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Peter Krause
Legal Affairs Secretary
State Capitol, Suite 1173
Sacramento, CA 95814

RE: **Attorney General's Advice to the Governor Concerning Linkage of California and Ontario Cap-and-Trade Programs**

Dear Mr. Krause:

By letter dated January 30, 2017, the California Air Resources Board (ARB) provided notice to Governor Brown that it is proposing to link its greenhouse gas emissions trading program ("California's Cap-and-Trade Program" or "California's Program") with the Cap-and-Trade Program developed by the Province of Ontario ("Ontario's Cap-and-Trade Program" or "Ontario's Program"). Pursuant to Government Code section 12894(f) and at the request of the Governor, we are providing advice and analysis to you about the four findings the Governor must make prior to any linkage of California's Cap-and-Trade Program with Ontario's Cap-and-Trade Program. Based on our review of the two programs, the statutory requirements of Division 25.5 of the Health and Safety Code, and ARB's discussion of the findings required by Government Code section 12894(f) ("ARB's Discussion of Findings"), and for the reasons described below, we conclude that there's an adequate basis to make each of the four findings.

BACKGROUND

A. Statutory Background

Government Code section 12894(f) prohibits ARB from linking its market-based compliance mechanisms for the reduction of greenhouse gases, such as the Cap-and-Trade Program, with comparable mechanisms from any other jurisdiction unless the Governor has first made all of the following four findings:

> 1. The jurisdiction with which the state agency proposes to link has adopted program requirements for greenhouse gas reductions, including, but not limited to, requirements for offsets, that are equivalent to or stricter than those required by Division 25.5 (commencing with Section 38500) of the Health and Safety Code.

2. Under the proposed linkage, California is able to enforce Division 25.5 (commencing with Section 38500) of the Health and Safety Code and related statutes against any entity subject to regulation under those statutes, and against any entity located within the linking jurisdiction to the maximum extent permitted under the United States and California Constitutions.

3. The proposed linkage provides for enforcement of applicable laws by the state agency or by the linking jurisdiction of program requirements that are equivalent to or stricter than those required by Division 25.5 (commencing with Section 38500) of the Health and Safety Code.

4. The proposed linkage and any related participation of the State of California in the Western Climate Initiative, Incorporated, shall not impose any significant liability on the state or any state agency for any failure associated with the linkage.

B. Regulatory Background

Beginning in 2007, California and the states of Arizona, New Mexico, Oregon, and Washington created the Western Climate Initiative (WCI) as a forum to discuss and set an overall regional goal to reduce greenhouse gas emissions consistent with each state's goal. The WCI served as the incubator for ideas for establishing a multi-jurisdictional, multi-sectoral greenhouse gas emissions reduction program, consisting of linked programs. Over time, four Canadian Provinces joined the WCI (British Columbia, Manitoba, Ontario, and Quebec). The work-product of the WCI, resulting from a multi-year effort, including public consultations, is a series of documents that set forth the consensus among the jurisdictions about the recommended regulations for a sub-national cap-and-trade market as well as other important components such as offsets, mandatory reporting of greenhouse gas emissions, infrastructure, and linking.

WCI's work contributed heavily to ARB's development of California's Program, which is designed to be environmentally rigorous and to facilitate linkage with similarly rigorous programs in other jurisdictions. Quebec and Ontario have likewise developed regulations based on the work of WCI. California and Quebec linked their Cap-and-Trade Programs in 2013, after the Governor made the four findings required by Government Code section 12894(f). Ontario's Program is substantially similar to Quebec's Program.

ANALYSIS

Finding 1: Stringency of program requirements for greenhouse gas reductions

The first required finding, set out in Government Code section 12894(f)(1), calls for a comparison of Ontario's "program requirements for greenhouse gas reductions"—including but not limited to its requirements for offsets—with California's statutory requirements, which are set forth in Division 25.5 of the Health and Safety Code. This statute requires, among other things, emissions reporting regulations, the reduction of emissions to specified levels by 2020 and 2030, and provisions to ensure that the reductions achieved through market-based

mechanisms like cap-and-trade or offsets are real, permanent, quantifiable, verifiable, and "in addition to … any reduction required by law or regulation … [or] that would otherwise occur."[1] Ontario's requirements need not be identical to these requirements, merely "equivalent" or "stricter."[2]

We agree with ARB that Ontario's requirements are equivalent to or stricter than those required by Division 25.5 of the Health and Safety Code. (See ARB's Discussion of Findings, pp. 4-10). Our analysis is based on the stringency of each jurisdiction's overall emission-reduction goals, each jurisdiction's implementation of these goals through cap-and-trade programs and reporting requirements, and each jurisdiction's treatment of offsets. As discussed below, to the extent Ontario's requirements in these areas differ from California's, those differences do not change our conclusion.

