UPDATED INFORMATIVE DIGEST

REGULATION TO IMPLEMENT THE CALIFORNIA CAP-AND-TRADE PROGRAM

Sections Affected: Amendments to Subchapter 10 Climate Change, Article 5, sections 95802, 95811, 95812, 95813, 95820, 95830, 95831, 95832, 95833, 95834, 95841, 95841.1, 95851, 95852, 95854, 95856, 95870, 95871, 95890, 95891, 95892, 95893, 95894, 95911, 95912, 95913, 95914, 95920, 95921, 95942, 95943, 95973, 95974, 95976, 95977.1, 95979, 95981, 95981.1, 95982, 95983, 95984, 95985, 95987, 95990, 96011, 96014, 96021, 96022, Appendix B, and Appendix E, title 17, California Code of Regulations (CCR) and adoption of new sections 95915 and 95989, title 17, CCR.

Background: The California Global Warming Solutions Act (Assembly Bill 32; Stats. 2006, Chapter 488) (AB 32), as amended by Assembly Bill 398 (Stats. 2017, Chapter 135) (AB 398), authorizes the California Air Resources Board (CARB or Board) to implement a comprehensive, multi-year program to reduce greenhouse gas (GHG) emissions in California. This act authorized the use of a market-based compliance mechanism. The California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Regulation or Program) was developed as a key element of California’s GHG emissions reduction strategy; it is designed to complement other measures to ensure the State’s 2020 GHG target is met while maintaining robust growth. The Regulation was originally adopted by the Board in October 2011, with additional amendments approved for adoption by the Board in June 2012, April 2013, April 2014, September 2014, June 2015, July 2017, and March 2018.

The Legislature reaffirmed California’s commitment to taking action against climate change by adopting Senate Bill (SB) 32 (Chapter 250, Statutes of 2016), which further directs CARB to ensure that statewide GHG emissions are reduced to at least 40 percent below the 1990 level no later than December 31, 2030. In addition, AB 398 (Chapter 135, Statutes of 2017) amends certain provisions of AB 32 to take effect starting January 1, 2021, and clarifies the role of the Cap-and-Trade Program in achieving the 2030 GHG reduction target.

In response to AB 398 and Board direction, CARB staff began a public process in October 2017 to propose additional amendments to the Regulation for Board consideration. In developing these amendments, CARB staff held a total of four publicly noticed workshops from October 2017 through June 2018 in which staff presented initial regulatory concepts and publicly discussed them with interested stakeholders. In conjunction with these workshops, CARB released two discussion drafts of possible changes to regulatory language, a concept paper on price containment, supporting material for assessing post-2020 caps, and a summary of stakeholder comments received. Each workshop was followed by a two-week informal public comment period and all materials and public comments are available on the Cap-and-Trade Program's
Public Meetings web page. In addition, CARB staff held numerous informal meetings with stakeholders to discuss specific topics related to the proposed amendments. These forums provided CARB staff and stakeholders with opportunities to present and discuss initial regulatory concepts and potential alternatives.

**Description of the Regulatory Action:** The amendments to the Cap-and-Trade Regulation, as adopted, make the Program consistent with AB 398 requirements and respond to Board direction. The amendments update existing provisions to ensure appropriate allowance allocation to provide transition assistance and minimize emissions leakage, clarify allowed uses of allocated allowance value, add a price ceiling and two Reserve tiers post-2020, revise quantitative offset usage limits, implement “direct environmental benefits in the state” (DEBS) provisions for offset credits, modify the process to address emissions leakage associated with electricity imported through the Energy Imbalance Market (EIM), and enhance CARB’s ability to implement and oversee the Regulation. The amendments will enable the Program to continue to reduce GHG emissions while minimizing emissions leakage and benefitting the California economy through investment in clean energy technologies. The amendments will also de-link the Program from Ontario’s program to reflect changes undertaken by Ontario to revoke the Ontario cap-and-trade program effective July 3, 2018.

Anticipated benefits of the amendments include reducing statewide GHG emissions to 40 percent below 1990 levels by 2030 in accordance with SB 32 and Executive Order B-30-15. Although the amendments do not modify the post-2020 caps or expected statewide GHG emissions reductions from the amendments approved in 2017, anticipated benefits include changes to the Regulation’s cost-containment provisions to provide more robust cost-containment. Given that the amendments will continue to ensure the GHG emissions reductions required by the Program, they may also protect public health and safety, worker safety, and the State’s environment. Additional benefits include improved clarity for covered entities.

