

## TITLE 17: CALIFORNIA AIR RESOURCES BOARD

### NOTICE OF PUBLIC HEARING TO CONSIDER AMENDMENTS TO THE CALIFORNIA CAP ON GREENHOUSE GAS EMISSIONS AND MARKET-BASED COMPLIANCE MECHANISMS REGULATION

The Air Resources Board (ARB or Board) will conduct a public hearing at the time and place noted below to consider proposed amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation.

DATE: September 22, 2016

TIME: 9:00 a.m.

PLACE: California Environmental Protection Agency  
Air Resources Board  
Byron Sher Auditorium  
1001 I Street  
Sacramento, California 95814

This item may be considered at any time during a meeting of the Board that will commence at 9:00 a.m. on September 22, 2016, and may continue at 8:30 a.m. on September 23, 2016. This item may not be considered until September 23, 2016. Please consult the agenda for the hearing, which will be available at least ten days before September 22, 2016, to determine the day on which this item will be considered. This will be the first of two planned Board hearings on the proposed amendments. The Board will not consider adopting the proposed amendments until a future hearing to be scheduled at a later date.

#### **WRITTEN COMMENT PERIOD AND SUBMITTAL OF COMMENTS**

Interested members of the public may present comments orally or in writing at the hearing and may provide comments by postal mail or by electronic submittal before the hearing.

Written comments not physically submitted at the hearing must be submitted on or after August 5, 2016, and received **no later than 5:00 p.m. on** September 19, 2016. ARB requests that when possible, written and email statements be filed at least ten days before the hearing to give ARB staff and Board members additional time to consider each comment. The Board also encourages members of the public to bring to the attention of staff in advance of the hearing any suggestions for modification of the proposed regulatory action. Comments submitted in advance of the hearing must be addressed to one of the following:

Postal mail: Clerk of the Board, Air Resources Board  
1001 I Street, Sacramento, California 95814

Electronic submittal: <http://www.arb.ca.gov/lispub/comm/bclist.php>

Please note that under the California Public Records Act (Gov. Code, § 6250 et seq.), your written and oral comments, attachments, and associated contact information (e.g., your address, phone, email) become part of the public record and can be released to the public upon request.

Additionally, the Board requests but does not require that persons who submit written comments to the Board reference the title of the proposal in their comments to facilitate review.

## **AUTHORITY AND REFERENCES**

This regulatory action is proposed under that authority granted in California Health and Safety Code, sections 38510, 38560, 38562, 38570, 38571, 38580, 39600, 39601, and 39602. This action is proposed to implement, interpret and make specific sections 38530, 38560.5, 38564, 38565, 38570, and 39600 of the Health and Safety Code and sections 12894 and 16428.8 of the Government Code.

## **INFORMATIVE DIGEST OF PROPOSED ACTION AND POLICY STATEMENT OVERVIEW**

### **Sections Affected:**

Proposed amendments to sections 95802, 95811, 95812, 95813, 95814, 95830, 95831, 95832, 95833, 95834, 95840, 95841, 95841.1, 95851, 95852, 95852.1, 95852.2, 95853, 95856, 95857, 95858, 95870, 95890, 95891, 95892, 95893, 95894, 95895, 95910, 95911, 95912, 95913, 95914, 95920, 95921, 95922, 95941, 95943, 95972, 95973, 95974, 95975, 95976, 95977, 95977.1, 95978, 95979, 95980, 95980.1, 95981, 95981.1, 95983, 95985, 95987, 95990, 96014, and Appendix C, title 17, California Code of Regulation. Proposed adoption of new sections 95803, 95835, 95859, 95871, 95944, 95945, new Appendix D, and new Appendix E, title 17, California Code of Regulations.

### **Documents Incorporated by Reference:**

The following documents are hereby proposed for incorporation by reference to the regulation:

- Processing Tomato Advisory Board (2014). Processing Tomato Advisory Board Inspection Procedures.

### **Background and Effect of the Proposed Regulatory Action:**

The California Global Warming Solutions Act of 2006 (Assembly Bill 32 or AB 32; Nuñez, Statutes of 2006, Chapter 488) authorizes ARB to implement a comprehensive, multi-year program to reduce greenhouse gas (GHG) emissions in California. AB 32 requires ARB to develop a scoping plan to reduce GHG emissions in California to 1990 levels by 2020 and to maintain and continue GHG emissions reductions beyond 2020. ARB's adopted Scoping Plan includes a comprehensive set of actions designed to reduce GHG emissions in California, improve the environment, reduce dependence on foreign oil, diversify energy sources, save energy, create new jobs, and enhance public health. Meeting the goals of AB 32 requires a coordinated set of strategies that work

within a comprehensive tracking, reporting, verification, and enforcement framework to reduce GHG emissions throughout the economy. The Scoping Plan includes a variety of measures that complement and reinforce one another to achieve AB 32 goals, including direct regulations, performance-based standards, and market-based mechanisms.

The Scoping Plan identified a cap-and-trade program (Program) as a key element of California's GHG reduction strategy. As envisioned in the Scoping Plan, the California Cap-and-Trade Program would eventually be linked with cap-and-trade programs operating in other states and provinces. The California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (Cap-and-Trade Regulation or Regulation) sets a fixed limit on GHG emissions from the sources responsible for approximately 80 percent of the State's total GHG emissions and reduces GHG emissions by applying a declining aggregate cap on GHG emissions. The Regulation creates a flexible compliance system through the use of tradable compliance instruments (allowances and offset credits), and it is designed to link with partners in other jurisdictions. The Cap-and-Trade Regulation went into effect January 1, 2012.

In 2015, California ranked as the world's sixth largest economy, up from number ten in 2012. Yet, GHGs per capita and GHG's per gross domestic product declined while the economy grew. Over the past half a century, the State has made great strides in addressing air pollution and continues to seek and implement new policies to meet national and state air quality standards. California's current climate program relies on a mix of an economy-wide cap with a market-based allowance trading system, accompanied by a suite of sector specific policies such as a renewable portfolio standard for electricity, a low carbon fuel standard, and strong vehicle emission standards. The recently released 2014 GHG inventory demonstrates that the State's suite of climate policies are yielding GHG reductions and the State is on track to achieve the 2020 statewide target and accomplish our longer-term climate goals.

Executive Order B-30-15 calls on ARB to update the AB 32 Climate Change Scoping Plan to incorporate the 2030 target. The 2030 Target Draft Scoping Plan will serve as the framework to define the State's climate change priorities for the next 15 years and beyond. Staff intends for the Board to consider and act on an update to the Scoping Plan prior to final action on the Cap-and-Trade Regulation amendments. It will chart the path to achieving the 2030 target and describe the potential role of a post-2020 Cap-and-Trade Program. ARB is proposing to move forward with the regulatory amendments to address areas for the third compliance period (2018-2020) and to provide an investment signal that the current suite of climate policies, including the Cap-and-Trade Program, are delivering the reductions needed to achieve the 2020 target and have an essential continued role to play in achieving the 2030 target. If the Board does not approve a 2030 Target Scoping Plan that includes a post-2020 Cap-and-Trade Program, the post-2020 related amendments would not move forward for Board consideration.

The Regulation is designed to achieve the most cost-effective statewide GHG emissions reductions; there are no individual or facility-specific emissions reduction requirements. Each entity covered by the Regulation has a compliance obligation that is set by its GHG emissions over a compliance period, and entities are required to meet that compliance obligation by acquiring and surrendering allowances in an amount equal to their compliance obligation. Companies can also meet a limited portion of their compliance obligation by acquiring and surrendering offset credits, which are compliance instruments that are based on rigorously verified emission reductions that occur from projects outside the scope of the Program. Like allowances, each offset credit is equal to one metric ton of GHG emissions.

