrative or regulation-related fees. CARB must keep in mind the State Constitutional requirement that fees must provide either a direct benefit or service to the fee payer, or be directly connected to a reasonable regulatory program serving the fee payers, otherwise, these fees are actually taxes and must be approved by a two-thirds vote of the legislature. Without a legitimate nexus, the above mentioned auction revenue proposals will likely be challenged since they are not only contrary to the legislative intent of AB 32 but are contrary to the procedural requirements of the State Constitution.

We appreciate your consideration and the opportunity to comment on the Cap-and-Trade **Second** 15-Day Rulemaking Package. We urge CARB to take the time to address the issues raised in *both* sets of CalChamber's 15-day comment letters. The suggested modifications are crucial to ensure that the program is ready, functional and efficacious. As long maintained by CalChamber, for California to be a leader in climate change, it is critical to design a cost-effective program that reduces GHG emissions while allowing for continued economic growth.

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 Coleman". The signature is fluid and cursive, with the first name "Brenda" being more prominent than the last name "Coleman".

Brenda Coleman
Policy Advocate

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

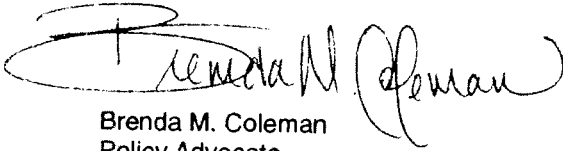
To ensure GHG reductions are achieved while maintaining the competitiveness of California businesses and the health of the economy, it is critical for CARB to monitor key indicators of not only the GHG reductions that are occurring but also indicators of the health of California's economy. We urge CARB 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". The signature is fluid and cursive, with a large initial "B" and "C".

Brenda M. Coleman
Policy Advocate