

CHAPTER 1: HOW DOES THE CAP-AND-TRADE PROGRAM WORK?

1.1 What is the Cap-and-Trade Program?

The Cap-and-Trade Program will reduce greenhouse gas (GHG) emissions from major sources (covered entities) by setting a firm cap on statewide GHG emissions while employing market mechanisms to cost-effectively achieve the emission-reduction goals. The statewide cap for GHG emissions from major sources, which is measured in metric tons of carbon dioxide equivalent (MTCO_{2e}), will commence in 2013 and decline over time, achieving GHG emission reductions throughout the program's duration. Each covered entity will be required to surrender one permit to emit (the majority of which will be allowances, entities are also allowed to use a limited number of ARB offset credits) for each ton of GHG emissions they emit. Some covered entities will be allocated some allowances and will be able to buy additional allowances at auction, purchase allowances from others, or purchase offset credits.

1.2 What is the Mandatory Reporting of Greenhouse Gas Emissions Regulation?

The Cap-and-Trade Program relies on data collected through the Mandatory Reporting of Greenhouse Gas Emissions Regulation (MRR) to identify major sources of greenhouse gas emissions in California. The MRR was originally adopted in 2007 and was updated in 2011 to meet the needs of the Cap-and-Trade Program. The MRR requires facilities, fuel, and carbon dioxide (CO₂) suppliers—as well as electric power entities—to report their annual GHG emissions in 2009 and every year thereafter. A detailed description of the reporting Regulation can be found in the Mandatory Reporting Guidance Document available at <http://www.arb.ca.gov/cc/reporting/ghg-rep/ghg-rep.htm>.

1.3 What are the Basic Components of the Cap-and-Trade Program?

1.3.1. What Is an Allowance?

An *allowance* is a tradable permit to emit one metric ton of a carbon dioxide equivalent greenhouse gas emission. The total number of allowances provided by ARB each year will be equivalent to the annual allowance budget specified in the Regulation. Each allowance will have a unique serial number.

1.3.2. What Is an Offset Credit?

An *offset credit* is equivalent to a GHG reduction or GHG removal enhancement of one metric ton of CO_{2e}. The GHG reduction or GHG removal enhancement must be real, additional, quantifiable, permanent, verifiable, and enforceable and may only be issued to offset projects using approved Compliance Offset Protocols. ARB offset credits, along with allowances, are frequently referred to as “compliance instruments” since they are used by entities to comply with the program. However, a covered entity may only meet up to 8 percent of its compliance obligation using ARB offset credits. More information on the requirements for offset credits, approved Compliance Offset Protocols, and offset projects can be found in Chapter 6.

1.3.3 What Is a Compliance Period?

A *compliance period* is the time frame during which the compliance obligation is calculated. The years 2013 and 2014 are known as the “first compliance period,” and the years 2015–2017 are known as the “second compliance period.” The third compliance period is from 2018–2020. At the end of each compliance period each facility will be required to turn in compliance instruments, including allowances and a limited number of ARB offset credits, equivalent to their total GHG emissions throughout the compliance period.

1.4 Who Will Have to Comply with the Cap-and-Trade Program?

Starting in 2012, major GHG-emitting sources, such as electricity generation (including imports), and large stationary sources (e.g., refineries, cement production facilities, oil and gas production facilities, glass manufacturing facilities, and food processing plants) that emit more than 25,000 MTCO₂e per year will have to comply with the Cap-and-Trade Program. The program expands in 2015 to include fuel distributors (natural gas and propane fuel providers and transportation fuel providers) to address emissions from transportation fuels, and from combustion of other fossil fuels not directly covered at large sources in the program’s initial phase. Additional information, including a preliminary list of the covered entities, can be found in Chapter 2 and at http://www.arb.ca.gov/cc/capandtrade/covered_entities_list.pdf.

1.5 How Do I Determine if My Company Needs to Comply with Cap-and-Trade Program?

Most facilities within the specified sectors mentioned above that emit GHGs will have to comply with the Cap-and-Trade Program and/or the Mandatory Reporting Regulation. Some facilities will be required to report their annual emissions but not have to surrender compliance instruments. This is determined by the type of energy or industrial sector and the facility’s annual GHG emissions. For example, most industries that emit 10,000 or greater metric tons of CO₂e are required to report their GHGs whereas, the subset of industrial facilities with annual emissions equal to or greater than 25,000 metric tons of CO₂e are required to comply with the Cap-and-Trade Program. To determine if your facility is subject to both or either regulation, please refer to the detailed description in Chapter 2.

1.5.1 What Does My Company Have to Do in Order to Comply with the Cap-and-Trade Regulation?

To comply with the Cap-and-Trade Regulation, each facility must register with ARB, report its annual GHG emissions, create the necessary accounts, designate an account authorized representative, and surrender compliance instruments by the established deadlines. Facilities are also required to retain their records for 10 years. A more detailed explanation of each of these requirements is located in Chapter 3.

1.6 What Is a Compliance Obligation, and How Does My Company Determine How Many Allowances and ARB Offset Credits We Need to Surrender?

A company's *compliance obligation* is equivalent to the quantity of allowances or a limited number of ARB offset credits a facility is required to surrender to ARB by a specified deadline in order to comply with the Cap-and-Trade Program. Each facility's compliance obligation will be determined by the quantity of reported and verified GHGs emissions. ARB will directly allocate a proportion of allowances to qualified facilities subject to the program. Each facility will be responsible for acquiring the remaining allowances or limited number of offset credits to comply with the program. Chapter 3 describes how to estimate the quantity of allowances your facility will be freely allocated. A discussion of how to acquire allowances and offset credits can be found in Chapter 5.