The amendments to the Regulation were initiated with the publication of a notice in the California Notice Register on September 4, 2018, and notice of public hearing scheduled for October 25, 2018, later rescheduled via a Notice of Postponement to November 15, 2018. A Staff Report: Initial Statement of Reasons, entitled “Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms” (Staff Report or ISOR), which is incorporated by reference herein, the full text of the proposed regulatory amendments, and other supporting documentation were made available for public review and comment starting on September 7, 2018, running for 45 days through to October 22, 2018. The Board was informed of proposed amendments to the Regulation and received written and oral comments at the November 2018 public hearing but did not take action on the proposal.

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1 Workshop comments, presentations and other materials can be found on the Cap-and-Trade website at https://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm.

2 The original Notice of Public Hearing and Notice of Postponement, along with all other regulatory materials, can be found at https://www.arb.ca.gov/regact/2018/capandtrade18/capandtrade18.htm.
CARB released a Notice of Public Availability of Modified Text and Availability of Additional Documents (15-Day Notice) on November 15, 2018, which placed additional documents into the regulatory record and presented modifications to the regulatory text in response to Board direction and public comments received at the November 15, 2018, Board hearing and public comments made during the 45-day comment period. Modifications made via the 15-day Notice included revising the approach to address EIM emissions leakage, revising the waste-to-energy allocation calculation to increase transition assistance, adding third compliance period allocation for legacy contract generators, classifying leakage risk for newly eligible sectors, removing the true-up allocation related to a CPUC decision on natural gas pricing, revising conformance and invalidation provisions for United States forest offset projects, and clarifying text to ensure clarity on application of the AB 398 DEBS requirement.3

At its second public hearing regarding the Regulation on December 13, 2018, the Board approved Resolution 18-51, certifying the environmental analysis, approving the written responses to environmental comments, making required California Environmental Quality Act (CEQA) and other findings, and adopting the final regulatory amendments. The Resolution also directed the Executive Officer to finalize the Final Statement of Reasons (FSOR) for the regulatory amendments and to submit the final rulemaking package to the Office of Administrative Law for review. The FSOR provides written responses to all comments received on the amendments during the 45-day and 15-day comment periods, during the November 15, 2018, Board hearing, and during the final December 13, 2018, Board hearing.

Below is a summary of amendments to the Regulation. A more detailed description of the initial amendments appears in the Summary and Rationale section of the Staff Report.

Summary of Modifications

1. Cost Containment Post-2020

AB 398 provides legislative direction to CARB to strengthen key cost containment features of the Cap-and-Trade Program post-2020. AB 398 directs CARB to create a price ceiling in 2021, which will ensure covered entities will never have to pay above a set price for compliance instruments. In addition, AB 398 directs CARB to remove some allowances from the current Allowance Price Containment Reserve (current Reserve) and make them available at the price ceiling. In the event the allowances available in the new post-2020 Reserve and the price ceiling are depleted, AB 398 directs CARB to make available to covered entities additional tons that represent reductions that are real, permanent, quantifiable, verifiable and enforceable by the State board and that are in addition to any GHG emission reduction otherwise required by law.

3 Full details of these 15-day revisions, along with full text with each change clearly notated, are available online at: https://www.arb.ca.gov/regact/2018/capandtrade18/capandtrade18.htm.
or regulation and any other GHG emission reduction that would otherwise occur. To implement these directives, the amended Regulation includes a price ceiling and a process for conducting sales at the price ceiling of allowances and price ceiling units pursuant to new Regulation section 95915.

AB 398 also requires that the Program include two new “price containment points” at levels below the price ceiling. Allowances from the current Reserve, allowances allocated to the post-2020 Reserve, and allowances that remain unsold at auction for more than 24 months beginning in 2021 will be made available for sale at these two price containment points. Amendments implement these two price containment points within the existing structure of the Reserve, and the remainder of this Digest refers to these as the two “new post-2020 Reserve tiers.”

