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California Unveils Preliminary Draft Regulation For A Cap-And-Trade Program As One Of The Main Strategies To Reduce Greenhouse Gas Emissions That Cause Climate Change

by Taraneh Fard & Olivier Theard

On November 24, 2009, the California Air Resources Board unveiled its proposed draft regulation for a greenhouse gas ("GHG") cap-and-trade program in its effort to put California on the path to achieve the mandate imposed by Assembly Bill 32 ("The Global Warming Solutions Act") of reducing GHG emissions to 1990 levels by the year 2020, and ultimately achieving an 80% reduction from 1990 levels by 2050. The cap-and-trade strategy is a proposed solution that is intended to provide the certainty that GHG emission reductions will be achieved by setting emission goals, while offering the needed flexibility in reaching those goals through the creation of tradable permits. In other words, the "cap" is a legal limit on the quantity of greenhouse gases that a particular region can emit each year and the "trade" means that companies may swap among themselves the permission—or permits—to emit greenhouse gases. Release of the preliminary draft regulation marks the beginning of the next phase of the cap-and-trade rulemaking, culminating in the California Air Resources Board's consideration in 2010 of the first broad based cap-and-trade program in the nation. The rule will be in effect by January 1, 2012.

The preliminary draft combines in one place the results of a year-long public process involving 21 workshops on issues related to cap-and-trade program design, and builds on more than two years of collaboration with the partners of the Western Climate Initiative, which involves six other Western states and four Canadian provinces. As a preliminary draft version, it contains both draft regulatory language on process and structure along with narrative sections that memorialize significant issues that remain to be resolved within a cap-and-trade program.

The preliminary draft covers the full range of elements for the cap-and-trade program outlined in the Assembly Bill 32 Scoping Plan, adopted in December 2008, which contains the main strategies California will use to reduce greenhouse gases. The draft proposal would:

- Require a minimum number of allowances to be auctioned at the program's start.

- Include emissions from transportation fuel combustion (e.g., gasoline, diesel, ethanol) by covering the supplies of fuel to vehicles and other small sources.

- Require about 600 of the state's largest GHG-emitting stationary sources that emit 25,000 or more metric tons of GHGs annually, along with electricity imports, to manage their emissions under an aggregate declining emissions cap at 15% below today's levels.

- Allow the limited use of high quality offsets outside of capped sectors to cover a portion of the overall emissions reductions.

- Establish clear rules for emissions trading, monitoring and enforcement.

When fully implemented, the program is designed to address 85 percent of California's greenhouse gas emissions, including emissions from electricity generation, large industrial sources, transportation fuels, and residential and commercial use of natural gas. Nonetheless, the draft fails to address what may be some hotly contested issues including (1) how much to rely on auctions of credits, which would require power companies and the like to buy permission to pollute (the emitters want allowances given to them, especially early on) and (2) how *gasoline and residential heating fuel suppliers* will react to the legislation since they could be included in the first cap-and-trade phase, which had only been expected to focus on *big pollution sources* like power plants and refineries. Indeed, if gasoline and residential heating fuel supplies are included under the cap in 2012, the program could lead to a rise in the price of gasoline by eight cents a gallon, if carbon permits are eventually traded at a likely $10 a ton. The California Air Resources Board says it is weighing whether to bring fuel deliverers under the cap in 2012 or in 2015. Furthermore, California businesses are already regularly criticizing the plan as going too far too fast—and costing too much. Thus, whether the net effect of the plan will be a new green economy or disaster for overburdened businesses is still fiercely debated.

Notwithstanding the above, California and other local governments see themselves as the vanguard of addressing climate change, especially in light of slow national action. Indeed, "California is the first out of the box," Mary Nichols, California Air Resources Board Chair, told reporters on a conference call. It is a “milestone . . . to address our state’s contributions to climate change, as the eighth largest economy in the world.”

The draft rules kick off a comment period where the California Air Resources Board will be accepting written comments until January 11, 2010, that will ultimately lead to a final regulation next fall. Some of the key details not yet decided upon, including plan costs and suggestions on how much support to give industry, will be presented through the advice and review of a blue ribbon committee of outside experts called the Economic & Allocation Advisory Committee, which plans to release some of its recommendations in January of 2010.

In short, the goal of the cap-and-trade program is to commit the state of California to responsible limits on global warming emissions and to gradually step down those limits over time. Setting commonsense rules, a cap-and-trade program is intended to spark the competitiveness and ingenuity of the marketplace to reduce emissions as smoothly, efficiently, and cost-effectively as possible. Not surprisingly, President Obama has made it clear that establishing a bold cap-and-trade program is a *priority*given that the European nations, operating under the 1997 Kyoto Protocol, a climate treaty that the U.S. refused to ratify, have regulated greenhouse gases under a cap-and-trade system for several years.

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