1.7 What Are the Deadlines for Each Action Required by My Company?

Table 1.1 summarizes the major compliance requirements for covered entities. Please refer to the subsequent chapters in this document and the Regulation for additional details.

Table 1.1. Main Compliance Deadlines for Covered Entities			
Event	Description	Regulation Location	Occurrence
Reporting and Verification			
MRR reporting deadline for most entities	Deadline to submit GHG reports to ARB using the online mandatory reporting tool. Applies to all stationary sources that are not electric power entities.	95103 (e)	April 10 of each year
MRR reporting deadline for electric power entities	Deadline to submit GHG reports to ARB using the online mandatory reporting tool. Applies to all electric power entities.	95103 (e)	June 1 of each year
MRR verification deadline	Deadline of verification statement to be received by ARB from verification body.	95103 (f)	September 1 of each year

Deadline for Offset Verification Statements	Deadline of offset verification statements to be received by ARB.	95977 (d)	Within nine months after the conclusion of the Reporting Period for which offset verification services were performed.
Opt-in Covered Entities Reporting Deadline	Deadline for opt-in covered entities to submit GHG reports to ARB using the online mandatory reporting tool.		<ul style="list-style-type: none"> • In 2012, the recommended deadline was June 1, 2012. • For years 2013 and subsequent, the recommended deadline is April 10.
Program Registration			
Program registration deadline for covered entities	Deadline to register for the Cap-and-Trade Program for covered entities	95830 (d)(1)(B)	January 31, 2012
Registration deadlines for new entrants	Deadline to register for the Cap-and-Trade Program for facilities that became covered entities	95830 (d)(1)(A)	Within 30 calendar days of the reporting deadline contained in the MRR if the entity is not a covered entity as of January 1, 2013.
Request to Opt Into Program	Opt-in covered entities must submit a request to opt into program by requesting a user ID through the Compliance Instrument Tracking System Service (CITSS).	95830 (d)(2)	<ul style="list-style-type: none"> • In 2012, opt-in covered entities should make their request by November 30, 2012. • For 2013 and subsequent years, opt-in covered entities should make their request by March 1.
Allocation			
Allocation to utilities for the next calendar year	Distribution of free allowances into utilities' holding account for the following calendar year emissions. For example, on July 15, 2012, allowances will	95870 (d)	September 14, 2012; November 1 of 2013 to 2019.

	be distributed for the 2013 calendar year.		
Allocation to industry for the next calendar year	Distribution of free allowances into industrial facilities' holding account for the following calendar year emissions. For example, on November 1, 2012, allowances will be distributed for the 2013 calendar year.	95870 (e)	November 1 of 2012 to 2019
POU (Publicly Owned Utility) Compliance/Holding Accounts	POUs must inform ARB of the share of their allowances that should be placed in compliance versus holding accounts	95892 (b)(2)	September 1 of 2012 to 2019
Auction			
Auction Registration	Registration deadline for Auctions	95912 (c)(2)	Registration deadline for an auction occurs 30 days prior to the auction.
Auction	Auction of compliance allowances	95910 (a)	In 2012, single auction on November 14. Starting 2013, four auctions will occur each year on the twelfth business day, or first business day thereafter, of the second month of each quarter. For example, 2013 auctions will be held February 19, May 16, August 16, and November 19.

Deadline for allowances to be consigned to auction	Electric utilities can consign allowances to be sold in the auctions. These allowances must be consigned ahead of time.	95910 (d)(4)	The deadline to consign allowances to the auction occurs 10 days prior to the auction in 2012, and 75 days prior to the auction in 2013 and thereafter.
Sale of Reserve Allowances			
Sale of Allowances from the Allowance Price Containment Reserve	In addition to the auction, allowances are sold from the allowance price containment reserve at three reserve price tiers, starting at \$40, \$45, and \$50 per allowance in 2013. Only covered entities and opt-in covered entities may participate in this sale.	95913 (c)(3)	Sale of allowances through the allowance price containment reserve occurs 6 weeks after the standard allowance auction. Bids must be submitted 2 weeks prior to sale of allowances.
Surrender			
Compliance Instrument Surrender Deadline; (A) — Annual Surrender, (T) — Triennial Surrender	Allowances must be surrendered annually to ARB in the amount according to a facility's compliance obligation, determined by the facility's emissions. The annual compliance obligation is 30 percent of the reported emissions of the previous year. The triennial compliance obligation is the sum of the reported emissions during a compliance obligation minus the instruments surrendered as part of the annual compliance obligation.	95856 (d)	Annual surrender of compliance instruments occurs on Nov. 1 of the calendar year following a year of reported emissions. For example the surrender of instruments for 2013 will occur Nov. 1, 2014. Triennial surrender occurs the calendar year following the end of a compliance period. Compliance periods are 2013–2014, 2015–2017, and 2018–2020. Thus, triennial surrender will occur Nov, 1 of 2015, 2018, and 2021.

1.8 What Happens if My Company Cannot Meet a Deadline?

Facilities that do not adhere to the Cap-and-Trade Program requirements will be subject to stringent penalties. The Health and Safety Code allows ARB to determine the appropriate enforcement mechanism based on the specific circumstances for a rule violation.

1.9 How Do I Create an Offset Project?

There are stringent requirements for developing offset projects that may generate ARB offset credits used for compliance. Currently, there are four Compliance Offset Protocols that are approved and may be used to develop offset projects under the Cap-and-Trade Program. They are urban forestry, forestry, livestock digesters, and destruction of ozone-depleting substances.

We strongly recommend that each party interested in developing an offset project review the qualification criteria outlined in Chapter 6 of this document and speak with ARB or an approved Offset Project Registry.