Emission-reduction goals

Ontario's emission-reduction goals from all programs apply to the same seven greenhouse gases as those in Division 25.5 of the Health and Safety Code.[3] The numeric goals from all programs (including cap-and-trade) are, like those in the Health & Safety Code, based on a 1990 emissions baseline. By that measure, as shown in the chart below, Ontario's goals are stricter than California's target for 2020, but slightly less strict for 2030. In addition, Ontario's goal for 2050 is equivalent to California's 2050 goal, which is set by Executive Order.

Economywide greenhouse gas reduction goals: Percent below 1990 baseline

Year	Ontario	California
2020	15%[4]	0%[5]
2030	37%[6]	40%[7]
2050	80%[8]	80%[9]

[1] (Cal. Health & Safety Code §§ 38530 [requirements for reporting], 38562 subd. (d) [requirements for market-based mechanisms], 38550 [emissions target for 2020], 38566 [target for 2030].)

[2] (Cal. Government Code § 12894 subd. (f)(1).)

[3] (*Compare* Cal. Health & Safety Code § 38505 subd. (g) *with* Government of Ontario, Bill 172, Climate Change Mitigation and Low-carbon Economy Act ("Ontario Climate-Change Statute.") § 5, May 19, 2016, available at https://www.ontario.ca/laws/statute/s16007.)

[4] (Ontario Climate-Change Statute § 6(1).)

[5] (Cal. Health & Safety Code § 38550.)

[6] (Ontario Climate-Change Statute, § 6(1).)

[7] (Cal. Health & Safety Code § 38566.)

[8] (Ontario Climate-Change Statute, § 6(1).)

[9] (Cal. Executive Order B-30-15.)

In our view, these goals are, overall, equivalent to or stricter than those in Division 25.5 of the Health and Safety Code. Ontario's 2020 goal is significantly stricter than California's 2020 goal, and more than compensates for its slightly less strict 2030 goal. Moreover, Ontario's 2030 goal represents greater per-capita reductions than California's does, as a result of Ontario's higher per-capita emissions in 1990 and its faster population growth since. Finally, California's 2050 goal is not explicitly set forth in Division 25.5 of the Health and Safety Code, so Ontario's goal of 80 percent reductions by that date is at least arguably stricter than required by the Health and Safety Code.

Cap-and-trade program and reporting requirements

Ontario's Program[10] and reporting requirements[11] are likewise equivalent to or stricter than what Division 25.5 of the Health & Safety Code requires. Ontario's Program satisfies these requirements (including, among other things, that reductions be real, permanent, quantifiable, verifiable, and additional) in materially the same way California's Program does.[12] In each jurisdiction, the Cap-and-Trade Program covers more than 80 percent of greenhouse gas emissions, with Ontario's applying to some emissions that California's does not.[13] The annual cap on emissions in each jurisdiction is set at a level designed to achieve additional reductions beyond those that would occur in a business-as-usual scenario.[14] Covered entities comply in similar fashions in each jurisdiction.[15] Allowances are allocated similarly, and auctions are

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[10] (Government of Ontario, Regulation 144/16, The Cap and Trade Program ("Ontario Cap-and-Trade Reg.,") May 19, 2016, available at https://www.ontario.ca/laws/regulation/r16144.)

[11] (Government of Ontario, Regulation 143/16, Quantification, Reporting and Verification of Greenhouse Gas Emissions ("Ontario Reporting Reg."), May 19, 2016, available at https://www.ontario.ca/laws/regulation/160143.)

[12] California's Cap-and-Trade Program is found in ARB regulations, rather than in Division 25.5 of the Health & Safety Code. (17 Cal. Code Regs. §§ 95801-96022.) California's Cap-and-Trade Program as designed represents ARB's implementation of the relevant statutory requirements. The similarity of Ontario's Program demonstrates that its requirements are "equivalent to or stricter than those required by Division 25.5."

[13] (*Compare*, *e.g.*, Ontario's Cap-and-Trade Reg. § 4, Ontario Reporting Reg., Sched. 2 [specifying covered emissions] *with*, *e.g.*, 17 Cal. Code Regs. §§ 95152(c)(16), (d)(7), (e)(8), (f)(7), (g)(5), (h)(5), (i)(1) [exempting some of those same emissions from California's Program].)