In 2012, ARB staff proposed two sets of amendments to the Regulation. The first set was focused on implementation requirements and the second on linking the California and Québec cap-and-trade programs. At its June 2012 Board hearing, the Board approved the implementation amendments, which became effective September 1, 2012. At its April 2013 Board hearing, the Board approved the linkage amendments with a linked California and Québec cap-and-trade program effective January 1, 2014.

In 2013, ARB proposed another set of amendments to the Regulation that extended transition assistance for some covered entities, refined the required data collected from registered participants to support market oversight, and added an additional cost containment measure. These amendments also included a new Mine Methane Capture compliance offset protocol, updates to offset implementation and usage, refinement of resource shuffling provisions, and changes to the surrender order of compliance instruments. The Board approved these amendments in April 2014, and they took effect July 1, 2014.

In 2014, ARB staff proposed an additional two sets of Cap-and-Trade Regulation amendments. The first set of targeted amendments clarified the quantification of production data, updated the compliance offset protocols, and modified requirements related to compliance, corporate association disclosures, and offset transfer price reporting related to the transaction of market instruments. This first set of 2014 amendments was adopted by the Board in September 2014, and they took effect January 1, 2015. The second set of 2014 amendments modified the Regulation to include a new Rice Cultivation Compliance Offset Protocol and to update the United States Forest Compliance Offset Protocol to allow eligibility for projects in parts of Alaska. This second set of amendments was adopted by the Board in June 2015 and became effective November 1, 2015.

This proposed regulatory action includes ARB staff's proposal to amend the Cap-and-Trade Regulation to extend the major provisions of the Program beyond 2020, to broaden the Program through linkage with Ontario, Canada, to prevent emissions leakage in the most cost-effective manner through appropriate allocation to entities, to clarify compliance obligations for certain sectors, and to enhance ARB's ability to implement and oversee the Program. Amendments also propose to use the Program to demonstrate California's compliance with the federal Clean Power Plan.

In developing the proposed amendments described in this notice, ARB staff held a total of ten publicly noticed workshops from October 2015 through June 2016 and released four discussion papers and three research papers on amendment topics that warranted special attention. Staff engaged with the Environmental Justice Advisory Committee, which was established by ARB pursuant to AB 32 to provide advice in developing the Scoping Plan and other pertinent matters, through calls with the members and public workshops. In addition, ARB staff held numerous informal meetings with stakeholders to discuss specific topics related to the proposed amendments. These forums provided ARB staff and stakeholders with opportunities to present and discuss initial regulatory concepts and potential alternatives. The timeframe of the workshops and meetings allowed ARB to incorporate stakeholder feedback and alternatives into the proposed amendments. Over 200 input letters were received in response to the workshops. For more information on the public process for these proposed amendments, please refer to Chapter IX of the Staff Report.

### **Objectives and Benefits of the Proposed Regulatory Action:**

Air Resources Board staff is proposing these amendments to achieve several goals: (1) to continue the Cap-and-Trade Program beyond 2020, (2) to provide for California compliance with the federal Clean Power Plan, (3) to link the Program with the new cap-and-trade program in Ontario, Canada beginning January 1, 2018, and supplement the regulatory process for potential future linkages, (4) to update the Program with the latest information on leakage risks and other allocation factors; and (5) streamline certain aspects of the Program. The proposed amendments also address stakeholder concerns related to cost-containment. To that effect, staff is proposing amendments to the Regulation, including those related to continuing the Program beyond 2020, regarding compliance period duration, allowance allocation, market program implementation, and offset program implementation. Staff has proposed annual post-2020 allowance budgets. Staff has also proposed post-2020 compliance periods and backstop requirements that support California's compliance with the Federal Clean Power Plan. Staff further proposes to update many assistance factors and some benchmarks used to calculate allowance allocation. Proposed amendments for market provisions relate to implementation, auction and reserve sales, information reporting, cost-containment, and enhancements of market oversight.

Anticipated benefits of the proposed amendments include reducing statewide GHG emissions to 40 percent below 1990 levels by 2030 in accordance with California's Executive Order B-30-15. Given the GHG emissions reductions that will occur because of the Program, these amendments may also directly improve the health and welfare of California residents, worker safety, and the State's environment. Moreover, expanding the number of sources that are able to trade allowances via Program linkage reduces the overall cost of achieving emissions reductions and improves the efficiency of the Program. Additional benefits include improved clarity for covered entities regarding allowance allocation, compliance timelines, and offset program implementation. The proposed amendments will also improve cost-containment, enhance market monitoring, and clarify the emissions reductions that are achieved by the Program.

Specific discussion of the proposed amendments to the Cap-and-Trade Regulation follows. A detailed description of the proposed updates is provided in Chapter II of the “Staff Report: Initial Statement of Reasons for Rulemaking—Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based compliance mechanisms,” referred to as the ISOR. The proposed Regulation Order is provided in Appendix A of the ISOR.

### ***Setting Emissions Caps***

Staff proposes amendments that establish the annual GHG allowance budgets for the post-2020 Program; these budgets prescribe the number of allowances that will be issued by ARB, and thereby set the emissions caps. As with the existing annual caps through 2020, staff proposes to set a cap trajectory for the post-2020 Program that provides a gradual GHG emissions reduction path toward the 2030 and 2050 targets. Staff also proposes to set initial annual allowance budgets for 2031 through 2050 to signal the long-term trajectory of the Program and inform investment decisions. As the Scoping Plan is required to be updated at least once every five years, staff recognizes the equation for the caps from 2032 to 2050 will need to be refined as part of a post-2030 discussion in how best to meet the long-term 2050 target.

### ***Allowance Price Containment Reserve***

Staff is proposing revisions to the operation of the Allowance Price Containment Reserve (Reserve), some of which would take effect beginning in 2018 and some of which would take effect beginning in 2021. The proposed amendments that would take effect in 2018 would transfer to the Reserve State-owned (not utility-consigned) allowances that remain unsold at auction for a significant period of time. The proposed method would specify that allowances that remain unsold for more than 24 months would be transferred to the Reserve. Staff is also proposing a change in the scheduling of Reserve sales such that, outside of the Reserve sale immediately prior to a compliance deadline, Reserve sales would only be held if the settlement price from the auction held in the prior quarter is high enough to equal 60 percent of the lowest Reserve tier price through 2020 and 60 percent of the Reserve Sale Price post-2020. The proposed changes that would take effect in 2021 would collapse the three Reserve tier prices of the existing Reserve into a single tier and would offer allowances from that tier at each Reserve sale at a single price, which would be the sum of the Auction Reserve Price used at auction plus \$60. This \$60 amount reflects the estimated 2020 difference between the Auction Reserve Price and highest Reserve tier price.

### ***Western Climate Initiative and Linkage with Ontario, Canada***

The California Cap-and-Trade Program is linked with the cap-and-trade program in the Canadian province of Québec and is proposing linkage with the new cap-and-trade program of Ontario, Canada, starting in 2018. Linking with other programs expands the number of sources that are able to trade allowances, which reduces the overall cost of achieving emissions reductions and improves the efficiency of the allowance market. In

addition, an expanded, linked Program can result in greater emissions reductions relative to the stand-alone California Cap-and-Trade Program because each linked partner jurisdiction also achieves emissions reductions.

As members of the Western Climate Initiative, California, Québec, and Ontario collaborated on the development of cap-and-trade program-design recommendations, providing a roadmap for program implementation and harmonization. The similar design features and minimum stringency requirements facilitate linkage among the programs. Senate Bill (SB) 1018 (Ch. 39, Statutes of 2012) requires that the Governor of California make several findings prior to linking the California Program with other jurisdictions to enable compliance instruments (allowances or offset credits) issued by other jurisdictions to be used in California's Program (Gov. Code, § 12894(f)).

Currently, the existing Québec and proposed Ontario programs have identified annual allowance budgets only through 2020, and both will begin the process of updating their regulations later this year. Ontario will also include provisions related to offset credits as part of their rulemaking documents later this year. Because neither jurisdiction had begun its rulemaking processes to set post-2020 annual allowance budgets and, in the case of Ontario, to adopt offset provisions, at the time of this Staff Report, ARB staff will include Québec-specific and Ontario-specific rulemaking documents as additional rulemaking materials in fall 2016 as information becomes available. Ontario-specific post-2020 annual allowance budgets and offset credit provisions are expected prior to the submittal of the required SB 1018 findings for linkage with Ontario. The existing SB 1018 findings related to California's linkage with Québec remain valid, and no additional findings under SB 1018 are necessary to remain linked with Québec.

### ***Linkage with External Greenhouse Gas Emissions Trading Systems and Programs***

ARB has considered forms of linkage that would allow registrants to have access to the compliance instruments issued by another Greenhouse Gas Emissions Trading System (GHG ETS) or GHG Program that would not require as extensive of harmonization of operating rules as are required for a Québec or Ontario-style linkage. The need for a more limited form of linkage arises from discussions with other GHG ETSs that have different market rules, different sectoral coverages, and different compliance obligations. In addition, the successful operation of California's Cap-and-Trade Program and offsets protocols has led other jurisdictions to consider adoption of non-ETS programs that would allow retirement of California compliance instruments as a compliance option. While no formal negotiations are under way, staff is proposing several regulatory provisions to clarify how such approaches could be implemented.

Staff is proposing two new forms of agreement with other jurisdictions that would not require the same level of bilateral integration or equivalency as the California-Québec style linkage. The first type would allow entities in California to retire compliance instruments issued by another GHG ETS to be used to meet their compliance obligation in California. Implementation of this type of linkage would require a Board-approved linkage agreement and SB 1018 linkage findings prior to Board approval. The second

form would allow entities registered in a non-California GHG Program to retire California compliance instruments to meet obligations in their own program. (The term “program” encompasses GHG ETS as a specific kind of program, but is not limited to an emissions trading system.) SB 1018 findings would not be required for this type of agreement. For either of these agreements to be reached, there would be a formal rulemaking and public process with a final step of Board approval.

### ***Compliance with the Federal Clean Power Plan (CPP)***

Staff proposes several amendments that will support California’s compliance with the federal Clean Power Plan (CPP), a set of control requirements promulgated by U.S. EPA for GHG emissions from existing electrical generating units (EGU). The proposed amendments would allow compliance by EGUs with the Regulation to demonstrate California’s compliance with CPP as well. The proposed amendments include alignment of Cap-and-Trade Program compliance periods with CPP compliance periods, including an initial bridge period to link the two programs; requirements for all CPP affected EGUs to participate in the Cap-and-Trade Program; provisions setting interim mass targets and final mass targets for aggregate emissions from affected EGUs; and provisions establishing federally enforceable backstop emissions standards.

### ***Allowance Allocation***

Staff proposes to retain the same general approaches to calculating allowance allocation to industrial covered entities, electrical distribution utilities (EDUs), natural gas suppliers, and other entities; however, some changes to allowance allocation provisions are proposed. Some of these changes would take effect beginning in the third compliance period, and further modifications are proposed for the post-2020 Program. Methodologies for post-2020 changes are presented in the Staff Report and placeholders for regulatory language that would allow for implementation of these methodologies are included in the proposed Regulation. Staff proposes to continue stakeholder engagement on proposed methodologies and any proposed revisions to the methodologies. Any additional proposed changes to regulatory text would be circulated for a 15-day comment period.

For allocation to industrial covered entities in the third compliance period, staff proposes changes to update some product-based benchmarks using data that more accurately represent the current sector makeup, eliminate some product data benchmarks, define products such that they align with data reported to ARB in prior product benchmark processes, streamline product benchmarks in the fluid dairy sector, and align benchmarks to ensure that entities producing the same products are allocated to under the same benchmarks. Staff also proposes to eliminate the product-based benchmarks for nut and tissue products and to shift to energy-based benchmarks for these sectors because of technical challenges and data availability. For some sectors, notice is provided in the amendments that staff expects to re-calculate the benchmark, but a newly calculated value is not yet available. Staff is committed to working with stakeholders to acquire the needed data to update these benchmarks before the



upcoming 15-day changes to the Regulation, which will occur during this rulemaking and prior to final consideration of the amendments by the Board.

In 2011 and 2012, Board Resolutions 11-32 and 12-33, respectively, directed staff to investigate potential improvements to industrial allowance allocation to better meet the AB 32 objective to “minimize emissions leakage” to the extent feasible.<sup>1</sup> In response to this Board direction, ARB commissioned three emissions leakage potential studies to inform the development of assistance factors for allowance allocation to manufacturing sectors. Staff proposes to use the findings from these studies, along with complementary data, to revise the methodology for developing assistance factors and to establish new assistance factors for industrial sectors for the post-2020 period. Each of the three studies errs on the side of caution in that they make assumptions that result in higher leakage risk assessments. In utilizing the results of the studies, staff proposes to err on the side of caution to translate the study findings into assistance factors. The assumptions used in the studies and staff’s approach would ensure that sectors in need of high emissions leakage protection will receive appropriate protection. A description of the proposed methodology for calculating revised assistance factors can be found in Appendix E of the ISOR. As this proposed methodology is a new framework relative to the existing methodology for establishing assistance factors and stakeholders have expressed concern regarding adequate time to review the leakage studies and work with staff to review and refine any proposed use of those studies, staff is not including any specific post-2020 assistance factors in the 45-day proposed Regulation, but proposes to continue the discussion with stakeholders and may provide industry specific assistance factors in a 15-day comment period.

Staff proposes several changes and clarifications to the Regulation about allowed uses of EDU and natural gas supplier use of allocated allowance value that would be implemented starting in 2018. Staff proposes to add a requirement that any EDU allocated allowance auction proceeds must be returned to ratepayers in a non-volumetric manner. This requirement would align EDU and natural gas supplier proceeds return requirements. The proposed amendments also create a 10-year deadline for spending allocated allowance auction proceeds to ensure that this value is expended within a reasonable period. Staff also proposes to amend reporting on use of EDU and natural gas supplier allowance value to focus on allocated allowance auction proceeds spent during the previous year, instead of requiring (as is done under the current Regulation) reporting of the previous vintage year’s allocated allowance value.

Staff proposes to continue allowance allocation to EDUs after 2020 using an approach based in part on the methodology used for 2013-2020 EDU allocations. Under this methodology, the 2020 expected cost burden (either the direct cost of compliance with the Program or the pass-through cost in purchased electricity) for each EDU would be the starting point for calculating post-2020 allowance allocations. Staff would calculate the 2020 emissions cost burden for each EDU using load data from the California Energy Commission’s 2015 Demand Forecast and resource data from 2015 S-2 forms, supplemented by additional data as needed. The allowance allocation calculation

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<sup>1</sup> Health & Saf. Code, § 38562(b)(8).

would be modified to exclude some allowances that are currently provided to the electricity sector; these allowances would instead be allocated directly to industrial entities. Staff also proposes to allocate to EDUs for renewable electricity in certain cases where the entity has invested renewable generation sources, but the electricity from those sources is not directly delivered to California. This allowance allocation would be instead of continuing the Renewables Portfolio Standard (RPS) adjustment in the post-2020 Program. To address the reality that not all renewable electricity is directly delivered to California, staff proposes to set the amount of zero-GHG emission RPS-eligible electricity for the expected 2020 emissions calculation for each EDU at 28 percent instead of 33 percent, which is the 2020 RPS requirement for all EDUs. The amount allocated to each EDU would then decline at the annual cap decline factor in subsequent years. In addition, because the final large coal-powered generator providing electricity to California utilities will be retired by 2026, utilities using power from that resource would have their allowance allocation adjusted to account for the replacement of coal power with natural gas power beginning with vintage 2026 allowance allocations. Staff proposes to continue stakeholder engagement on this proposed methodology and any proposed revisions to the methodology. Proposed regulatory text would be circulated for a 15-day comment period.

For post-2020 natural gas supplier allocation, staff is evaluating an acceleration of the consignment requirement to ensure a level playing field in terms of consignment for electricity and natural gas utilities. This change would ensure that a carbon cost is felt by all users of natural gas, whether those users are covered entities with a direct carbon cost or non-covered entities that face an indirect carbon cost. Ensuring that the cost signal is felt by all natural gas customers will further the policy desire to limit the amount of fugitive methane emissions from this sector, incentivizing efficiency or alternatives to the use of natural gas. Staff proposes to continue stakeholder engagement on natural gas supplier consignment. Proposed regulatory text would be circulated for a 15-day comment period. Related to reaching full consignment of natural gas supplier allocation, staff proposes to extend the limited exemption of emissions from qualified thermal output for operators of cogeneration facilities and district heating facilities until natural gas suppliers are required to consign all allowances to auction. Once full consignment of allocated allowances to auction is achieved, there will no longer be a need for the exemption.

Staff proposes minor changes to the legacy contract generator allocation provisions of the current Regulation to move the application deadline earlier in the year and to the requirements for what constitutes a good faith renegotiation. Staff also proposes to amend the regulatory requirements for return of allocated allowances to ARB when an entity does not operate under the activity for which it was provided allocation or when the entity does not have a compliance obligation. These changes would be implemented in the third compliance period.

For the post-2020 period, staff is also evaluating amendments that may continue to allocate allowances to universities, public service facilities, and water agencies after

2020 using the same methodologies that currently apply to budget year 2016 to 2020 allocations. Proposed regulatory text would be circulated for a 15-day comment period.

### ***Covered Sectors, Covered Entities, and Exempt Emissions***

Staff proposes to change some Regulation provisions that define which entities and emissions are covered by the Program. These changes generally aim to provide more equitable treatment of facilities and emissions that are covered by the Program and to enhance the environmental benefits of the Program. Staff proposes to change the entity that incurs the compliance obligation for emissions associated with imported liquefied petroleum gas (LPG) from the consignee of the LPG to the importer of the LPG. This change harmonizes the Cap-and-Trade Regulation with the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions (MRR).

Staff proposes to add a limited exemption from a compliance obligation for emissions from the direct combustion of municipal solid waste in a waste-to-energy facility for the 2016 and 2017 data years. Emissions from waste-to-energy facilities were exempt from the Program from 2013 through 2015, and this change extends the exemption through the second compliance period. The waste-to-energy facilities will no longer be exempt beginning in 2018. Staff also proposes to extend the limited exemption of emissions from qualified thermal output for operators of cogeneration facilities and district heating facilities until natural gas suppliers are required to consign all allowances to auction.

Staff proposes a limited exemption of emissions for liquefied natural gas suppliers for the second compliance period. Staff believes that a limited exemption of these emissions from the Program is necessary during the second compliance period to address the potential for emissions leakage created by a mismatch in the points of compliance between MRR and the Cap-and-Trade Regulation. With the proposed changes to the Regulation and MRR, the points of compliance will be aligned and there will no longer be a leakage risk.

Staff proposes to remove emissions from natural gas hydrogen fuel cells from the list of emissions without a compliance obligation; emissions from these sources would begin incurring a compliance obligation in 2018, at the start of the third compliance period. In addition, staff proposed to remove emissions from continuous-bleed pneumatic devices from the list of emissions without a compliance obligation beginning in 2019.

Finally, staff proposes changes to the Regulation to allow a covered entity that is eligible to exit the Program due to reduced annual emissions that were below the threshold for an entire compliance period to remain in the Program as an opt-in covered entity if the entity so chooses.

### ***Electricity Sector***

The current accounting system in place for imported electricity through the California Independent System Operator's (CAISO) Energy Imbalance Market (EIM) is

inconsistent with the requirement of AB 32 that ARB account for the total GHG emissions in the State, including all GHG emissions from the generation of electricity delivered to and consumed in California. Because the EIM cost optimization model may not in all cases report the full GHG burden experienced by the atmosphere as a consequence of the electricity consumed in California, resulting in emissions leakage, ARB staff proposes to retain the current point of compliance of the CAISO participating resource scheduling coordinator, but to supplement that compliance obligation with a compliance obligation on entities that purchase from EIM (“EIM purchasers”) to serve load in California. The regulatory amendments provide one approach to support full GHG accounting. Staff will continue to coordinate with CAISO and stakeholders to evaluate any needed alternatives or refinements to the proposed amendments. Further options have been provided to stakeholders in a recent workshop,<sup>2</sup> and may be explored later in this regulatory process, with an opportunity for notice and comment, as an alternative to the option currently proposed.

In addition, as described above in the allowance allocation section, staff proposes to discontinue the RPS adjustment after 2020. This RPS adjustment is voluntary, and it is only applicable when the importer purchases both electricity and renewable energy credits (REC) together and can demonstrate that the electricity was not delivered to California. This provision of the Regulation was extremely difficult to track and enforce, in part because the Regulation requires that RPS adjustments could only be taken in cases in which the electricity associated with the RECs was not directly delivered to California and in several cases resulted in claims of a RPS adjustment that exceeded the generation capacity of a specific generating unit. After 2020, staff proposes to modify the Regulation to provide each EDU with an allowance allocation that accounts for RPS-eligible electricity that is purchased together with RECs but cannot be directly delivered to California, and eliminate the RPS adjustment from the Regulation.

Staff proposes to modify the eligibility requirements for Voluntary Renewable Electricity (VRE) program participation to permit allowance retirement for electricity generation from solar installations interconnected with the distribution system of a California EDU, permit allowance retirement for RECs as long as they have not been used for compliance in any other program, and continue to permit allowance retirement for solar generation that has received an incentive under California’s Solar Initiative Programs. Additional proposed modifications specify how allowance retirement will be allocated among VRE applicants during the year in which the VRE account is exhausted and clarify requirements for documentation of generator eligibility. Staff does not propose to allocate any additional allowances to the VRE Reserve Account because requests for VRE retirement have been much lower than anticipated. Finally, staff proposes several changes to provide greater clarity and eliminate language that is no longer necessary.

In addition, staff is proposing to remove the qualified export exemption in the third compliance period to ensure that emissions leakage is minimized to the extent feasible, as required by AB 32.

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<sup>2</sup> [http://www.arb.ca.gov/cc/capandtrade/meetings/062016/arb\\_and\\_caiso\\_staff\\_presentations.pdf](http://www.arb.ca.gov/cc/capandtrade/meetings/062016/arb_and_caiso_staff_presentations.pdf); also included in Appendix F.

## ***Compliance Offset Credits***

Staff is proposing to clarify and modify aspects of offset program implementation. These amendments address listing and delegation requirements, regulatory compliance, changes in law, Authorized Project Designee requirements, offset project listing requirements, project transfer requirements, monitoring and reporting requirements, verification requirements, verification body requirements, offset credit issuance, forestry reversals, invalidation, and the early action program.

Staff is proposing modifications to the offset listing requirements to specify that all projects must list no later than one year after Offset Project Commencement. Staff is also proposing modifications to allow offset projects to transfer from one Offset Project Registry to another and to allow transferring of offset projects to and from ARB. Staff is proposing a clarification to the listing requirements for forest offset projects to prevent relisting projects on the same land as a previous project. Staff is proposing modifications to the Authorized Project Designee section to define which individuals from the Offset Project Operator may delegate responsibility to the Authorized Project Designee.

