**California Council for Environmental and Economic Balance**

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August 2, 2013

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

Via email:

**RE: Proposed Amendments to the California Cap-and-Trade Program**

Dear Chairman Nichols:

The California Council for Environmental and Economic Balance (CCEEB) is a non-partisan, non-profit coalition of business, labor and public leaders that advances strategies for a strong economy and a healthy environment. CCEEB appreciates the work the California Air Resources Board (ARB) has completed since the adoption of the California Cap-and-Trade Program (Cap-and-Trade). We would also like to thank you and your staff for being open and accessible to our membership as this program developed. CCEEB hosted technical workshops in which ARB staff presented and answered questions. This was an invaluable exercise that we believe helped inform compliance entities and reduced the uncertainty of transitioning into the initial Cap-and-Trade auctions.

CCEEB appreciates the currently proposed changes to the industry assistance factor (IAF) and the broader coverage for new or opt-in entities. We are still concerned that the analysis for trade exposure on a state level is an untested new process with potential for inadvertent oversight and errors but believe these changes will provide additional time to further study the leakage potential process and the cumulative impacts of other complementary measures on California businesses.

CCEEB agrees with ARB's approach to recognize the environmental and economic challenges that result from imposing a Cap-and-Trade program solely at the state level. The proposed extension the IAF for an additional compliance period and further research on the specifics of trade exposure, will help ease the transition to a low carbon economy. In the absence of national and global greenhouse gas policies, California business sectors will be trade exposed. The cost of carbon will be set by the direct measures adopted under AB 32, including 10% of allowances withheld, and the declining cap.

ARB should continue researching the implications of allowance allocation and potential impacts to trade-exposed businesses prior to the second compliance period in order to avoid any detrimental impacts in future compliance periods. As the statute emphasizes cost-effectiveness, a conservative approach of assuming an entity is trade exposed could guard against harmful economic impacts of unnecessarily reducing the industrial assistance factor in future compliance periods.

ARB has identified certain business sectors in the Cap-and-Trade program as energy-intensive and trade-exposed (EITE) requiring assistance to mitigate transition risk and emissions leakage risk. CCEEB recommends that the ARB continue an on-going dialogue with stakeholders to ensure successful implementation of the overall program. In particular, dialogue must focus on:

- The potential contribution of reductions in allowances to leakage of jobs and emissions to facilities outside the state;
- Additional documentation needed to evaluate the impacts of the allowance reduction on the Cap-and-Trade market and the statewide economy;
- Options to reduce the impacts of the reductions on EITE sector entities

In reviewing the market design, CCEEB believes that an open market allows participants to comply at the lowest incremental cost. That result encourages business stability in the state and hopefully expansion and job growth. Unnecessary restrictions placed on the operation of the market potentially restrict the market's ability to perform as a process that allows the lowest cost compliance.

Portions of the current regulation may unnecessarily constrain the market. The advantage of a Cap-and-Trade program is to allow compliance entities to create solutions that best fit their business models and consumer behaviors. Due to the small market currently proposed initially, some limitations may be necessary. However, care must be taken to ensure market liquidity. Of particular concern are:

**Holding Limits**

- The current holding limit is too restrictive for regulated entities with large compliance obligations. Significant amounts of allowances, for large compliance entities will be locked in compliance accounts. This creates an uneven playing field that favors traders over regulated entities. Compliance entities, especially those with large compliance obligations, must be able to hold and trade a larger portion of their allowances to adequately manage their risk throughout the Cap-and-Trade program.

- CCEEB recommends that the program allow compliance entities to hold, in holding accounts, sufficient allowances to cover their obligation for the entire compliance period based on a rolling three-year emissions obligation. This change would free up allowances for the major compliance entities and enable a much more liquid market where an entity could adequately hedge its forward risk without major complications. While there are still allowances locked in compliance accounts in some years, the increase in holding limits makes these limitations much more manageable.

- Holdings limits are intended to prevent one entity from cornering the market. However, holding limits also place significant strain on many compliance entities. Auction frequency would ostensibly alleviate the concern of one entity cornering the market while creating more liquidity within the market. CCEEB recommends moving towards monthly auctions in order to avoid the need for holding limits.

**Compliance Process**

- Business fluctuations at the end of a compliance period are anticipated. These fluctuations could adversely impact the smooth operation of the market. CCEEB recommends that current vintage allowances (i.e. borrowing from the current year) be allowed to be used during the true-up period (i.e. the time between the end of a compliance period and when that compliance period's obligation is due). This will provide a mechanism for end of compliance period truing-up that will increase market confidence.

CCEEB supports the use of high-quality offsets to constrain costs. While CCEEB believes offsets should only be limited based only on quality as opposed to imposing quantitative or geographic limits, we recognize the position of the ARB. But for price containment purposes, offset credits should be allowed without any geographical or quantitative restrictions if the price containment reserve is becoming depleted.

