State of California
AIR RESOURCES BOARD

California Cap-and-Trade Program

Resolution 12-27

June 28, 2012

Agenda Item No.: 12-4-5

WHEREAS, sections 39600 and 39601 of the Health and Safety Code authorize the Air Resources Board (ARB or Board) to adopt standards, rules, and regulations and to do such acts as may be necessary for the proper execution of the powers and duties granted to and imposed upon the Board by law;

WHEREAS, the California Global Warming Solutions Act of 2006 (AB 32; Chapter 488, Statutes of 2006; Health & Safety Code section 38500 et seq.) declares that global warming poses a serious threat to the economic well-being, public health, natural resources, and environment of California and creates a comprehensive multi-year program to reduce California's greenhouse gas (GHG) emissions to 1990 levels by 2020;

WHEREAS, AB 32 added section 38501 to the Health and Safety Code, which expresses the Legislature's intent that ARB coordinate with State agencies and consult with the environmental justice community, industry sectors, business groups, academic institutions, environmental organizations, and other stakeholders in implementing AB 32; and design emissions reduction measures to meet the statewide emissions limits for greenhouse gases in a manner that minimizes costs and maximizes benefits for California's economy, maximizes additional environmental and economic co-benefits for California, and complements the State's efforts to improve air quality;

WHEREAS, section 38501(c) of the Health and Safety Code declares that California has long been a national and international leader on energy conservation and environmental stewardship efforts, and the program established pursuant to AB 32 will continue this tradition of environmental leadership by placing California at the forefront of national and international efforts to reduce GHG emissions;

WHEREAS, section 38501(d) of the Health and Safety Code confirms that national and international actions are necessary to fully address the issue of global warming, but action taken by California to reduce GHG emissions will have far reaching effects by encouraging other states, the federal government, and other countries to act;

WHEREAS, section 38501(e) of the Health and Safety Code states by exercising a global leadership role, California will also position its economy, technology centers, financial institutions, and businesses to benefit from national and international efforts to

reduce emissions of greenhouse gases. More importantly, investing in the development of innovative and pioneering technologies will assist California in achieving the 2020 statewide limit on emissions of greenhouse gases and will provide an opportunity for the state to take a global economic and technological leadership role in reduction emissions of greenhouse gases;

WHEREAS, section 38510 of the Health and Safety Code designates ARB as the State agency charged with monitoring and regulating sources of GHG emissions in order to reduce these emissions;

WHEREAS, section 38560 of the Health and Safety Code directs ARB to adopt rules and regulations in an open public process to achieve the maximum technologically feasible and cost-effective GHG emissions reductions from sources or categories of sources;

WHEREAS, section 38562 of the Health and Safety Code requires ARB to adopt GHG emissions limits and emissions reduction measures by regulation to achieve the maximum technologically feasible and cost-effective reductions in GHG emissions in furtherance of achieving the statewide GHG emissions limit, to become operative beginning on January 1, 2012;

WHEREAS, section 38562(b) of the Health and Safety Code requires ARB, to the extent feasible and in furtherance of achieving the statewide greenhouse gas emissions limit, to do all of the following:

> Design the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize total benefits to California, and encourages early action to reduce greenhouse gas emissions;
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> Ensure that activities undertaken to comply with the regulations do not disproportionately impact low-income communities;
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> Ensure that entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions;
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> Ensure that activities undertaken pursuant to the regulations complement, and do not interfere with, efforts to achieve and maintain federal and state ambient air quality standards and to reduce toxic air contaminant emissions;
>
> Consider cost-effectiveness of these regulations;
>
> Consider overall societal benefits, including reductions in other air pollutants, diversification of energy sources, and other benefits to the economy, environment, and public health;

Minimize the administrative burden of implementing and complying with these regulations;

Minimize leakage; and

Consider the significance of the contribution of each source or category of sources to statewide emissions of greenhouse gases.

