State of California
AIR RESOURCES BOARD

AMENDMENTS TO THE CALIFORNIA CAP ON GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE MECHANISMS REGULATION

Resolution 18-4

March 22, 2018

Agenda Item No.: 18-2-2

WHEREAS, sections 39600 and 39601 of the Health and Safety Code authorize the California Air Resources Board (CARB 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 Legislature has enacted the Global Warming Solutions Act of 2006 (Assembly Bill 32 or AB 32; Chapter 488, Statutes of 2006; Health & Safety Code section 38500 et seq.), which declares that global warming poses a serious threat to the economic well-being, public health, natural resources, and the environment of California, and creates a comprehensive multi-year program to reduce California's greenhouse gas (GHG) emissions to 1990 levels by 2020;

WHEREAS, section 38551 of the Health and Safety code directs that the statewide GHG limit shall remain in place indefinitely and that emissions reductions be continued and maintained beyond 2020;

WHEREAS, section 38566 of the Health and Safety Code, added pursuant to Senate Bill 32 (SB 32; Chapter 250, Statutes of 2016), further directs that CARB shall ensure that state GHG emissions are reduced to at least 40 percent below the statewide GHG limit no later than December 31, 2030;

WHEREAS, section 38510 of the Health and Safety Code designates CARB 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 CARB 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 CARB 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 CARB, to the extent feasible and in furtherance of achieving the statewide GHG 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 GHG emissions;
>
> Ensure that activities undertaken to comply with the regulations do not disproportionately impact low-income communities;
>
> Ensure that entities that have voluntarily reduced their GHG emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions;
>
> 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 GHG emissions.

WHEREAS, the Legislature has enacted Assembly Bill 197 (Chapter 250, Statutes of 2016), which directs CARB to follow the requirements of section 38562(b) of the Health and Safety Code, consider the social cost of GHG emissions and prioritize direct emission reductions from sources in California;

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

WHEREAS, the Legislature has enacted Assembly Bill 398 (Chapter 135, Statutes of 2017), which amends certain provisions of AB 32 through 2030, and expressly supports CARB's authority to adopt regulations that utilize market-based compliance mechanisms post-2020;

WHEREAS, section 38570(c) of the Health and Safety Code further directs CARB 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, the Board adopted the Final Regulation Order establishing a GHG cap-and-trade program for California; the Regulation first 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 ($MTCO_2e$) per year) stationary sources 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, emissions leakage prevention, ratepayer benefit, transition assistance, and fulfillment of AB 32 statutory objectives;

Provides for distribution of allowances to industrial covered entities on the basis of direct and indirect GHG costs with the exception of indirect GHG costs for purchased electricity. These indirect costs for electricity were to be compensated through electrical distribution utilities;

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 2-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 CARB 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, the Board adopted amendments to the Regulation in 2012 to make targeted implementation changes that became effective September 1, 2012;

WHEREAS, the Board adopted amendments to the Regulation in 2013 to formally link the Cap-and-Trade Program with the Province of Québec's cap-and-trade-program that became effective October 1, 2013, making California and Québec allowances and offsets available for compliance purposes in both jurisdictions;

WHEREAS, the Board adopted amendments to the Regulation in 2014 to adopt an additional compliance offset protocol for Mine Methane Capture, and make additional implementation changes that became effective July 1, 2014;

WHEREAS, the Board adopted a second set of amendments to the Regulation in 2014 to adopt updates to the compliance offset protocols for Livestock, Ozone Depleting Substances, and United States Forests, and make additional implementation changes that became effective January 1, 2015;

WHEREAS, the Board adopted amendments to the Regulation in 2015 to adopt an additional compliance offset protocol for Rice Cultivation, adopt an update to the compliance offset protocol for United States Forests, and make additional implementation changes that became effective November 1, 2015;

WHEREAS, the Board adopted amendments to the Regulation in 2017 to set the GHG allowance budgets from 2021 through 2050, to modify the Allowance Price Containment Reserve, to formally link with the Ontario cap-and-trade program beginning in 2018, and make additional implementation changes that became effective October 1, 2017;

WHEREAS, the Board has considered the community impacts of the proposed regulation, including environmental justice concerns as well as the social cost of carbon;

WHEREAS, the Board believes the success of California's 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—Public Hearing to Consider the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms" (ISOR), which presents the rationale and basis for the proposed regulation and identifies the data, reports, and information relied upon;

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, CARB's regulatory program that involves the adoption, approval, amendment, or repeal of standards, rules, regulations, or plans has been certified by the Secretary for Natural Resources under Public Resources Code section 21080.5 of the California Environmental Quality Act (CEQA; California Code of Regulations, title 14, section 15251(d)), and CARB conducts its CEQA review according to this certified program (California Code of Regulations, title 17, sections 60000-60007);