[14] (Environmental Commissioner of Ontario, "Facing Climate Change: Greenhouse Gas Progress Report 2016," p. 66, November 2016, available at https://eco.on.ca/our-reports/climate-change/; ARB, "First Update to the Climate Change Scoping Plan," p. 92-93, May 15, 2014, available at https://www.arb.ca.gov/cc/scopingplan/document/updatedscopingplan2013.htm.)

[15] (*Compare* Ontario Climate-Change Statute § 14 *and* Ontario Cap-and-Trade Reg. §§ 10-20 *with* 17 Cal. Code Regs.t§ 95850, 95856; see also ARB's Discussion of Findings, p. 8.)

conducted similarly.t[16] Both jurisdictions have similar reporting and verification requirements.[17] Each jurisdiction also has similar protections against fraud,[18] market manipulation,[19] and price spikes.[20]

Offsets

Ontario's requirements for the use of offsets in its Cap-and-Trade Program are also equivalent to or stricter than what Division 25.5 of the Health & Safety Code requires. With respect to those statutory requirements, Ontario's offset provisions are materially the same as ARB's.

Like California, Ontario limits the use of offsets to eight percent of an entity's compliance obligation, and requires that any offset projects obtain government approval and satisfy any applicable eligibility criteria before they can generate credits.[21] In California, eligibility criteria are set forth in protocols governing specific types of offset projects, and offset projects cannot generate credits unless they satisfy the criteria in a given protocol.[22] Each of the six protocols ARB has promulgated incorporate the requirements of Division 25.5 of the Health and Safety Code, and require that emission reductions from offset projects receive credits only if they are real, permanent, quantifiable, verifiable, enforceable, and additional.[23] In the context of offsets, ARB has interpreted this last "additionality" requirement as requiring that reductions would not otherwise have occurred in a "conservative business-as-usual scenario,"[24] and has calibrated its six offset protocols to ensure that they only credit reductions that meet that test.[25] This interpretation and method of implementing the statute was upheld by the Court of Appeal in *Our Children's Earth Foundation v. ARB* (2014) 234 Cal. App. 4th 870.

Ontario does not currently have any offset protocols in place, and will not be in a position to approve any offset credits until it has done so. However, Ontario has proposed a regulatory

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[16] (Ontario Climate-Change Statute, § 31; Ontario Cap-and-Trade Reg. §§ 56, 58; 17 Cal. Code Regs. § 95840; see also ARB's Discussion of Findings, p. 8.)

[17] (ARB's Discussion of Findings, pp. 6-7 [comparing Ontario Reporting Reg. with ARB's Mandatory Reporting Regulation].)

[18] (Ontario Climate-Change Statute §29, Ontario Cap-and-Trade Reg.t§ 51; 17 Cal. Code Regs. § 95921.)

[19] (Ontario Cap-and-Trade Reg. §§ 40, 42; 17 Cal. Code Regs. § 95920.)

[20] (Ontario Cap-and-Trade Reg. §§ 55, 59; 17 Cal. Code Regs. §§ 95910-95914.)

[21] (Ontario Climate-Change Statute § 34-37; 17 Cal. Code Regs. §§ 95970.)

[22] (*Our Children's Earth Foundation v. ARB* (2014) 234 Cal. App. 4th 870, 878-79.)

[23] (17 Cal. Code Regs. § 95970(a)(1).)

[24] (17 Cal. Code Regs.t§ 95802(a)(4).)

[25] (See *Our Children's Earth Foundation*, 234 Cal. App. 4th at 880-81; 17 Cal. Code Regs. § 95973, subd. (a)(2)(A).)

framework for offsets,[26] and is working to develop 13 offset protocols.[27] This will potentially lead to offset credits from projects that do not comply with an ARB protocol (because, for example, they are generated outside of the U.S. or are a type of project for which ARB has not developed a protocol) being traded in the California market. We nevertheless expect that any offset credits generated by Ontario will satisfy the applicable requirements in Division 25.5 of the Health and Safety Code, by representing reductions that are real, permanent, quantifiable, verifiable, enforceable, and additional. Ontario's proposed offsets regulation incorporates each of these requirements,[28] using a definition of additionality similar to ARB's.[29] Should Ontario deviate from these requirements in its final offsets regulation, or otherwise promulgate offset protocols that do not adhere to the requirements of the Health and Safety Code, this analysis may change.

