

ATTACHMENT B

PUBLIC HEARING TO CONSIDER ADOPTION OF A PROPOSED REGULATION TO IMPLEMENT A CALIFORNIA CAP-AND-TRADE PROGRAM

Staff's Suggested Modifications to the Original Proposal

TO BE PRESENTED AT THE DECEMBER 16, 2010 HEARING
OF THE AIR RESOURCES BOARD

Note: shown below are staff's suggested modifications to the originally proposed regulatory text set forth in Appendix A to the Staff Report: Initial Statement of Reasons, released October 28, 2010. Only those portions containing the suggested modifications are included.

Comments and Suggested Modifications to the Original Regulatory Proposal Set Forth in Attachment A to Resolution 10-42

This document is printed in a style to indicate changes from the originally proposed regulatory language. All originally proposed regulatory language is indicated by plain type. Staff's suggested modifications to the original proposal are shown in underline to indicate additions to the original proposal and ~~striketrough~~ to indicate deletions. All proposed modifications will be made available to the public for a fifteen-day comment period prior to final adoption. For proposals without specific proposed regulatory language, staff provides an outline of the approach to be taken to construct necessary regulatory language. Because of the scope and complexity of some of the proposed changes, staff plans to will solicit stakeholder input through holding public workshops on those issues prior to making specific regulatory language available to the public in a fifteen-day comment period prior to final adoption.

PROPOSED CHANGES FOR WHICH STAFF DOES NOT PLAN TO HOLD PUBLIC WORKSHOPS

Modifications to section 95852, Emissions Categories Used to Calculate Compliance Obligations.

1. Staff recommends modifying §95852.2 to clarify emissions without a compliance obligation.

Modify title 17, CCR, §95852.2 to read:

§ 95852.2. Emissions without a Compliance Obligation.

Emissions from the following source categories as identified in sections 95100 through 95199 of the Mandatory Reporting Regulation count toward

applicable reporting thresholds but do not count toward a covered entity's compliance obligation set forth in this regulation. ~~These source categories~~
Emissions without a compliance obligation include:

(a) ~~CO₂ Combustion~~ combustion emissions from the following biomass-derived portion of biomass-derived fuels (except biogas from digesters) ~~from the following sources:~~

- (1) Solid waste materials, including the biogenic content of solid waste materials that are not 100 percent biomass, as determined by the methodology specified in ASTM D6866, based on exhaust sampling or fuel sampling (and fuel usage recordkeeping) at the specified frequency;
- (2) Waste pallets, crates, dunnage, manufacturing and construction wood wastes, tree trimmings, mill residues, and range land maintenance residues;
- (3) All agricultural crops or waste; or
- (4) Wood and wood wastes identified to follow all of the following practices:
 - (A) Harvested pursuant to approved timber management plan prepared in accordance with the Z'berg-Nejedly Forest Practice Act of 1973 or other locally or nationally approved plan;
 - (B) Harvested for the purpose of forest fire fuel reduction or forest stand improvement; and
 - (C) Do not transport or cause the transport of species known to harbor insect or disease nests outside zones of infestation or quarantine zones identified by the department of Food and Agriculture of the Department of Forestry and Fire Protection, unless approved by these agencies.

~~(b)(5)~~ Biodiesel:

- ~~(4)~~ (A) Agri-biodiesel derived solely from virgin oils, including esters derived from virgin vegetable oils from corn, soybeans,

sunflower seeds, cottonseeds, canola, cramble, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, and camelina, and from animal fats.

~~(2)~~(B) Biodiesel is defined as monoalkyl esters of long chain fatty acids derived from following plant or animal matter that meets the requirements of the American Society of Testing Materials (ASTM) D6751:

~~(A)~~(i) Waste oils;

~~(B)~~(ii) Tallow; or

~~(C)~~(iii) Virgin oils.

~~(e)~~(6) Fuel ethanol:

~~(1)~~(A) Cellulosic biofuel produced from lignocellulosic or hemicellulosic material that has a proof of at least 150 without regard to denaturants;

~~(2)~~(B) Corn starch; or

~~(3)~~(C) Sugar cane.