WHEREAS, sections 38562(c) and 38570 of the Health and Safety Code authorize ARB to adopt regulations that utilize market-based compliance mechanisms;

WHEREAS, section 38570(b) of the Health and Safety Code also directs ARB, to the extent feasible and in furtherance of achieving the statewide GHG emissions limit, to do all of the following before including any market-based compliance mechanism in the regulations:

Consider the potential for direct, indirect, and cumulative emissions impacts from these mechanisms, including localized impacts in communities that are already adversely impacted by air pollution;

Design any market-based compliance mechanism to prevent any increase in the emissions of toxic air contaminants or criteria air pollutants; and

Maximize additional environmental and economic benefits for California, as appropriate.

WHEREAS, section 38570(c) of the Health and Safety Code further directs ARB to adopt regulations governing how market-based compliance mechanisms may be used by regulated entities subject to GHG emissions limits and mandatory emissions reporting requirements to achieve compliance with their GHG emissions limits;

WHEREAS, section 38571 of the Health and Safety Code directs ARB to adopt methodologies for the quantification of voluntary GHG emissions reductions and regulations to verify and enforce any voluntary GHG emissions reductions that are authorized by ARB for use to comply with GHG emissions limits established by ARB; the adoption of methodologies is exempt from the rulemaking provisions of the Administrative Procedure Act;

WHEREAS, the Board adopted the Final Regulation Order establishing a GHG cap-and-trade program for California; the regulation became effective January 1, 2012 and includes the following elements:

Addresses emissions of carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), sulfur hexafluoride (SF_6), and nitrogen trifluoride (NF_3);

Identifies the program scope: starting in 2012, electricity, including imports, and large (emissions >25,000 metric tons carbon dioxide equivalent per year) industrial facilities are included; starting in 2015, distributors of transportation fuels, natural gas, and other fuels are included;

Establishes a declining aggregated emissions cap on included sectors. The cap starts at 162.8 million allowances in 2013, which is equal to the emissions forecast for that year. The cap declines approximately 2 percent per year in the initial period (2013–2014). In 2015, the cap increases to 394.5 million allowances to account for the expansion in program scope to include fuel suppliers. The cap declines at approximately 3 percent per year between 2015 and 2020. The 2020 cap is set at 334.2 million allowances;

Provides for distribution of allowances through a mix of direct allocation and auction in a system designed to reward early action and investment in energy efficiency and GHG emissions reductions; allowances will be distributed for the purposes of price containment, industry transition and assistance, and fulfillment of AB 32 statutory objectives;

Establishes a market platform for allowance auction and sale;

Establishes cost-containment mechanisms and market flexibility mechanisms, including trading of allowances and offsets, allowance banking, a two year compliance period and two 3-year compliance periods, the ability to use offsets for up to 8 percent of an entity's compliance obligation, and an allowance reserve that provides allowances at fixed prices to those with compliance obligations;

Establishes a mechanism to link with other GHG trading programs and approve the use of compliance instruments issued by a linked external GHG trading program;

Establishes requirements and procedures for ARB to issue offset credits according to offset protocols adopted by the Board;

Includes four offset protocols adopted by the Board as part of the regulation;

Establishes a robust enforcement mechanism that will discourage gaming of the system and deter and vigorously punish fraudulent activities; and

Provides an opt-in provision for entities whose annual GHG emissions are below the threshold to voluntarily participate in this program.

WHEREAS, staff has proposed amendments to the cap-and-trade regulation; the draft regulation is set forth in Attachment A hereto and includes the following elements:

Individual identity verification requirements to ensure integrity in the tracking system;

A multi-step transfer process to mitigate against potential theft of compliance instruments;

Additional detail and clarification for the auction process to enable staff to implement the auction with clear requirements for auction participants;

Consolidation of accounts for entities with direct corporate associations to simplify and minimize the accounts associated with entities held by a parent company;

Opt-out from consolidation of accounts at the discretion of the entities with a direct corporate association;

First auction to be held on November 14, 2012;

Auction purchase limits for all covered entities to ensure equitable treatment;

A 'cure' period to allow market participants to address some holding limit violations; and

A process to increase the holding limit exemption upon Executive Officer approval.