To populate the two new post-2020 Reserve tiers and price ceiling, AB 398 requires the distribution of two-thirds of Reserve allowances that remained in the Reserve as of December 17, 2017 to be divided equally into the two new post-2020 Reserve tiers. All allowances remaining in the current Reserve as of December 31, 2020, (e.g., the one-third that remains available for sale in the current Reserve) are required by AB 398 to be made available for sale at the price ceiling starting in 2021. The amendments distribute allowances to the two new post-2020 Reserve tiers and the price ceiling, following these AB 398 requirements. The amendments also allocate an additional 22.7 million allowances to the second new post-2020 Reserve tier to reflect the change in the quantitative offset usage limit from 4 percent to 6 percent in 2026, consistent with the original rationale for funding the current Reserve.

The proposed amendments set the 2021 price ceiling value at $65 in real 2021 dollars and specify that this value will escalate each year by 5 percent plus the rate of inflation. The price ceiling and two new post-2020 Reserve tiers are well below the current single-tier Reserve tier prices in 2021. The price ceiling stays below the post-2020 Reserve value in the current Regulation through 2026, and it increases slightly above the current Regulation from 2027 to 2030. The new post-2020 Reserve tiers remain below the post-2020 Reserve in the current Regulation throughout the 2020s.

Amendments also implement a requirement in AB 398 that, after 2020, allowances that remain unsold at the Current Auction for more than 24 months be transferred to the Reserve. Both the existing Regulation and AB 398 reallocate current vintage allowances that remain unsold at the Current Auction for more than 24 months to the Reserve.

AB 398 requires CARB to take into account multiple factors in setting the price ceiling, including impacts on the state’s economy, the current Reserve tier prices in 2020, the social cost of carbon, the Auction Reserve Prices, environmental and economic leakage, and the cost per metric ton of emissions reductions. Staff’s assessment of each of these factors is described in greater detail in the Staff Report. The new post-2020 Reserve and price ceiling work in coordination with other features of the Program that provide compliance flexibility to meet the 2030 target reliably and cost effectively.
2. Offsets and Offset Program Implementation

The amendments comply with AB 398 direction to “[e]stablish offset credit limits according to the following: (I) From January 1, 2021, to December 31, 2025, inclusive, a total of 4 percent of a covered entity’s compliance obligation may be met by surrendering offset credits of which no more than one-half may be sourced from projects that do not provide direct environmental benefits in state. (II) From January 1, 2026, to December 31, 2030, inclusive, a total of 6 percent of a covered entity’s compliance obligation may be met by surrendering offset credits of which no more than one-half may be sourced from projects that do not provide direct environmental benefits in the state.”

The amendments specify that the quantitative offset usage limit will be 4 percent for emissions from 2021 to 2025 and six percent for emissions from 2026 to 2030. Amendments also specify that all offset projects in the State automatically provide direct environmental benefits in the State (DEBS). As described in greater detail in the Staff Report, CARB’s currently approved Compliance Offset Protocols ensure that projects located in the State provide for the reduction or avoidance of air pollutants in the State beyond the GHGs for which the project is credited, and/or the reduction or avoidance of pollutants that could have an adverse impact on waters of the State. The amendments also establish a process for out-of-state offset projects to provide documentation to CARB to demonstrate that they provide DEBS.

Additional changes clarify definitions, timing, and processes related to the Compliance Offset Program.

3. Allowance Allocation

The amendments respond to Board Resolution 17-21 direction by providing allowance allocation to waste-to-energy facilities for transition assistance over the years 2018 to 2024; continuing allocation to legacy contract generators without an industrial counterparty through the life of the contract; and extending the alternative, more slowly declining, cap adjustment factors in Table 9-2 through 2030 for certain industrial facilities with an especially high leakage risk.

For allocation to industrial covered entities, the amendments adjust assistance factors for the third compliance period and set new assistance factors for the post-2020 period. The amendments revise Table 8-1 to set assistance factors for all sectors at 100 percent for the period 2021 to 2030 in order to comply with AB 398 direction to “[s]et industry assistance factors for allowance allocation commencing in 2021 at the levels applicable in the compliance period of 2015 to 2017 [i.e., 100 percent], inclusive.” For 2018 to 2020 assistance factors, Board Resolution 17-21 directed staff to “…propose subsequent regulatory amendments to provide a quantity of allocation, for the purposes of minimizing emissions leakage, to industrial entities for 2018 through 2020 by using the same assistance factors in place for 2013 through 2017 [100 percent].”
Amendments revise 2018-2020 assistance factors to 100 percent for all industrial sectors.

To ensure appropriate leakage protection, the energy-based allocation methodology is changed to include process emissions in the calculation of allowance allocation. The amendments also add a limited true-up provision to the energy-based allocation methodology for allocation of vintage 2020 and 2021 allowances to true up the initial vintage 2018 and 2019 allowance allocation to reflect the change in 2018 to 2020 assistance factors.

Amendments also expand, in limited circumstances, the data years that CARB may employ when determining baseline values used for allocation to university covered entities and public service facilities; extend the application deadline for the limited exemption from a compliance obligation for emissions from the production of qualified thermal output; and add new industrial activities to Table 8-1.

4. Use of Allowance Value Allocated to Electric and Gas Utilities

Amendments clarify, enhance, and streamline provisions on the permissible use of allowance value allocated to EDUs and natural gas (NG) suppliers for the purpose of benefitting their ratepayers consistent with the goals of AB 32. Adopted amendments require that expenditure of EDU allocated allowance proceeds must fall into one of four general categories that benefit ratepayers and are consistent with the goals of AB 32: renewable energy, energy efficiency and fuel switching, other GHG reducing activities, and non-volumetric return of proceeds to ratepayers. Similarly, NG suppliers must use allocated allowance proceeds for energy efficiency or other GHG reducing activities, or for non-volumetric return of proceeds to ratepayers. Amendments provide a potential path for the use of allocated allowance proceeds for wildfire risk reduction and allow limited use of allocated allowance proceeds on certain educational programs.

Other changes clarify allowance value use for reasonable administrative and outreach costs, and specify particular activities that are prohibited uses of allowance value, including compliance activities, lobbying, and benefitting employees or shareholders. The amendments require the reporting of estimated GHG reductions for each use of allocated allowance proceeds and reorganize reporting requirements to clarify how expenditures must be reported and what time periods they cover.

5. Use of Allowance Value Deadline

Amendments clarify the deadline for spending allocated allowance proceeds received prior to October 1, 2017, to ensure that this allocated value benefits ratepayers in a timely manner. Allocated allowance proceeds received prior to October 1, 2017, must be spent within ten years of the effective date of the ten-year spending requirement, meaning they must be spent by December 31, 2027.
6. Energy Imbalance Market

Under AB 32, CARB must account for statewide GHG emissions, including all emissions resulting from the generation of electricity delivered to and consumed in California, whether that electricity is generated in-state or imported to California to serve California load. In 2015, CARB found that the design of the Energy Imbalance Market (EIM) does not accurately account for the full GHG emissions experienced by the atmosphere from electricity imported under EIM, resulting in emissions leakage. CARB refers to these emissions as EIM Outstanding Emissions. Beginning in 2016, the California Independent System Operator (CAISO) and CARB began coordinating to address GHG accounting inaccuracies in the EIM.

In 2017, CARB adopted amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions (MRR) to implement a “bridge solution” to account for the full GHG emissions experienced by the atmosphere from imported electricity under the EIM. The “bridge solution” in MRR provides a method to calculate EIM Outstanding Emissions by determining the amount of electricity transferred into California by EIM, multiplying that amount by the default emission factor CARB uses for unspecified market transactions, and then subtracting known emissions associated with specific EIM imports. Under the “bridge solution” in the Cap-and-Trade Program, CARB retires unsold allowances from the pool of state-owned allowances equal to EIM Outstanding Emissions. This approach accounts for the emissions leakage associated with EIM Outstanding Emissions and ensures environmental integrity of the Program, but it does not assign the emissions leakage directly to covered entities. The “bridge solution” is currently in effect, but was put in place as a temporary solution.

These amendments implement an “EIM Purchaser” approach to address emissions leakage associated with EIM and assigns the emissions leakage directly to covered entities. An “EIM Purchaser” is defined as an electrical distribution utility (EDU) that both receives allowance allocation and serves California load with EIM purchases. EIM emissions leakage will be addressed by CARB directly retiring allowances allocated to EIM Purchasers in an amount equal to the EIM Purchaser’s share of EIM Outstanding Emissions. This approach accounts for EIM emissions leakage and shifts the responsibility for addressing the leakage from the State to the electricity sector. The change places the responsibility to ensure environmental integrity of the Program only on those EDUs that participate in EIM and receive freely allocated allowances. The requirements for EIM Purchasers would begin on April 1, 2019.

7. Voluntary Renewable Electricity Program

Amendments include targeted, minor clarifications to the Voluntary Renewable Electricity (VRE) Program. The amendments clarify the documentation necessary to establish that a generator meets the VRE Program eligibility requirements, clarify the requirement that generation must not have served load prior to June 2005, require applicants to include documentation of sales and purchase of the electricity or renewable energy credits, and make minor administrative changes to the signature and
attestation requirements. The amendments are not intended to modify any other aspect of the VRE requirements, including volume of allowances set aside for the VRE Program, or to change any accounting provisions.

8. Registration in Compliance Instrument Tracking System Service

Amendments change tracking system registration requirements to improve efficiency of the user registration process, to prevent accumulation of incomplete user registrations for individuals that do not complete the process, and to clarify a tracking system restriction. The amendments allow CARB to deny user registration if a registrant does not provide Know-Your-Customer documentation in a timely manner and clarify that an individual may only have one account in the tracking system, regardless of jurisdiction of registration.

9. Auction and Reserve Sale Administration

Amendments change the Auction Reserve Price announcement timing to allow for a joint announcement with linked jurisdictions each year, clarify the order of sale for allowances used to fulfill an untimely surrender obligation, and clarify the process for the disposition of these allowances if they remain unsold in an undersubscribed auction. In addition, the amendments change the auction application requirements, clarify that letters of credit and bonds submitted as bid guarantees must allow the financial services administrator to make payment requests electronically via facsimile or other electronic forms accepted by the financial services administrator, and change Reserve sale application requirements.

10. Program Administration

The Regulation is amended to address outstanding compliance obligations owed by bankrupt entities by enabling the Executive Officer to retire allowances in the amount of the outstanding obligation from the allowance budget two years after the current allowance budget year that is not already allocated to entities starting in 2019. The amendments also expressly state that compliance instruments issued by CARB may only be used for the designated purposes in the Cap-and-Trade Program. This provision clarifies that a compliance instrument issued by CARB cannot be used solely to meet requirements in other regulatory programs; rather, it must be used to meet an authorized or required purpose of the Cap-and-Trade Program.

11. Ontario Linkage

The Ontario government published a July 3, 2018, regulation (386/18) revoking Ontario’s cap-and-trade regulation (144/16). This regulation also prohibits Ontario’s cap-and-trade participants from purchasing, selling, trading or otherwise dealing with emission allowances and credits (compliance instruments). Based on these actions, the amended Regulation de-links California’s Program from Ontario’s program. The amendments clarify provisions related to amending auction notices, as well as delaying,
rescheduling, or canceling auctions; further clarify how the Executive Officer may exercise existing authority to protect the environmental stringency of the California Program; and also clarify that Ontario-issued compliance instruments currently held in California entity accounts continue to remain valid for compliance and trading, but no new transfers of instruments after June 15, 2018, would be accepted. Amendments ensure the environmental stringency of the California Cap-and-Trade Program is maintained as if there had not been a linkage approved with the External GHG ETS, via the cancelation or issuance of additional allowances.

Comparable Federal Regulations: There are no directly comparable federal regulations mandating economy-wide Cap-and-Trade Programs. The amended Regulation continues to place a compliance obligation on large industrial sources, fuel suppliers, and electricity generators and importers for the GHG emissions associated with their current and future activities. The Cap-and-Trade Program and the present amendments do not conflict with federal regulations.

Changes to Underlying Laws: AB 398 amends provisions of AB 32, and CARB initiated this rulemaking process to implement the AB 398 requirements for the post-2020 Cap-and-Trade Program and to make other needed revisions to the Program. AB 398 does not adversely affect the statutory authority governing adoption of this Regulation; rather, AB 398 provides further support for the Regulation’s adoption.

Changes to the Effect of the Regulation: None.