~~(d)~~(7) Municipal Solid Waste (biogenic fraction only as determined by methodology specified in ASTM D6866):

~~(1)~~(A) Direct combustion; or

~~(2)~~(B) Conversion to a clean burning fuel:

~~(A)~~(i) Technology does not use air or oxygen in the conversion process except to maintain temperature control;

~~(B)~~(ii) Technology produces no discharges or emissions of air contaminants, including greenhouse gases;

~~(C)~~(iii) No discharges to surface or groundwater;

~~(D)~~(iv) Produces no hazardous wastes as identified in ASTM D6866;

~~(E)~~(v) Removes recyclable and green waste compostable materials, and recycles or compost these materials; ~~or~~

~~(F)~~(vi) Any wastes that come to a facility come from an agency that diverts at least 30 percent of all solid waste collected through solid waste reduction, recycling, and composting; or

(vii) Tires.

~~(e)~~(8) Biomethane and biogas from the following sources:

~~(1)~~(A) All animal and other organic waste; or

~~(2)~~(B) Landfills gas and wastewater treatment plants.

~~(f)~~(b) Fugitive and process emissions from:

(1) CO₂ emissions from geothermal generating units;

(2) CO₂ and CH₄ emissions from geothermal facilities;

(3) CO₂ emissions from hydrogen fuel cells;

(4) At petroleum refineries: asphalt blowing operations, equipment leaks, storage tanks, and loading operations; ~~or~~

(5) At the facility types listed in section 95101(e) of the Mandatory Reporting Regulation, Petroleum and Natural Gas Systems: leak detection and leaker emission factors, and stationary fugitive and “stationary vented” sources on offshore oil platforms; ~~or~~

(6) Methane from landfills; or

(7) CH₄ and N₂O from municipal wastewater treatment plants.

Modifications to section 95854. Quantitative Usage Limit on Designated Compliance Instruments—Offset Credits.

1. Staff recommends modifying §95854 to provide greater flexibility to use offset credits to fulfill a compliance obligation.

Modify title 17, CCR, §95854 to read:

§ 95854. Quantitative Usage Limit on Designated Compliance Instruments—Offset Credits.

(a) The number of offset credits that each covered entity may surrender to meet its annual or triennial compliance obligation must conform to the following limit:

O_O/S must be less than L_O

Where:

O_O = Total number of compliance instruments that are designated as subject to this quantitative usage limit pursuant to subarticle 4, section 95821(b), (c), and (d), including sector-based offset credits as defined in section 95821.

~~Sector-based offset credits as defined in section 95821 cannot represent more than 25% of O in the first and second compliance periods and 50% of O in all other periods.~~

S = Covered entity's annual or triennial compliance obligation.

L_O = Quantitative offset credit usage limit, set at 0.08.

(b) The number of sector-based offset credits that each covered entity may surrender to meet its annual or triennial compliance obligation must conform to the following limit:

O_S/S must be less than L_S

Where:

O_S = Total number of sector-based offset credits as defined in section 95821.

S = Covered entity's annual or triennial compliance obligation.

L_S = Quantitative offset credit usage limit, set at 0.02 for the first compliance period, and at 0.04 for the second and third compliance periods.

Modifications to section 95857. Untimely Surrender of Compliance Instruments by a Covered Entity.

1. Staff recommends modifying §95857(d) to distribute allowances surrendered based on the untimely surrender obligation across all three tiers of the Allowance Price Containment Reserve.

Modify title 17, CCR, §95857(d) to read:

- (d) When the covered entity or opt-in covered entity meets its obligations pursuant to subsection (c) above, the Executive Officer shall:
 - (1) Remove the restrictions on transfers from the holding accounts controlled by the covered entity and affiliated entities;
 - (2) Transfer the allowances used to fulfill the untimely surrender obligation in the following manner:
 - (A) ~~Three-fourths~~ One fourth to the ~~highest-priced~~ each tier of the Allowance Price Containment Reserve Account; and
 - (B) One fourth to the Retirement Account.

Modifications to section 95911. Format for Auction of California GHG Allowances.

1. Staff recommends modifying §95911(b)(4) to distribute allowances that remain unsold when the auction settlement price equals the auction reserve price be distributed across all three tiers of the Allowance Price Containment Reserve.

Modify title 17, CCR, §95911(b)(4) to read:

- (4) Allowances designated by ARB for an auction which remain unsold when the auction settlement price equals the auction reserve price shall be transferred equally to the ~~highest-priced tier~~ three tiers in the Allowance Price Containment Reserve Account. If the number of allowances unsold is not divisible by three, the transfer of the final allowances shall be to the lowest-price tiers.

Modifications to section 95913. Sale of Allowances from the Allowance Price Containment Reserve.