WHEREAS, staff conducted two public workshops, provided informal regulatory text, and also participated in numerous other meetings with various stakeholders to provide additional opportunities to participate in the regulatory development process;

WHEREAS, the Board has considered the community impacts of the proposed regulation, including environmental justice concerns;

WHEREAS, the Board believes the success of a cap-and-trade program is predicated on GHG regulations that are clear, consistent, enforceable, and transparent;

WHEREAS, staff has prepared a document entitled "Staff Report: Initial Statement of Reasons for the 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" (ISOR), which presents the rationale and basis for the proposed regulation and identifies the data, reports, and information relied upon;

WHEREAS, the California Environmental Quality Act (CEQA), Public Resources Code section 21080.5, allows public agencies with regulatory programs to prepare a plan or

other written document in lieu of an environmental impact report or negative declaration once the Secretary of the Resources Agency has certified the regulatory program;

WHEREAS, that portion of the ARB's regulatory program that involves the adoption, approval, amendment, or repeal of standards, rules, regulations has been certified by the Secretary of Resources Agency (CEQA Guidelines section 15251(d));

WHEREAS, in accordance with ARB's certified regulatory program, and the policy and substantive requirements of CEQA, ARB prepared an environmental analysis as part of the ISOR that assessed the potential for significant long or short term adverse and beneficial environmental impacts associated with the proposed action (CCR section 60005 (b));

WHEREAS, the environmental analysis included in the ISOR concluded that the amendments will not have any significant or potentially significant adverse effect on the environment;

WHEREAS, public hearings and other administrative proceedings were held in accordance with the provisions of Chapter 3.5 (commencing with section 11340), part 1, division 3, title 2 of the Government Code;

WHEREAS, the proposed regulatory language was made available to the public at least 45 days prior to the public hearing to consider the proposed regulation;

WHEREAS, in consideration of the ISOR, written comments, and public testimony it has received to date, the Board finds that:

The proposed regulatory text adds mostly administrative details to actions that were already required under the adopted cap-and-trade regulation;

The proposed regulatory text meets the statutory requirements identified in section 38562 of the Health and Safety Code;

The proposed regulatory text meets the statutory requirements for a market-based mechanism identified in section 38570 of the Health and Safety Code;

The proposed regulatory text was developed in an open public process, in consultation with affected parties, through public workshops, individual meetings, and other outreach efforts;

The proposed regulatory text is predicated on GHG regulations that are clear, consistent, enforceable, and transparent and helps meet the goals of AB 32;

The cost-effectiveness of the proposed regulatory text has been considered, and the proposed regulation will achieve cost-effective GHG emissions reductions;

The proposed amendments are consistent with ARB's environmental justice policies and will equally benefit residents of any race, culture, or income level;

The proposed amendments will not result in any significant adverse impacts on the environment;

An enforceable market program is essential to meet the goals of AB 32;

A clear and well described market program is essential to successful implementation of the cap-and-trade program; and

No reasonable alternative considered, or that has otherwise been identified and brought to the attention of ARB, would be more effective at carrying out the purpose for which the regulatory text is proposed or would be as effective and less burdensome to affected entities than the proposed amendments.

NOW, THEREFORE, BE IT RESOLVED that the Board hereby approves for adoption the proposed amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms.

BE IT FURTHER RESOLVED that the Executive Officer is the final decision maker in accordance with title 17, California Code of Regulations, section 60007, and shall consider and approve the written responses to any comments raising environmental issues prior to taking final action to adopt the regulatory amendments, or if he determines that this is warranted, present the regulatory amendments to the Board for further consideration.

BE IT FURTHER RESOLVED that the Board directs the Executive Officer to update the Board at least annually on the status of the cap-and-trade program. These annual updates should include elements described in Resolution 10-42 and Resolution 11-32.

I hereby certify that the above is a true and correct copy of Resolution 12-27, as adopted by the Air Resources Board.

Mary Alice Morency, Clerk of the Board

Resolution 12-27

June 28, 2012

Identification of Attachments to the Board Resolution

Attachment A: Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms