AB 32 Implementation Group

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

**TO:** Dr. Steve Cliff, California Air Resources Board
Chief, Climate Change Program Evaluation Branch

**FR:** AB 32 Implementation Group

**DATE:** July 9, 2013

**RE:** Cap-and-Trade Public Meeting To Discuss Market Related Reporting And Cost Containment – June 25, 2013

*Submitted Electronically*

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The AB 32 Implementation Group is comprised of employers and taxpayer groups advocating for policies to achieve greenhouse gas emission reductions to meet AB 32 goals in a manner that will protect jobs and the economy.

These comments are in response to the California Air Resources Board (CARB) workshop 'Cap-and-Trade Public Meeting To Discuss Market Related Reporting And Cost Containment'– June 25, 2013.

Implementation of AB 32 is a massive undertaking that poses enormous risks to a recovering California economy. Job creation continues to lag behind the national levels, and new business investments in California continue to be lackluster. As we prepare for the second compliance period in the cap-and-trade market, it is imperative that CARB take this opportunity to simplify, streamline, and preserve options for mid-course corrections against the potentially disastrous market and economic consequences of AB 32 regulations.

A well functioning market has clear, stable rules that participants can trust will not result in adverse conditions. If very high allowance prices in future years will be unacceptable to policymakers, the cost containment policies need to be adopted as soon as possible. Price spikes that could cause the market to break in the manner experienced during the 2000/2001 electricity crisis would be devastating to the California economy and the effort to encourage other jurisdictions to pursue similar GHG emission reduction programs. There is time to make the necessary adjustments to the Scoping Plan and cap-and-trade program that will succeed in meeting the greenhouse gas reduction goals set forth in AB 32 while avoiding or reducing the damage that high prices represent.

Allowance prices reflect the demand and supply for allowances. But CARB has yet to recognize that the biggest cost containment threat factor will be a growing economy. California companies will be eager to take advantage of market opportunities after a half decade of dwindling production, declining profits, and job losses due to retreating markets. A failure by CARB to acknowledge the impacts of high allowance prices, insufficient reserves, or an inadequate response by CARB to allowance price fluctuations will ensure a cap-and-trade crisis. Such a crisis will stifle the California economy and result in significant emissions leakage undermining the environmental integrity of the program.

Therefore, at a minimum, CARB must immediately address cost containment issues including industry assistance levels, holding and purchase limits, and the availability and expanded use of offsets for compliance. These adjustments must be made in order to assure businesses and industries of the stability of the cap-and-trade market as well as help to ameliorate the threat posed by prices exceeding the Allowance Price Containment Reserve (APCR).

Steps that can and should be taken include:

- Providing 100% Assistance Factor to all trade exposed industries
- Expediting the availability of offsets and removing the limitations on the use of offsets for compliance
- Providing an up-to-date Emissions Inventory
- Conducting a thorough economic analysis on the existing programs marginal costs in achieving GHG emission reductions and modifying programs accordingly

**Industry Assistance Levels**

In last year's report to the Legislature, CARB announced that in order "[t]o meet the target, the climate program must cut 80MMT of CO2E in 2020. California is on track to achieve this AB 32 goal."

Yet, it is likely to be CARB's own refusal to make the necessary adjustments to the climate program that presents the biggest threat to the ultimate success of the program. In that statement, CARB acknowledges that the AB 32 goals are the result of the 2% per year declining cap on emissions in the cap-and-trade program. A conclusion that is confirmed by the independent Legislative Analyst's Office.

Simply put, maintaining the current level of industry assistance through 2020 sends a sufficiently strong carbon price signal to obligated industries without withholding and other artificial manipulations of allowance pricing in the market. As CARB's plan also includes a 10% additional reduction requirement and energy efficiency benchmarks which ensure continued efficient and economic progress on emissions reductions, CARB's focus should be on recognizing the sources of uncertainty in future allowance prices as represented by the APCR.

There is a compelling need for this change to contain costs in the program – economic recovery, both here in California and in the nation. CARB has not adjusted the program to reflect the reality that no other states have joined the cap-and-trade regulation and there is no operating national carbon trading program. This is not likely to change. The recent proposal from the US EPA would only regulate power plant emissions, not industry sectors. The risk of leakage due to costs incurred by California industry but not their competitors is high.

It is good news for California that the economy and jobs can be protected by maintaining the 2013/14 level of assistance for all industries in the second and third compliance periods and also meet AB 32 goals. For this reason we urge CARB to immediately classify all industries as eligible to receive industry assistance at the 2013/14 levels through 2020 to contain costs for the regulated industries.

**Offsets**

Offsets are a time proven cost-containment mechanism. But a failure to fully utilize this tool will diminish its effectiveness. The stringent criteria that result in extensive delays for approving offset protocols are counterproductive and weaken the cost-containment potential that abundant and reasonably priced offsets offer market participants. By artificially limiting the size of the offset market available to California businesses and offset developers, CARB effectively neutralizes the vital cost controlling aspects of an offset program.

CARB should remove the arbitrary limit on the number of offsets that can be used to meet a compliance entity's surrender obligation. The 8% limit is inconsistent with the current implementation requirements (technologically feasible and economically efficient) and will not provide sufficient offsets to meet the needs of a growing economy in California. The limit on the number of offsets increases reliance on the APCR in the case of a disastrous price spikes, almost ensuring increases in compliance costs and the risk of leakage.

**Emissions Inventory**

CARB's failure to present an updated emissions inventory prior to devising "fixes" for the cost-containment threats is revealing. It continues to show CARB's misplaced focus and lack of understanding of free market dynamics. In order to determine whether regulatory adjustments to achieve AB 32 goals could be made to "maximize cost-effectiveness" and "minimize leakage" as required by AB 32, we will need to determine how far down the emissions reduction road we've traveled. For example, the trajectory of the declining cap could be adjusted to reflect emission reductions achieved by complementary measures at a greater than expected rate.

**Conclusion**

AB 32 Implementation Group urges that the issues be considered with regard to cost containment in response to CARB Board Resolution 12-51.

Should you have any questions or need anything further from us, please feel free to contact Shelly Sullivan (916) 858-8686.

cc: The Honorable Mary Nichols
ARB Board Members
California State Legislature
Virgil Welch, ARB Special Assistant
Richard Corey, ARB Executive Office
Edie Chang, ARB Deputy Executive Office
Ms. Rajinder Sahota, Manager, Cap-and-Trade Program Monitoring
Mr. Jakub Zielkiewicz, Staff, Cap-and-Trade Program Monitoring
Mr. Sean Donovan, Staff, Cap-and-Trade Program Monitoring
Dr. Ray Olsson, Staff, Cap-and-Trade Program Monitoring