Finally, Ontario's proposed treatment of invalidated offset credits differs slightly from California's. Similar to Quebec, Ontario proposes to hold the offset project developer responsible for replacing the credits.[30] When necessary, Ontario proposes to withdraw offset credits from a buffer account paid into by offset project developers.[31] California generally places responsibility for invalidated offset credits on the entity that surrendered them,[32] occasionally employing a buffer account.[33] Both approaches ensure that invalidated offsets do not undermine the integrity of the cap, and are in keeping with the requirements of Division 25.5 of the Health and Safety Code. Accordingly, as noted above, there is an adequate basis for the Governor to issue Finding 1 in the affirmative.

Finding 2: Enforceability of California requirements

The second required finding, set out in Government Code section 12894(f)(2), concerns whether California will retain its existing legal authority to enforce Division 25.5 of the Health and Safety Code against two sets of entities: (1) those subject to California' Program, and (2) to the extent permitted by the U.S. and California Constitutions, those located in Ontario.

We agree with ARB's analysis of this criterion in its Discussion of Findings (at pp. 10-11), and we believe an adequate basis exists to make this finding. Like the linkage with Quebec, the proposed linkage with Ontario does not create any apparent limitation on California's legal authority to bring enforcement actions against either set of entities. With respect to the first

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[26] (Government of Ontario, Compliance Offset Credits Regulatory Proposal, Nov. 4, 2016, *available at* http://www.downloads.ene.gov.on.ca/envision/env_reg/er/documents/2016/012-9078.pdf.)

[27] (*Id.* § 20)

[28] (*Id.* § 7.0.)

[29] (*Id.* § 12.5.)

[30] (*Id.* § 17)

[31] (*Id.*)

[32] (17 Cal. Code Regs. § 95985 subds. (g-h).)

[33] (*Id.* §§ 95983, 95985 subd. (i).)

category, entities with compliance obligations under California's program will remain subject to enforcement of California law in California courts, even though they will be able to satisfy their compliance obligations by surrendering Ontario compliance instruments (i.e., allowances or offset credits). This is because all entities with California compliance obligations must register with ARB and consent to the jurisdiction of California courts.[34] Likewise, offset providers that generate credits under a California protocol will remain subject to jurisdiction in California courts, and the offset credits they generate will be subject to invalidation by California, even though those credits may be surrendered by an Ontario entity to satisfy a compliance obligation under Ontario's program.[35]

Second, a small number of Ontario-based entities may have to register with ARB and expressly consent to jurisdiction in California (because, for example, they own facilities in California that are subject to the California's Program, or they seek offset credits for projects in the U.S.).[36] Even some Ontario-based entities that do not have to register with ARB may still be subject to jurisdiction in California if they have the Constitutionally required "minimum contacts" with California.[37] Examples of entities that could have such minimum contacts include entities doing business in California, entities knowingly selling fraudulent compliance instruments to a California entity with a California compliance obligation, and any other entities with conduct "expressly aim[ed]" at California.[38]

Any limits on California's enforcement authority over Ontario entities will result not from the linkage but from preexisting Constitutional limitations on California jurisdiction. For example, California may be unable to assert jurisdiction over Ontario entities whose unlawful activities are not "expressly aimed" at California and do not create a "substantial connection" with California.[39] Thus, Ontario entities that generate fraudulent offset credits and sell them to a Quebec entity that sells them to a California entity may have to be held responsible in courts in Ontario rather than in California.[40] In any event, while these existing Constitutional limitations may affect the ability of California to enforce its laws against Ontario entities, the linkage itself will not limit California's ability to enforce Division 25.5 of the Health and Safety Code. Thus, there is an adequate basis for the Governor to issue Finding 2 in the affirmative.

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[34] (17 Cal. Code Regs. § 95830 subd. (b)(3), 95832 subd. (d).)

[35] (*Id.*)

[36] (See *J. McIntyre Machinery, LTD. v. Nicastro* (2011) 131 S.Ct. 2780 [holding that Constitutional requirements for jurisdiction are met when defendant has expressly consented to jurisdiction].)

[37] (*See International Shoe Co. v. Washington* (1945) 326 U.S. 310.)

[38] (*Calder v. Jones* (1984) 465 U.S. 783.)

[39] (*See Walden v. Fiore* (2014) ___ U.S. ____, 134 S.Ct. 1115, 1121, 1124 fn. 7.)