Staff is proposing clarifications to the offset project reporting requirements to more expressly identify the consequences of not reporting and clarify that a project will terminate if reporting is not continuous. Proposed changes clarify that the offset project must relist under the most recent version of the applicable offset protocol if the initial reporting deadline is missed. Additional proposed modifications extend the initial reporting deadline to 28 months to allow for a 24-month Reporting Period and an additional four months to prepare the Offset Project Data Report. Other changes clarify attestation, version number, and date requirements for Offset Project Data Reports. Staff is also proposing modifications to the procedures for interim data collection to recognize that more than gas and fuel data are used in the quantification of GHG emissions reduction and removal enhancements.

Staff is proposing modifications to the requirement that offset projects may not receive ARB offset credits for the entire Reporting Period when they are out of regulatory compliance with any local, regional, and national environmental health and safety laws and regulations that apply to the offset project. The proposed amendments would limit the period of time livestock and mine methane capture offset projects are ineligible to receive ARB offset credits for not being in regulatory compliance to the time period the project was actually out of regulatory compliance, to the extent that time period can be proven.

Staff is also proposing clarifications that if a law, regulation, or legally binding mandate to limit GHG emissions that directly applies to an offset project goes into effect during the crediting period of a project, then the project may continue to receive ARB offset credits for the remainder of their crediting period, but may not renew their crediting period. Staff is proposing modifications to the verification requirement for sequestration offset projects to recognize that, even after a crediting period ends for a sequestration

project, the project may continue to sequester carbon. For projects that significantly increase their stored carbon, the proposed changes would permit less-frequent verification. Staff is also proposing modifications to the verification requirements to clarify that, if a project is deferring verification for a Reporting Period, the Offset Verification Statement does not need to be submitted to ARB within eleven months of the end of the Reporting Period.

Staff is proposing modifications to the verification services requirements to simplify verifier and verification body rotation. Further proposed modifications clarify requirements for the start of verification services and scheduling of verification body audits. Staff is also proposing modifications to provide verifiers additional flexibility about where verification activities must occur. Verifiers may choose which activities are necessary to conduct while on site and which activities may be completed during the desk review. The proposed modifications also clarify that offset verification services are not complete until ARB offset credits have been issued for the Reporting Period, that the verification body has 15 calendar days to revise the offset verification report and the Offset Verification Statement in response to an ARB request, and that the Offset Project Operator or Authorized Project Designee are the only entities that may change the Offset Project Data Report. Staff is also proposing modifications to the verification body requirements to clarify that direct supervision of a technical expert is only needed during the site visit and modifications to the conflict of interest requirements.

Staff is proposing modifications to the issuance procedures for both registry and ARB offset credits to allow the Authorized Project Designee to request issuance of both registry and ARB offset credits to any authorized party. Staff is proposing modifications to the issuance of ARB offset credits to clarify that ARB offset credits may only be issued for GHG emissions reductions or removal enhancements that occur during a Reporting Period, to clarify that ARB offset credits will not be issued if they would immediately be subject to invalidation, and to clarify that the GHG emissions reductions and removal enhancements must meet the requirements of the entire Regulation and the relevant Compliance Offset Protocol to be issued ARB offset credits. The proposed changes also clarify that the issuance of ARB offset credits is limited to projects located in the United States or United States Territories, which is consistent with the geographic scope of the compliance offset protocols. Further modifications are proposed to change the order in which registry offset credits are canceled during the ARB offset credit issuance process.

Staff is proposing modifications to forestry offset reversal requirements to allow additional time to provide a verified estimate of carbon stocks after an unintentional reversal to allow for salvage harvesting, reinventory, and verification. Additional proposed modifications correct errors in the calculation of the number of ARB offset credits to retire or replace after a reversal.

Finally, staff is proposing several modifications to the invalidation requirements. Proposed changes clarify that correctable errors found during a second verification of an Offset Project Data Report cannot be fixed and should be noted in the Offset

Verification Statement. Further proposed modifications clarify that more than three early action reporting periods may have their invalidation timeframes shortened by a subsequent full offset verification. Proposed modifications also allow compliance offset projects to have the invalidation timeframe of the last three Reporting Periods, instead of just the final Reporting Period, in a non-renewed crediting period reduced by a reverification of the final Offset Project Data Report. Staff is proposing modifications to existing provisions that make offset credits subject to invalidation for the entire Reporting Period when the offset project is out of regulatory compliance with any local, regional, and national environmental health and safety laws and regulations that apply to the offset project. Specifically, the proposed amendments would limit the period of time offset credits issued to livestock and mine methane capture projects are subject to invalidation for not being in regulatory compliance to the time period the project was actually out of regulatory compliance, to the extent that time period can be proven. Additional proposed modifications quantify the number of ARB offset credits that must be removed from the ARB Forest Buffer Account after an invalidation and identify who is responsible for replacing a portion of the invalidated ARB offset credits.

### ***Registration in CITSS***

Staff is proposing an amendment to the Regulation that directs a covered entity to register in the jurisdiction in which the entity incurs a compliance obligation. The proposed change requires that such entities register in CITSS as California covered entities. The proposed change will allow an entity that incurs compliance obligations in more than one jurisdiction to have a CITSS entity account in each jurisdiction in which an obligation is incurred.

Staff is proposing an amendment to the Regulation to allow designated account representatives to be swapped at any time upon receipt of a designation of a Primary Account Representative or Alternate Account Representative, and to make an individual who has been convicted of a felony offense in the United States or outside of the United States ineligible for user registration. Staff is also proposing to amend the Regulation to allow an individual who will be a representative of a covered entity located outside of the United States to submit evidence of an account at a bank outside of the United States. The user registration must be accompanied by an attestation from the covered entity that the individual will be a designated representative and that the covered entity does not have personnel located in the United States that could be designated as the representative.

Staff is proposing to move the requirements for initial registration, account assignment, assignment of account representatives, corporate association disclosures, and know-your-customer requirements to sections 95830 through 95834 of the Regulation. Provisions relating to changes in facility assignment to accounts, new facilities, changes in entity registration type, and requirements for leaving the Program are all consolidated in new section 95835.

Staff incorporated, and then modified, several corporate association disclosure requirements during rulemaking proceedings in 2013 and 2014. Staff proposes changes to the requirements to further clarify and streamline these disclosure requirements. The proposed amendments would require that a registered entity would continue to disclose (a) all direct and indirect corporate associations with other registered entities; (b) all parent entities up through the ultimate parent (even if those entities are not registered); and (c) all direct and indirect corporate associations between chains of registered entities that have a direct or indirect association. A registered entity would also have to disclose direct corporate associations with another registered entity if the two entities employ the same account representative or consultant, unless the entities have documented procedures to prevent the sharing of information. Outside of the above disclosures, the proposed amendments specify that a registered entity would only have to disclose direct corporate associations with unregistered entities (a) that operate in related markets and (b) upon request of the Executive Officer. Finally, a registered entity that intends to only hold offset credits would not have to disclose any corporate associations.

### ***Auction and Reserve Sale Administration***

Staff is proposing modifications to Regulation provisions that describe the administration and format of auctions and sales of allowances from the Allowance Price Containment Reserve (Reserve sales). The proposed modifications are largely to provide clarity, internal consistency, and improvements for implementation efficiency. All proposed changes are informed by staff experience gained through conducting jurisdiction-specific auctions, conducting joint auctions with Québec, and offering Reserve sales to date.

### **COMPARABLE FEDERAL REGULATIONS:**

There are no directly comparable federal regulations mandating economy-wide Cap-and-Trade Programs. The proposed regulatory action continues to place a compliance obligation on large industrial sources, fuel suppliers, and electricity generators and importers for the GHG emissions associated with their activities in 2021 and beyond. The GHG emissions from these entities, except for the GHG emissions from electricity generating units (EGUs) covered by the federal Clean Power Plan (Code of Federal Regulations, Title 40, Chapter 1, Subchapter C, Part 60, Subpart UUUU) (CPP), beginning in 2022, are not currently covered by any federal regulations. Covering these GHG emissions does not conflict with federal regulations.

Affected EGUs under CPP are covered under the proposed regulatory action; indeed, compliance by affected EGUs with the proposed amendments is the means by which the State proposes to demonstrate compliance with CPP. The federal CPP allows for “state measures,” such as California’s Cap-and-Trade Program, that place requirements on affected EGUs in order to meet aggregate mass-based emissions limits for the entire sector during each compliance period. The proposed regulatory action is not different



from federal regulations; it is a “state measure” that is embraced by the CPP as a means of complying with federal regulations.

### **AN EVALUATION OF INCONSISTENCY OR INCOMPATIBILITY WITH EXISTING STATE REGULATIONS**

During the process of developing the proposed regulatory action, ARB has conducted a search of any similar regulations on this topic and has concluded that these regulations are neither inconsistent nor incompatible with existing state regulations.

### **MANDATED BY FEDERAL LAW OR REGULATIONS**

The proposed regulatory action is not generally mandated by federal law or regulations. However, CPP mandates, discussed above, do require that California limit emissions from electricity generating units at certain power plants by developing a compliance plan and accompanying regulations. Although California has discretion as to how it complies with CPP, it must achieve compliance. ARB is proposing amendments to the Cap-and-Trade Regulation, as described above, that can address CPP compliance, thereby supporting compliance with both state and federal mandates.

### **DISCLOSURES REGARDING THE PROPOSED REGULATION**

#### **Fiscal Impact/Local Mandate Determination Regarding the Proposed Action**

The determinations of the Board’s Executive Officer concerning the costs and savings necessarily incurred by public agencies and private persons and businesses in reasonable compliance with the proposed regulatory action are presented below.

#### *Cost to any Local Agency or School District Requiring Reimbursement under section 17500 et seq.:*

Currently, some local government entities (e.g., local utilities) are regulated parties in the Program and would continue to have a compliance obligation under the proposed regulatory action. These local governments could face administrative costs as well as costs associated with obtaining and surrendering compliance instruments. There may be additional impacts based on the continuance and appropriation of Greenhouse Gas Reduction Fund (GGRF) funds (i.e., the State’s portion of proceeds from Cap-and-Trade auctions) that are directed to local government. However, pursuant to Government Code sections 11346.5(a)(5) and 11346.5(a)(6), the Executive Officer has determined that the proposed regulatory action would not create costs or mandate to any local agency or school district that are reimbursable by the State pursuant to Government Code, title 2, division 4, part 7 (commencing with section 17500).

#### *Cost or Savings for State Agencies:*

The Cap-and-Trade Program covers some State government entities. Examples

include several University of California and California State University campuses. These entities would incur compliance costs under the proposed regulatory action. The State universities receive an allocation of allowances so they do not have to cover the full cost of their emissions obligation. State entities that purchase goods and fossil fuels in California, but are not directly covered by the Regulation, will face higher prices for fossil fuels and products that use fossil fuels. State entities could also potentially benefit from new lower-carbon technologies and innovations that may be indirect benefits of the proposed regulatory action. There could also be impacts to the State budget based on the continuance of GGRF fund that are directed to State government. Any changes to allowance allocation that provide for greater amounts of industrial assistance will also shift some allowance value that would have gone to the State for appropriation through the GGRF to covered entities, and vice versa.

*Other Non-Discretionary Costs or Savings on Local Agencies:*

No additional costs or savings to local agencies beyond those addressed above under “Cost to any Local Agency or School District Requiring Reimbursement under section 17500 et seq.” are anticipated.

*Cost or Savings in Federal Funding to the State:*

No costs or savings in federal funding is anticipated.

**Housing Costs (Gov. Code, § 11346.5, subd. (a)(12)):**

The Executive Officer has also made the initial determination that the proposed regulatory action will not have a significant effect on housing costs.

**Significant Statewide Adverse Economic Impact Directly Affecting Business, Including Ability to Compete**

The Executive Officer has made the initial determination that the proposed regulatory action would not have a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states, or on representative private persons.

**MAJOR REGULATION: Statement of the Results of the Standardized Regulatory Impact Analysis (SRIA) (Gov. Code, § 11346.3, subd. (c)):**

On April 1, 2016, ARB submitted a Standardized Regulatory Impact Assessment (SRIA) to the California Department of Finance (DOF). On May 9, 2016, DOF provided ARB with written comments on the submitted SRIA. ARB has revised the SRIA based on modifications included in the proposed regulatory action since the original SRIA submittal and to address DOF comments. The revised SRIA is included as Attachment C to the ISOR. The SRIA analysis is based on a range of prices that are intended to bound the possible allowance prices that may be observed under the proposed

regulatory action. A large number of factors influence allowance price, including the ease of substitution by firms to low-carbon production methods, consumer price response, and the pace of technological progress. A number of policy factors also impact the allowance price including methods for allocating allowances, the use of auction proceeds, and linkage with other jurisdictions, as well as factors such as the cost of GHG emission reduction technology, and potential impacts to the price of fuel. Impacts on California State Gross Domestic Product are small relative to the size of the California economy across the allowance prices analyzed.

*Creation or elimination of jobs within the State.*

The proposed regulatory action is estimated to result in small increases or decreases in employment. In aggregate, the REMI model utilized for the SRIA analysis predicts a small impact on overall employment in the State at the allowance prices analyzed. The slight increase in employment growth can be attributed to the recycling of allowance value to GGRF recipients and consumers. However, over the entire timeframe of the analysis, estimated increases in production costs mitigate the effect of the allowance value return leaving employment growth roughly unchanged relative to the baseline scenario in which the proposed amendments are not implemented.

*The creation of new businesses or the elimination of existing businesses within the state.*

The proposed regulatory action may lead to the elimination of some businesses in California as similar businesses outside California do not currently have to account for carbon costs. However, allocation to covered sectors is meant to minimize the potential for business elimination in California. The proposed regulatory action may also lead to the creation of businesses that produce or sell low-carbon technologies or other market related businesses such as offset providers and verifiers. The 2015 Paris Agreement under the United Nations Framework Convention on Climate Change aims at keeping the global temperature rise below 2 °C. The agreement is intended to motivate the United States and other signatories to start to take action to reduce GHG emissions. Increased global carbon pricing may mitigate the impact of the proposed regulatory action on the creation and elimination of business in California.

*Competitive advantages or disadvantages for businesses currently doing business within the State.*

Allocation of allowances to covered sectors is meant to minimize the potential for emissions leakage, which has the associated effect of minimizing competitive disadvantage for California businesses. In the short-term, this design feature of the Program should mitigate some competitive disadvantages for businesses in California as similar businesses outside California currently do not face a carbon price. Because of the 2015 Paris agreement under the United Nations Framework Convention on Climate Change, aimed at keeping the global temperature rise below 2 °C, we can expect the United States and other signatories to start to take action to reduce GHG

emissions. As these policies come online, businesses outside of the state will begin to face similar carbon costs in order to reduce GHGs, reducing the relative impact of the proposed regulatory action on California businesses.

*Increase or decrease of investment in the State.*

The proposed regulatory action is estimated to have a small impact on California private investment, which consists of purchases of residential and nonresidential structures and of equipment and software by private businesses and nonprofit institutions. The macroeconomic modeling results estimate that the annual rate of California investment is basically unchanged from the baseline scenario by the proposed amendments.

*The incentives for innovation in products, materials, or processes.*

The proposed regulatory action may offer some additional incentives for innovation in low carbon technology above what is provided by the complementary policies. The declining cap over time will require Cap-and-Trade Program covered entities to reduce emissions. The carbon price sends a signal for research, development, and deployment of innovative technologies and fuels that can support long-term GHG emissions reductions while production and the economy continue to grow. The carbon price may also lead existing covered entities to evolve from the production of traditional fuels to the production of the lower carbon fuels.

*The benefits of the regulation.*

The SRIA analysis does not quantify the benefits of the proposed regulatory action. However, the Cap-and-Trade Program has supported the mitigation of the economic consequences of rising GHG emissions. The Program has been designed to support growth in activities that result in lower GHG emissions. Most benefits are an indirect result of the Program, as investments in energy efficiency and energy conservation can result in economic benefits to consumers and clean energy sectors. For additional benefit analysis, please see heading titled, "Objectives and Benefits of the Proposed Regulatory Action".

*Department of Finance Comments and ARB Responses.*

ARB summarized the comments received on May 9, 2016, from DOF. Subsequently, ARB revised the SRIA to address DOF comments and changes to the proposed regulatory action. The revised SRIA and ARB's responses to DOF's comments can be found in Appendix C of the ISOR. The original SRIA submitted to DOF on April 1, 2016, and DOF's comment letter can be found at the DOF Major Regulations website.<sup>3</sup> Below is a summary of DOF's comments and ARB's responses.

In comments addressing the SRIA of the proposed amendments to the Regulation,

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<sup>3</sup> [http://www.dof.ca.gov/Forecasting/Economics/Major\\_Regulations/Major\\_Regulations\\_Table/](http://www.dof.ca.gov/Forecasting/Economics/Major_Regulations/Major_Regulations_Table/)

DOF generally concurred with the methodology and results of the SRIA. While the results of the assessment were sufficient to meet the requirements of CCR, Title I, Section 2002 (a)(1), some enhancements to the analysis were suggested by DOF to clarify the results. Specifically, DOF made three main suggestions for ARB to:

- Narrow the ranges of estimated impacts, if possible;
- Provide historical context to demonstrate how the current Cap-and-Trade Program has differed from initial expectations; and
- Translate results into specific impacts on individuals and businesses.

#### DOF Comment #1

The SRIA could be more specific about what impacts are expected rather than relying on a very large range in allowance value price. It is necessary to use a range of allowance values in this modeling assessment, as there will be uncertainty, but a smaller range would be helpful for the public in focusing their comments. In addition, future SRIAs for proposed regulations that affect the Cap-and-Trade Program should discuss how those regulations would affect the impacts discussed here.

#### ARB Response to DOF Comment #1

A large number of factors influence the price of allowances in the Cap-and-Trade Program.<sup>4</sup> The technological and behavioral factors include the ease of switching to low-GHG methods of production, the extent to which consumers shift to low-GHG products in response to price changes, and the pace of technological progress. A number of policy factors also apply, including emissions reductions from complementary environmental policies. The proposed amendments will affect the cost of using energy derived from fossil fuels, which in turn will affect the price of most goods and services throughout the California economy. Some covered entities will make efficiency improvements that result in reduced fuel expenditures and reduced emissions. The increased price of energy will cause secondary emissions reductions by non-covered entities through increased energy efficiency, decreased purchases of energy-intensive goods and services, and increased conservation (e.g., driving less).

Since the Regulation does not specify how or where emissions reductions will occur, it is impossible to know in advance what covered or non-covered entities will do to comply, or how they will respond to the proposed amendments. Therefore, possible compliance responses, as observed through the estimated change in capital, labor, energy, and fuel expenditures, must be modeled across a wide range of carbon prices. In addition, the impacts of any future regulatory action on these amendments to the Cap-and-Trade Regulation will be discussed when appropriate in subsequent rulemakings.

### DOF Comment #2

The SRIA could provide some historical context about how results of the existing Cap-and-Trade Program differed from initial expectations, and where uncertainty still remains. This information would be helpful in drawing attention to areas where the public could provide additional information on new technologies, or weigh in on potential unintended consequences.

### ARB Response to DOF Comment #2

California's Cap-and-Trade Regulation was adopted by ARB in October 2011 and achieved full implementation in 2015 with the inclusion of transportation fuels and natural gas suppliers under the cap. To date there have been two compliance deadlines in the Program, covering the first compliance period, 2013 and 2014. While there are many ex ante estimates of the impact of the Cap-and-Trade Program, it is difficult to assess the realized impacts given the short implementation timeline thus far. Amendments to the Cap-and-Trade Regulation in 2012, 2013, and 2014 provided opportunities to modify the Program and address unanticipated impacts, including changes to the tracking system, allowance allocation, and cost containment provisions. ARB will continue to monitor the Program and make modifications as necessary.

### DOF Comment #3

There are some areas where it is difficult to translate results into how individuals or businesses would be affected. For example, Tables 10 and Table 13 present percentage changes, but this information would be more relatable if presented in dollar amounts. Additional examples of how individuals and businesses could be affected would be helpful.

### ARB Response to DOF Comment #3

The SRIA has been revised to address these concerns. Table 10 and Table 13, now Tables 9 and 13 in the revised SRIA, have been modified to present the information in absolute dollar amounts, and additional detail has been added to the discussion regarding the impact to businesses and individuals.

### *Effect on Small Business*

Based on the Program inclusion threshold and on the entities already subject to the Cap-and-Trade Regulation, no small businesses would face a compliance obligation under the proposed regulatory action. Small businesses will be indirectly affected by the Cap-and-Trade Program due to the increased price of fossil fuels. Costs will vary based on the business's use of fossil fuels and its ability to reduce fossil fuel in its operations. Small businesses could experience some energy cost savings as a result of adoption of energy efficient technologies. The proposed regulatory action may also benefit small businesses that produce or sell low-carbon technologies and could result in the creation of some new small businesses. A detailed discussion of these impacts can be found in Chapter VI of the Staff Report.

Business Report (Gov. Code, §§ 11346.5, subd. (a)(11); 11346.3, subd. (d)):

In accordance with Government Code sections 11346.5, subdivisions (a)(11) and 11346.3, subdivision (d), the Executive Officer finds the reporting requirements of the proposed regulatory action which apply to businesses are necessary for the health, safety, and welfare of the people of the State of California.

Cost Impacts on Representative Private Persons or Businesses (Gov. Code, § 11346.5, subd. (a)(9)):

In developing this regulatory proposal, ARB staff evaluated the potential economic impacts on representative private persons or businesses. While individuals are not directly covered by the Cap-and-Trade Regulation, the proposed regulatory action will result in a cost to individuals through an increase in the price of fossil fuels and other goods based on their carbon content. Some businesses are covered by the Cap-and-Trade regulation, but sector costs vary widely, so there is no typical business for purposes of estimating cost of compliance. Businesses in California will also face an increase in the cost of goods based on their carbon content. ARB is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

**Alternatives Statement**

Before taking final action on the proposed regulatory action, the Board must determine that no reasonable alternative considered by the Board, or that has otherwise been identified and brought to the attention of the Board, would be more effective in carrying out the purpose for which the action is proposed, or would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

The Executive Officer analyzed two alternatives to the proposed regulation: one less flexible than the proposal (Alternative 1: Facility Specific Requirements); and one that may not achieve the environmental objectives (Alternative 2: Carbon Fee).

Under Alternative 1, ARB would cease to operate the Cap-and-Trade Program and would instead implement facility-specific requirements designed to achieve the same amount of estimated emissions reductions. This option would focus on requiring each covered facility to reduce emissions from a historical baseline level to 40 percent below that level by 2030 with interim targets. In addition to these reductions, supplemental policies may be needed to reduce emissions from non-covered sources. This alternative was rejected because it increases costs, reduces flexibility, and could generate more emissions leakage compared to the proposed Cap-and-Trade Program.

Under Alternative 2, a carbon fee would provide price certainty to covered facilities but would not guarantee that California would meet its GHG reduction goals. With perfect

information, a carbon fee and a cap-and-trade program could be designed to have identical effects on the economy. With imperfect information about the costs of emissions, a carbon fee would provide price certainty and an uncertain amount of emissions reductions, while a cap-and-trade program would provide a certain cap on emissions at an uncertain price. A carbon fee might not result in meeting the 2030 emissions target, or it could result in overshooting the target at an unnecessarily high cost. Because the primary goal of the Cap-and-Trade Program is to meet GHG emissions targets while minimizing costs, ARB staff believes a cap-and-trade program is a better match to California's goals.

## **ENVIRONMENTAL ANALYSIS**

ARB, as the lead agency for the Cap-and-Trade Regulation, prepared a Draft Environmental Analysis (EA) in accordance with the requirements of its regulatory program certified by the Secretary of Natural Resources. (California Code of Regulation, title 17, sections 60006-60008; California Code of Regulation, title 14, section 15251, subdivision (d).) The Draft EA provides a single coordinated programmatic environmental analysis of an illustrative, reasonably foreseeable compliance scenario that could result from implementation of the proposed amendments to the Cap-and-Trade Regulation as well as the proposed Clean Power Plan (CPP) Compliance Plan, including aspects of the Regulation that implement aspects of the proposed CPP Compliance Plan. The proposed Cap-and-Trade Regulation and CPP Compliance Plan have two separate notices and staff reports and will be considered by the Board in separate proceedings, but are connected actions. This approach is consistent with CEQA's requirement that an agency consider the whole of an action when it assesses a project's environmental effects, even if the project consists of separate approvals (Cal. Code Regs., tit. 14, § 15378(a)).

The resource areas from the California Environmental Quality Act (CEQA) Guidelines Environmental Checklist were used as a framework for a programmatic environmental analysis of the direct and reasonably foreseeable indirect environmental impacts resulting from implementation of the proposed amendments to the Cap-and-Trade Regulation, including those related to the CPP Compliance Plan. The Draft EA provides an analysis of both the beneficial and adverse impacts and feasible mitigation measures for the reasonably foreseeable compliance responses associated with the recommended amendments.

The Draft EA concluded implementation of these proposed amendments could result in the following short-term and long-term beneficial and adverse impacts: beneficial short-term and long-term impacts to air quality (statewide), energy demand and greenhouse gases; less-than-significant impacts to aesthetics, agriculture and forest resources, air quality, biological resources, cultural resources, energy demand, geology, soils, and mineral resources, greenhouse gases, hazards and hazardous materials, hydrology and water quality, land use and planning, noise, population employment, and housing, public services, recreation, transportation and traffic and utilities and service systems; and potentially significant and unavoidable adverse impacts to aesthetics, agriculture and forest resources, air quality (construction-related impacts, potential localized increases,



and potential odor impacts from Livestock Protocol implementation), biological resources, cultural resources, geology and soils, hazards and hazardous materials, hydrology and water quality, land use and planning, noise, recreation, and transportation/traffic. The potentially significant and unavoidable adverse impacts are primarily related to short-term, construction-related activities and implementation of offset projects that are reasonably foreseeable as a result of the proposed amendments to the Cap-and-Trade Regulation. This explains why some resource areas are identified above as having both less-than-significant impacts and potentially significant impacts. Please refer to the Draft EA for further details.

The Draft EA is included as Appendix B to the ISOR and can be obtained from ARB's website at: <http://www.arb.ca.gov/regact/2016/capandtrade16/capandtrade16.htm>

### **SPECIAL ACCOMMODATION REQUEST**

Consistent with California Government Code Section 7296.2, special accommodation or language needs may be provided for any of the following:

- An interpreter to be available at the hearing;
- Documents made available in an alternate format or another language;
- A disability-related reasonable accommodation.

To request these special accommodations or language needs, please contact the Clerk of the Board at (916) 322-5594 or by facsimile at (916) 322-3928 as soon as possible, but no later than 10 business days before the scheduled Board hearing. TTY/TDD/Speech to Speech users may dial 711 for the California Relay Service.

Consecuente con la sección 7296.2 del Código de Gobierno de California, una acomodación especial o necesidades lingüísticas pueden ser suministradas para cualquiera de los siguientes:

- Un intérprete que esté disponible en la audiencia
- Documentos disponibles en un formato alterno u otro idioma
- Una acomodación razonable relacionados con una incapacidad

Para solicitar estas comodidades especiales o necesidades de otro idioma, por favor llame a la oficina del Consejo al (916) 322-5594 o envíe un fax a (916) 322-3928 lo más pronto posible, pero no menos de 10 días de trabajo antes del día programado para la audiencia del Consejo. TTY/TDD/Personas que necesiten este servicio pueden marcar el 711 para el Servicio de Retransmisión de Mensajes de California.

### **AGENCY CONTACT PERSONS**

Inquiries concerning the substance of the proposed regulatory action may be directed to the agency representative Mary Jane Coombs, Manager, at (916) 322-7554, Jason Gray, Manager, at (916) 324-3507, or (designated back-up contact) Mark Sippola, Air

Resources Engineer, at (916) 323-1095, of the Climate Change Program Evaluation Branch.

### **AVAILABILITY OF DOCUMENTS**

ARB staff has prepared an ISOR for the proposed regulatory action, which includes a summary of the economic and environmental impacts of the proposal. The report is entitled “Staff Report: Initial Statement of Reasons for Rulemaking—Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms.”

Copies of the ISOR and the full text of the proposed regulatory language, in underline and strikeout format to allow for comparison with the existing regulations, may be accessed on ARB’s website listed below, or may be obtained from the Public Information Office, Air Resources Board, 1001 I Street, Visitors and Environmental Services Center, First Floor, Sacramento, California, 95814, (916) 322-2990 on August 2, 2016.

Further, the agency representative to whom non-substantive inquiries concerning the proposed administrative action may be directed is Trini Balcazar, Regulations Coordinator, (916) 445-9564. The Board staff has compiled a record for this rulemaking action, which includes all the information upon which the proposal is based. This material is available for inspection upon request beginning August 2, 2016 to the contact persons.

### **HEARING PROCEDURES**

The public hearing will be conducted in accordance with the California Administrative Procedure Act, Government Code, title 2, division 3, part 1, chapter 3.5 (commencing with section 11340).

Following the public hearing, the Board may vote on a resolution directing the Executive Officer to: make any proposed modified regulatory language that is sufficiently related to the originally proposed text that the public was adequately placed on notice that the regulatory language as modified could result from the proposed regulatory action, and to make any additional supporting documents and information available to the public for a period of at least 15 days; to consider written comments submitted during this period; and make any further modifications as may be appropriate in light of the comments received available for further public comment. The Board may also direct the Executive Officer to: evaluate all comments received during the public comment periods, including comments regarding the CEQA determination above, and prepare written responses to those comments as appropriate; and present to the Board, at a subsequently scheduled public hearing, the final proposed regulatory language, and staff’s written responses to relevant comments.

The public may request a copy of the modified regulatory text from ARB's Public Information Office, Air Resources Board, 1001 I Street, Visitors and Environmental Services Center, First Floor, Sacramento, California, 95814, (916) 322-2990.

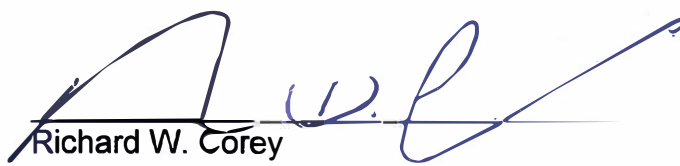
**FINAL STATEMENT OF REASONS AVAILABILITY**

Upon its completion, the Final Statement of Reasons (FSOR) will be available and copies may be requested from the agency contact persons in this notice, or may be accessed on ARB's website listed below.

**INTERNET ACCESS**

This notice, the ISOR, and all subsequent regulatory documents, including the FSOR, when completed, are available on ARB's website for this rulemaking at:  
<http://www.arb.ca.gov/regact/2016/capandtrade16/capandtrade16.htm>

CALIFORNIA AIR RESOURCES BOARD



Richard W. Corey  
Executive Officer

Date: July 19, 2016