1. Staff recommends modifying §95913(c)(1) to provide easier access for covered entities (including opt-in covered entities) to allowances in the Allowance Price Containment Reserve.

Modify title 17, CCR, §95913(c)(1) to read:

(c) Timing, Eligible participants, and Limitations.

(1) Eligible participants.

~~(A) Only covered entities (including opt-in covered entities) registered as provided in sections 95811 or 95813 shall be eligible to purchase allowances from the Allowance Price Containment Reserve.~~

~~(B) Only covered entities (including opt-in covered entities) which hold no compliance instruments in their holding accounts or limited use holding accounts may purchase allowances from the Allowance Price Containment Reserve.~~

PROPOSED CHANGES FOR WHICH STAFF PLANS TO SOLICIT STAKEHOLDER INPUT THROUGH PUBLIC WORKSHOPS**Modification to subarticle 7. Compliance Requirements for Covered Entities.**

1. Staff proposes to adjust deadlines to ensure that mandatory reporting and cap-and-trade compliance cycles are complementary.

Modifications to subarticle 8. Allowance Dispositions, and subarticle 9. Direct Allocations of California GHG Allowances.

1. Staff will explore expanding the prorating of allowances for distribution included in section 95870(d) to include all allowances distributed for free in the first compliance period, not just allowances distributed to industrial sources with leakage-exposed risk. If allowance dispositions proposed in subarticle 8 are modified, each disposition will have a respective modified section in subarticle 9.

2. Proposal on allowance allocation for the electricity sector: see Appendix 1.

3. Staff will explore the feasibility of modifying the allocation system to allow the output factor used in the allocation formula in section 95891 to be adjusted so that the final allocation to industries under the formula would be based on current year output rather than a rolling average of the three most recent years for which data is available.
4. Staff will review the thermal energy based allocation calculation methodology in section 95891(c) to ensure that the provisions for new entrants appropriately addresses facility expansions.
5. Staff will work with interested stakeholders to ensure proper treatment under the regulation of any electricity generators or combined heat and power facilities with pre-AB 32 long-term contracts that do not allow for pass-through of costs associated with greenhouse gas emissions.
6. Staff will evaluate the treatment of non-electricity generation sources covered at the start of the program to determine whether some form of transition assistance is needed for those not included in the industrial sectors listed in Table 8.1 in section 95870.

Modification to subarticle 8. Allowance Dispositions.

1. Staff recommends setting aside 0.5% of allowances each year to incentivize the in-state production of voluntary renewable energy. Staff will also develop rules for retiring allowances from this set aside and provisions for disposition of any allowances in this set aside account that remain unused.

Modifications to section 95891. Allocation for Industry Assistance.

1. Staff will modify Table 9.1 to incorporate specific GHG emissions efficiency benchmarks for each industry. Greenhouse gas emissions efficiency benchmarks will be used to determine the quantity of free allocation to leakage-exposed sectors. Since the process of determining the benchmark for each sector involves extensive data gathering and stakeholder engagement, staff recommends taking the following steps to finalize the analysis: 1) define the sector and products on which a benchmark will be established, 2) determine the sample population based on which the benchmark will be derived, 3) collect data for production and emissions, and 4) consult with stakeholders to ensure the reliability of the values to appropriately reflect GHG emissions efficiency of a given manufacturing process.
2. For the petroleum refining sector, staff recommends evaluating an Energy Intensity Index approach for allocation in the initial period if it is possible to implement with an adequate degree of transparency in the allocation process. If that is not possible, staff will incorporate a simple barrel allocation approach into the regulation. In either case, staff will work to transition to a more complex carbon-weighted barrel approach for the petroleum refining sector as soon as possible. For refineries that do

not report to Solomon Associates and therefore do not have an Energy Intensity Index, staff will evaluate other allocation methods including a simple barrel approach.

3. As a pilot project for the cement sector, staff will investigate use of a border adjustment, as recommended by the Economic and Allocation Advisory Committee (EAAC), to address residual leakage concerns that may remain after the allocation to cement producers using the updated output-based benchmark system. If necessary to address leakage concerns and feasible to complete in the 15-day change process, staff will incorporate a border adjustment system into the regulation.

New section on periodic regulation review.

Staff proposes to incorporate into the regulation specific requirements for a review of the program at least once every compliance period. The new regulatory text will include specific deadlines for completion of the review, a list of topics that must be addressed in the review, and minimum requirements for public input during the review process.