



January 23, 2013

Steve Cliff, Branch Chief
Climate Change Program Evaluation Branch

Rajinder Sahota, Manager
Climate Change Program Operating Section

California Air Resources Board
1001 "I" Street, Sacramento, CA, 95812

Re: Comments on 15-Day Notice of Proposed Amendments to the Cap-and-Trade Regulation to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions.

Dear Mr. Cliff and Ms. Sahota:

On behalf of the Natural Resources Defense Council, and our more than 80,000 members in California, we appreciate the opportunity to comment on the proposed amendments to amend the cap-and-trade regulations to allow for the use of compliance instruments from linked jurisdictions.

Linking has many potential benefits for California. Expanding the size of the market will reduce greenhouse gas emissions beyond what could be achieved through a California-only program, and provides greater flexibility to California sources by encompassing a wider range of emissions reduction opportunities, who may enjoy gains from trade if reductions can be achieved more cheaply in-state (which ARB's economic analysis forecasts is likely relative to Quebec). Linking to a larger and more liquid market can also improve the performance of California's program by reducing price volatility and the potential for market manipulation. Most importantly, maintaining momentum for the surge in bottoms-up policies at the sub-national level to reduce greenhouse emissions will be instrumental in mitigating the impacts on the health and welfare of Californians from climate change.

But there are also challenges. California's carbon market is in its nascent stage, and will require diligent monitoring and oversight to ensure a smooth start. While we strongly support the design of the California and Quebec programs, each developed under the rubric of the Western Climate Initiative (WCI), ARB must retain its capacity to promptly address potential contingencies that impact the California market. Accordingly, before California links its cap-and-trade program to that of another jurisdiction, including Quebec, we recommend ARB develop a protocol to outline a process and shared set expectations regarding subsequent modifications to the operation or design of a linked partner's cap-and-trade system.

1. Maintaining California's Leadership in Promoting Regional Climate and Clean Energy Solutions

Linking California and Quebec's cap-and-trade programs will set the stage for the first regional, economy-wide carbon market in North America, adding momentum to the proliferation of climate and clean energy strategies already underway in regions and localities around the world. Based on ARB's economic analysis provided in the record, linkage with Quebec will also drive additional investment into California, as emission reduction opportunities are projected to be cheaper in California than in Quebec.¹ The additional flow of revenue into California will boost the state's economy and can buttress the state's growing clean energy sectors.

Linking also offers opportunities to bolster and expand a broad array of energy and climate policies. Quebec's public transit policy, aggressive renewable energy targets and emphasis on clean tech and green job creation align with California's own initiatives under AB 32. Continuing the state's leadership role in promoting regional climate solutions through the WCI, North America 2050 (NA2050), and other sub-national partnerships will promote best practices and lessons learned on the entire suite of policies California is pursuing under AB 32.

2. Environmental Integrity and Review

Before linking with another jurisdiction, ARB must ensure the proposed linkage will not undermine the environmental integrity of California's program. As both Quebec and California's cap-and-trade programs adhere to shared WCI design principles – including the stringency of the cap, mandatory emissions reporting and verification requirements, criteria on offsets quality, limits on borrowing, and adequacy of penalty and enforcement mechanisms – we find linking with Quebec would not infringe on the integrity or environmental performance of California's program. As the record reflects, recent amendments to Quebec's program would bring the programs in even closer alignment.

But ARB must also ensure that the environmental integrity of California's program is maintained over time. Although we are encouraged by the strong working relationship between ARB and their Quebec counterparts, ARB should not trust in this relationship alone as a means of approaching ongoing implementation issues that may affect the linked programs. We therefore recommend ARB develop a protocol with Quebec and any future trading partners, in advance of linking, to review and assess subsequent changes in the design or operation of a linked partner's cap-and-trade system, including the approval of new offset protocols. The protocol would provide additional clarity and certainty to market participants and stakeholders on how ARB will approach ongoing harmonization issues and, as a last resort, a process for de-linking. At a minimum, ARB should provide public notice and opportunity to comment on any substantive changes to a linked jurisdiction's cap-and-trade program and bring those changes to the Board for review and consideration

¹ ARB, "Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions Staff Report: Initial Statement of Reasons," p.91-92 (May 9, 2012).

3. Government Code Section 12894 Findings

We support ARB's conclusion that linkage with Quebec satisfies the four conditions outlined in Government Code section 12894. Prior to linking California's cap-and-trade program to a program in another jurisdiction, section 12894 requires the Governor, upon the advice of the Attorney General, to make the following finding: (1) the linked program is equivalent to or stricter than AB 32; (2) the proposed linkage would not diminish California's ability to enforce AB 32; (3) the proposed linkage ensures program requirements are fully enforceable in the linked jurisdiction; and (4) the proposed linkage, and California's related participation in WCI, Inc., would not impose significant liability on California.

Regarding the first factor, we agree Quebec's mandatory greenhouse gas reduction targets are equivalent to or stricter than California's. Quebec's overall emission reduction target is numerically more stringent than California, as it calls for a 20 percent reduction below 1990 emission levels by 2020. As emissions-free hydropower already accounts for nearly all of Quebec's electricity generation, Quebec's reduction target will be particularly aggressive in driving reductions from other capped sectors. Finally, as noted above, due to both jurisdictions' adherence to joint design principles developed through the WCI, Quebec's program contains nearly identical provisions on key environment design components such as emissions reporting and verification, offsets quality, and penalties for noncompliance.

With regard to enforcement, we agree that the rules and regulations adopted in California and Quebec provide sufficient authority for each jurisdiction to fully enforce their respective emission reduction programs. As in California, daily monetary penalties may be assessed for violations of Quebec's emission reduction requirements (with higher maximums than in California), and automatic penalties attach to any shortfall in submitting compliance instruments under the cap-and-trade program. Every market participant in either program, mandatory or opt-in, must also affirmatively submit to the jurisdiction in which they registered.

But enforcement practices and coordination efforts cannot be entirely assessed in advance. Joint participation in WCI, Inc. will help streamline and harmonize administrative functions that bear on enforcement, such as compliance instrument tracking and market monitoring. The strong ties developed between ARB and regulators in Quebec in preparing to link also provides confidence that joint collaboration and attention to enforcement will continue. Prior to formalizing linkage, however, we recommend ARB include in the protocol recommended above a process for reconciling differences that may emerge in the stringency or approach to enforcement between linked jurisdictions.

We appreciate ARB's consideration of both the benefits and challenges of linking as reflected in the information and analyses provided in the rulemaking record. We look forward to working with ARB as it finalizes the linkage to Quebec and explores other avenues to export California's suite of clean energy programs developed under AB 32.

Sincerely,

Alex Jackson
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