



November 30, 2009



California Air Resources Board Releases Broad Cap-and-Trade Plan: Questions About Allowance Allocation Remain

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In a preliminary step toward implementation of a greenhouse gas cap-and-trade program under the Global Warming Solutions Act of 2006 (AB 32), the California Air Resources Board ("CARB") on November 24, 2009 released a broad proposal identifying sources of emissions to be capped and the general timeline on which emission allowances must be obtained by capped industries. Under AB 32, California must reduce its greenhouse gas emissions to 1990 levels by the year 2020. As currently framed, the cap-and-trade program would account for just 20 percent of these total emission reductions.

For those following developments in climate change regulation, many eyes are now on California as consideration of federal legislation is temporarily stalled. While a wide-ranging climate change bill (colloquially known as the "Waxman/Markey bill") was adopted by the House of Representatives last June, legislation in the U.S. Senate will not reach that chamber's floor until the spring of 2010 so that a major healthcare bill can be debated. Importantly, if the current language in the Waxman/Markey bill were to become law, any California cap-and-trade system would be preempted through 2017.

With federal legislation sidelined, the details of California's plan become more pertinent. Under CARB's plan, starting with the first phase of the program in 2012, electricity generation (including imports) and industrial sources and processes emitting 25,000 metric tons of carbon dioxide equivalent or more annually would be capped. More than 600 of California's largest stationary sources of greenhouse gases would have to comply. Starting in 2015, the second phase of the program would cap industrial fuel combustion at facilities with emissions below 25,000 metric tons of carbon dioxide equivalent, all commercial and residential fuel combustion of natural gas and propane,

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and transportation fuels. CARB is still considering the possibility of making these second-phase sources capped under the first phase in 2012.

A key concern for capped entities is whether “offset credits” might be used toward compliance. Offset credits could potentially be created when projects reduce emissions *outside of capped sectors* beyond any reduction otherwise required by law. However, these offset credits would have to survive rigorous scrutiny by an independent verification body before being valid for sale to capped entities. As currently proposed, capped entities could only use offset credits to satisfy a maximum of 4 percent of their total compliance obligations.

With last week’s proposal, CARB has left unaddressed how emission allowances (each allowance would confer the right to emit one metric ton of carbon dioxide equivalent) will be distributed or auctioned in the program. This has been by far the most significant source of controversy in the consideration of climate change legislation by Congress, and should be no less controversial in Sacramento as the method by which emission allowances are allocated fundamentally determines compliance costs. CARB will formally propose its allowance allocation methodology next year after receiving recommendations from its Economic and Allocation Advisory Committee. For those interested in this advisory committee’s thinking, a partial draft of developing recommendations can be viewed [here](#).

Looking ahead, CARB will hold a workshop to discuss the plan on December 14, 2009. CARB has also set a deadline for written comments on the plan for January 11, 2010. CARB is expected to finalize the cap-and-trade program toward the end of 2010, with the program expected to begin on or before January 1, 2012. CARB’s plan can be accessed by clicking [here](#). Please contact Craig Moyer or Dana Palmer in Manatt’s Los Angeles office should you have any questions about current or proposed federal and state climate change regulation.

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For additional information on this issue, contact:



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