AB 32 Implementation Group

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

September 27, 2011

To: Mary Nichols, Chair
California Air Resources Board

Fr: The AB 32 Implementation Group

Re: CARB's Cap-and-Trade 2nd 15-Day Rulemaking Package

The AB 32 Implementation Group is a coalition of business and taxpayer groups working for effective implementation of AB 32. Our goal, has been, and continues to be to serve as a constructive voice in the implementation of AB 32 and ensure that the greenhouse gas emission reductions required by the statute are achieved while maintaining the competitiveness of California businesses and protecting the interests of consumers and workers.

As we come closer to the deadline for submitting the rule to the Office of Administrative Law, we want to express our concern about the 15-day comment process and the need for further rule changes and updates next year. The rule is extremely complex and it will have a large impact on the California economy. In that regard, we would request the California Air Resources Board (CARB) include in the Final Statement of Reasons (FSOR) a schedule by which workshops and needed revisions will occur so the public can schedule and provide feedback in order for the staff to hear and incorporate reasonable changes to the rule.

We appreciate the modest improvement you have proposed for the rule, but we submit these comments to reaffirm the need for changes to elements we brought to your attention in comments for the first 15-Day Rulemaking Package.

The AB 32 IG still has significant concerns about specific elements of the cap-and-trade proposal that arbitrarily increase the compliance cost and leakage, at the cost of jobs and economic growth at a time when California businesses and workers desperately need both. These elements are not necessary to implement the stringency of the cap itself, and therefore have no environmental benefit; all they do is increase compliance costs and create leakage. AB 32 itself requires CARB to "[d]esign the regulations, including distribution of allowances where appropriate, in a manner that is equitable, [and] seeks to minimize costs" and "[m]inimize leakage." Cal. Health and Safety Code section 38562(b)(1) and (8).

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One of CARB's most important policy responsibilities in cap-and-trade design is cost-containment, to minimize leakage and costs. Two key tools for cost-containment are direct allocation of allowances without charge, and the use of offsets. Unfortunately, CARB continues to advance limitations and restrictions on both of these tools that directly frustrate AB 32's legal requirements.

EMISSION LEAKAGE, ALLOWANCE ALLOCATIONS & PROPOSED ARBITRARY "HAIRCUT"

Protecting against leakage of emissions and jobs must continue to be the paramount cap-and-trade design issue for CARB. With none of California's neighboring states committing to climate targets and policies, emissions leakage will continue to be a risk for the program and a risk for California businesses. Unlike their out-of-state competitors, California's industries will face carbon costs that will make them less competitive. While CARB appears to recognize the need to protect California's carbon-intensive trade exposed industries by proposing direct allowance distribution to these industries, the proposed arbitrary 10 % "haircut" is completely inconsistent with the need to protect these industries and California jobs.

CARB should NOT arbitrarily withhold up to 10% of the allowances that trade exposed and energy intensive industries need in order to minimize costs and leakage. Yet, CARB continues to propose an arbitrary 10% reduction in the number of allowances to be distributed to leakage prone industries. This is inequitable, does not minimize costs, and does not minimize leakage. It is not necessary or even helpful in ensuring the stringency of the overall cap. CARB should discontinue this proposal, and should not arbitrarily withhold allowances that it has already determined these industries need.

We would note the irony in CARB's intent to provide an allowance reserve (from which allowances will be sold at arbitrarily high prices) as a cost containment mechanism, and then propose to fund that reserve by withholding allowances that it should be directly allocating to leakage prone industries without charge. In this framework, the allowance reserve is not a cost-containment measure, but an arbitrary cost increase with no overall program benefit.

It is also disappointing CARB continues to propose less than 100% allowance allocation to the industrial sector in future compliance periods. The leakage analysis is insufficient to justify this. It is also premature to make this decision when there is time to do such analysis prior to the 2015 compliance time period. This decision should depend on the level of participation by other states and jurisdictions in the program as a key metric for how much each industry sector is at risk for leakage.

FUELS-UNDER-THE CAP

We also believe treatment of fuels-under-the-cap issue needs to be revisited. The Scoping Plan proposed inclusion of transportation fuels in the cap-and-trade program beginning in 2015, largely due to the expectation that Western Climate Initiative states would address fuels this way in their state programs. Since California is already implementing the Low Carbon Fuel Standard, and no WCI states are prepared to link to California, we recommend that the leakage impacts of a California-only fuels-under-the-cap (on top of the LCFS) be re-examined.

Since CARB does not intend to implement Fuels under the Cap until the 2015-2017 compliance period, it is important for CARB to take the opportunity now to assess all available alternatives in addressing transportation fuels in a simple and comprehensive framework under AB 32.

OFFSETS

CARB has established a very stringent framework both for existing offset protocols and for approving new offset protocols. Despite modest improvements to the rules relating to invalidation of offset credits and buyer liability, these requirements are likely to arbitrarily limit the size of the offset market available to California businesses and offset developers.

Given this level of stringency, as we have commented previously, CARB should not continue to set an arbitrary limit on the number of offsets that can be used to meet a compliance entity's surrender obligation. The proposed 8% limit is no more likely than the previous 4% limit to provide enough offsets to meet the needs of a growing economy in California. As with the arbitrary withholding of necessary allowances for leakage prone industries, this arbitrary limit on the number of offsets that can be used increases costs and leakage.

Another significant cost and leakage driver in the offsets requirements is CARB's ability to decertify an offset after it has been purchased (and even surrendered) and impose liability for this decertification on the offset purchaser. Given the stringency of offset approval, it is questionable why CARB would even propose to decertify offsets that had already qualified under the most rigorous rules. It arbitrarily increases costs and leakage to then punish an offset purchaser by imposing liability for the decertification on the purchaser. This will have the direct effect of pulling allowances out of the market as a hedge against decertified offsets, raising allowance prices and compliance costs and leakage for all capped entities.

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DISPUTE RESOLUTION PROGRAM

Currently the cap-and-trade and mandatory reporting regulations give CARB's Executive Officer sole authority on program implementation, including determining whether regulated parties have complied with regulations and to determine penalties. Absent costly and time consuming litigation, there is currently no independent administrative option for stationary source facilities to challenge the Executive Officer's decisions that could not be resolved.

The AB 32 IG believes the Executive Officer should not have the final decision on such a comprehensive program as AB 32, and instead it would be in both CARB's and the regulated industry's best interest that a formal, autonomous dispute resolution process should be established in order to provide independent decision making with equity for all parties involved in any dispute.

This program should use an unbiased mechanism to resolve disputes, variances and penalty disagreements with the Executive Officer. Without such a program issues that could be resolved relatively quickly could become time-consuming litigation which could hinder the goals of AB 32.

INDUSTRY STAKEHOLDER ADVISORY

The AB 32 Implementation Group supports and encourages a stakeholder advisory committee to provide continual and thoughtful feedback to CARB as the program rolls out during the next few years.

CONCLUSION

We hope you will address these concerns as you move forward in the implementation of AB 32. The AB 32 IG continues to advocate for periodic program review in order to assure we are achieving the environmental and economic goals set forth in AB 32. Should you have any questions or need anything further from us, please feel free to contact Shelly Sullivan (916) 858-8686.