Essentially all of the studies on the economics of Cap-and-Trade demonstrate that offsets can be used to contain costs. In some models (most notably those by USEPA, CRS and CRA), Cap-and-Trade program cost reductions range from 40% to 80% depending on the model and the restrictions on the use of offsets. Within California and the nation, economic modeling has demonstrated that offset projects can provide near-term opportunities for cost-effective, verifiable GHG reductions that deliver long-term, sustained emissions reduction benefits.

Arguments in favor of limiting offsets due to localized impacts have been eliminated by the ARB Co-Pollutant Emission Assessment[1] that indicates de minimis co-pollutant co-benefits from quantitative and geographic restrictions of offsets. This analysis has dispelled concerns over greater potential increases in co-pollutant emissions as well as assumptions that communities could significantly benefit from additional co-pollutant reductions. As such, there is no reason to limit the use of offsets as a compliance instrument to provide long-term cost containment while providing environmental integrity.

Restricting offsets generation to projects located within a certain geographic sphere or to those that provide co-benefits is contrary to what should be the fundamental aim of an offsets program, i.e. maximizing GHG reductions at the least cost to mitigate the effects of global warming. Additional limits on offsets geographically will increase California allowance costs and potentially create leakage. Cost containment via added offsets is consistent with the goals of the program.

Developing economies are using more energy to fuel their economic growth, thereby increasing global GHG emissions, while at the same time rejecting binding caps on emissions. If we place

[1] Cap-and-Trade Initial Statement of Reasons, Part I, Volume VI, Appendix P, Co-Pollutant Emissions Assessment

constraints on finding low-cost offsets in the name of obtaining local co-benefits or creating local "green jobs," California will deter the adoption of similar GHG policies in other nations. Moreover, imposing limits on the use of offsets—either quantitative or geographic—simply raises the cost of the emission reduction program to California residents. This increased cost will affect the ability to reach longer term and increasingly challenging emission reduction targets at a cost that is acceptable to society.

The ARB should to delegate issuance of ARB offset credits (ARBOCs) to third party registries, adopt additional offset protocols, and recognize regional, national and international offset programs, while working with California regulators and other stakeholders to facilitate the development of developing projects in California in the event that long-term demand for allowances begins to drain the price containment reserve.

CCEEB recommends that the ARB delegate issuance of ARBOCs to third parties and adopt new protocols rapidly to ensure that adequate supply is available in the second compliance period. Additional supply options should include:

a) Use of additional Climate Action Reserve Protocols;
b) Use of applicable American Carbon Registry approved methodologies
c) Supporting the development of Pilot REDD Projects;
d) Allow use of Climate Action Reserve Landfill Credits generated before 2012;
e) Approve protocols developed by California air districts, as appropriate.

**Cost Containment**

Resolution 12-51 has asked ARB staff to examine several parts of the Cap-and-Trade program for cost containment. While this work may have taken place internally it is important for ARB to present these findings to stakeholders along with potential amendments or justifications for the status quo. Additionally, CCEEB supports the following recommendations[2] to implement from the Joint Utility Group (JUG):

> A) Measures which take effect now and gradually over time reduce the likelihood of prices rising above the APCR in the future by: 1) reducing demand for compliance instruments; 2) increasing the supply of compliance instruments; and 3) ensuring that compliance instruments are accessible in the marketplace.
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> B) Measures that, when triggered, would quickly alter compliance instrument demand/supply dynamics and constrain upward pressure on market prices for a period of time. An example trigger is a percentage level of depletion of the APCR.
>
> C) Measures that, when triggered, would keep allowance prices at the third tier of the APCR regardless of current demand, while preserving the environmental integrity of the Cap-and-Trade Program over time.

Consideration and implementation of the specifics from the JUG proposal should address many of the findings from Resolution 12-51 and will provide certainty that there are mechanisms in place to avoid third tier costs of the APCR.

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[2] http://www.arb.ca.gov/cc/capandtrade/meetings/062513/industry-present.pdf

AB 32 implementation is still in a critical stage in regulatory development and ARB should give significant consideration to achieving the goals in a manner consistent with the statute, which clearly enumerates that the policy should, "achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions."

Thank you for considering our comments. If you wish to discuss this matter further, please contact Bob Lucas at 916-444-7337.

Sincerely,

Robert W. Lucas
Climate Change Project Manager

Gerald D. Secundy
President

cc: The Honorable Jerry Brown, Governor, State of California
Nancy McFadden, Executive Secretary to Governor Brown
Cliff Rechtschaffen, Senior Advisor to Governor Brown
Matthew Rodriguez, Secretary, California Environmental Protection Agency
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