WHEREAS, in accordance with CARB's certified regulatory program, and the policy and substantive requirements of CEQA, CARB prepared an environmental analysis as part of the ISOR that serves as a substitute document equivalent to an addendum to the prior July 17, 2017, final Environmental Analysis (EA) prepared for the Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (2017 EA) that assessed the potential for significant long- or short-term adverse and beneficial environmental impacts associated with the proposed action (title 17, California Code of Regulations, section 60005(b));

WHEREAS, the environmental analysis in the ISOR explains CARB's determination that no additional environmental analysis is required for the proposed amendments because the proposed amendments do not involve any changes that result in any new significant adverse environmental impacts or a substantial increase in the severity of the significant adverse impacts previously disclosed in the 2017 EA;

WHEREAS, staff determined that, for the proposed amendments, CARB can rely on the 2017 EA and no additional environmental review is required because the record evidence shows that the amendments will not result in new significant adverse environmental impacts or a substantial increase in severity of previously identified significant adverse impacts, as described in Chapter VI of the ISOR;

WHEREAS, the Board has reviewed and considered the addendum-equivalent EA;

WHEREAS, staff has proposed amendments to the Cap-and-Trade Regulation, as set forth in Appendix A to the Initial Statement of Reasons released to the public on January 30, 2018; the amended Regulation is set forth in Attachment A hereto and includes the following elements:

Clarify existing requirements related to changes of facility ownership. Specifically, the proposed amendments clarify that the Cap-and-Trade Regulation requires a successor entity after a change in ownership to be responsible for the outstanding, pre-transfer compliance obligation of the predecessor covered entity. A recent bankruptcy court opinion, which CARB is appealing, held that the Cap-and-Trade Regulation does not provide for successor liability. However, allowing covered entities to sell their facilities without the purchaser assuming the compliance obligation may open a loophole in the operation of the Cap-and-Trade Program and undermine the cap. The proposed amendment ensures that all market participants operate under the same requirements and that every purchaser after a change in ownership must account for the outstanding (i.e., unsurrendered) compliance obligation of the predecessor covered entity.

Clarify the regulatory procedure for establishing the Auction Reserve Price. Under the existing California Regulation, the Auction Reserve Price in effect for a specific joint auction is determined as the higher of the Annual Auction Reserve Prices established individually by California and Québec, after converting the prices to a common currency. California's Regulation does not recognize the possibility that the joint Auction Reserve Price could be set by the Ontario Auction Reserve Price. The proposed amendment is necessary to reflect that Ontario and Québec use Province-specific inflation rates when setting their Annual Auction Reserve Prices, and allows the CARB Executive Officer to certify the auction result in the event that Ontario's Auction Reserve Price is higher than both California's and Québec's.

WHEREAS, the Board finds that:

Staff's proposed regulatory text meets the statutory requirements identified in section 38562 of the Health and Safety Code, including equitable and cost effective distribution of allowances to maximize total benefits to California, minimizing leakage, and cost effectiveness;

Staff's proposed regulatory text meets the statutory requirements for a market-based mechanism identified in section 38570 of the Health and Safety Code, including consideration of the potential for direct; indirect, and cumulative emission impacts; prevention of increases in emissions of toxic air contaminants or criteria pollutants; and maximizing additional environmental and economic benefits for California;

Staff has considered the social cost of GHG emissions and prioritized emission reduction rules that result in direct emission reductions pursuant to section 38562.5 of the Health and Safety Code;

The proposed amendments were developed in an open public process;

No reasonable alternatives to the amendments considered to date, or that have otherwise been identified and brought to the attention of CARB, would be more effective at carrying out the purpose for which the amendments are proposed or would be as effective and less burdensome to affected entities than the proposed amendments;

The proposed amendments are consistent with CARB's environmental justice policies and do not disproportionately impact people of any race, culture, or income; and

The proposed amendments are covered by the prior environmental analysis prepared to comply with CEQA (i.e., the 2017 EA), and no additional environmental review, or revisions to the prior environmental analysis, are required because substantial evidence in the records shows there are no changes that will result in new significant adverse environmental impacts or a substantial increase in severity of previously identified significant adverse impacts.

NOW, THEREFORE, BE IT RESOLVED that the Board hereby approves for adoption amendments to sections 95835 and 95911; Title 17 California Code of Regulations, as set forth in Attachment A.

I hereby certify that the above is a true and correct copy of Resolution 18-4 as adopted by the Air Resources Board.

Rana McReynolds

Rana McReynolds, Clerk of the Board

Resolution 18-4

March 22, 2018

Identification of Attachments to the Board Resolution

Attachment A: Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation section(s) 95835 and 95911 Title 17 California Code of Regulations, as set forth in Appendix A to the Initial Statement of Reasons, released January 30, 2018.