[40] (*Id.* at 1125 [holding that defendant's actions must be aimed at forum state itself, not just at victim that happens to reside in forum state]; *see also Picot v. Weston* (9th Cir. 2015) 780 F.3d 1206, 1213 ["[T]he fact that a contract envisions one party discharging his obligations in the forum state cannot, standing alone, justify the exercise of jurisdiction over another party to the contract."].)

Finding 3: Enforceability of Ontario requirements

The third required finding, set forth in Section 12894(f)(3), calls for a determination that Ontario's requirements will be enforceable, either by California or Ontario.

For reasons discussed above, California likely does not have jurisdiction to enforce Ontario laws. However, as described in ARB's Discussion of Findings, pp. 11-13, Ontario has full authority to enforce its program requirements, and will retain this authority under the proposed linkage. Ontario's enforcement authority includes the ability to impose civil, criminal, and administrative penalties.[41] In general, Ontario's authority to enforce the requirements of its program is equivalent to California's authority to enforce the requirements of Division 25.5 of the Health and Safety Code and implementing regulations like the Cap-and-Trade Program. In some instances, Ontario's authority exceeds California's (e.g., Ontario has minimum financial penalties).[42] Moreover, Ontario has mechanisms designed to ensure that violations of its Cap-and-Trade Program do not endanger the Program's emission-reduction goals. For example, like in California and Quebec, regulated entities in Ontario that fail to surrender sufficient compliance instruments face an additional compliance obligation of three allowances or offsets for each one they failed to surrender, with a buffer account also available.[43] And, as described earlier, Ontario has provisions to protect against fraud or manipulation in the market for compliance instruments. Accordingly, there is an adequate basis for the Governor to make Finding 3 in the affirmative.

Finding 4: Liability for failure associated with the linkage

The fourth required finding, set forth in Section 12894(f)(4), calls for a determination that, in the event of a problem related to the linkage or California's participation in the Western Climate Initiative, the State of California and ARB will not face any "significant liability."

As we advised with respect to the Quebec linkage, the State and its employees would be immune from liability from ARB's discretionary policy decision to adopt a regulation linking California's cap-and-trade program with Ontario's.[44] Even if California or ARB could be liable for "any failure associated with the linkage," neither the proposed linkage nor California's participation in WCI will lead to such "failure" (e.g., theft of allowances, tax fraud) that initially

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[41] (ARB's Discussion of Findings, pp. 11-13 [Comparing Ontario's enforcement authority with California's].)

[42] (*Id.* pp. 12-13.)

[43] (*Id.* p. 8.)

[44] (*See, e.g.*, Gov. Code, §§ 815, subds. (a) and (b); 818.2, 820.2; 821; *see also Barner v. Leeds* (2000) 24 Cal.4th 676, 684-685; *Caldwell v. Montoya* (1995) 10 Cal.4th 972, 981; *Johnson v. State of California* (1968) 69 Cal.2d 782, 793,794; ARB's Discussion of Findings, p. 13t)

plagued the European Union's multi-jurisdictional trading system.[45] Those problems arose from conditions—uneven security measures among participating jurisdictions, disparate tax treatment of compliance mechanisms[46]—that are not present in the proposed linkage with Ontario.

Any jurisdiction that wishes to link with the California Program, such as Ontario, will need to be a member of WCI, Inc. and will use the California-developed infrastructure for the combined Programs. The creation of a single-market infrastructure for any California-linked program is intended, in part, to remove the possibility of a jurisdictional weak-link in the cyber-security of the linked program. WCI's administration of the linked market thus is designed to enhance the security of the market. (See ARB's Discussion of Findings, pp. 13-14.) Indeed, California's participation in WCI is more likely to shield the state from liability than subject it to liability. (*Id.*)

In sum, there is an adequate basis for the Governor to issue Finding 4 in the affirmative.

CONCLUSION

We believe the Governor has an adequate basis to make each of the four findings required by Government Code section 12894(f), thereby permitting ARB to move forward with the proposed linkage with Ontario.

Please contact us if you have any questions.

Sincerely,

ROBERT W. BYRNE
Senior Assistant Attorney General

For XAVIER BECERRA
Attorney General

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[45] (See Will Bierbower, *A Brief History of Fraudulent Activity on the EU-ETS*, ReVolt, Feb. 25, 2015, available at http://blogs.worldwatch.org/revolt/a-brief-history-of-fraudulent-activity-on-the-eu-ets-2/.)

[46] (See *id.*)