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Dissecting California's Cap-and-Trade Plan: What's your Piece of the Carbon Pie?

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It sounds like an old joke:

"How many allowances do you get?"
"I don't know. How many allowances do I get?"

But in reality, this is a serious question. When the California Air Resources Board (CARB or Board) released their 3,900-plus pages proposed Cap and Trade Regulation package, they unveiled for the world a regulatory scheme that will directly or indirectly touch every manufacturer, business, and individual in California.

Determining who gets to emit greenhouse gases for free and who has to pay for that right, and when, was the most anticipated of the policy questions surrounding the package's release. The amount of greenhouse gas allowances freely distributed to entities in the program is truly a billion-dollar question. A single allowance is equal to one metric ton of CO_2e emissions.

So who gets what?
As with anything this new and this complicated, it depends. And it is not finalized. The CARB staff is accepting comments up until the Board acts on December 16, 2010. The proposed regulation also has ten sections reserved for future language, including some directly affecting allowance distribution. It is expected that modifications to the regulation will occur even after the Board meeting.

So how does it work?
The proposed regulation has two formulas for free distribution for industrial entities--one based on production and the other on thermal use (steam and fuel), with applicability dependent on the type of facility. For electrical utilities, CARB has yet to decide the specifics. These formulas dictate how many allowances each industrial facility gets in any given year and include:

> **Benchmark Efficiency Factors** intended to reward those facilities that are more efficient than others in their own industry,
>
> **Assistance Factor** intended to help specific industries compete with entities outside of California, and
>
> **Cap Adjustment Factor** which declines annually and is specifically intended to reduce the amount of free allowances available each year.

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Inputs to these formulas come from either tables in the regulation, or from verified GHG Mandatory Reporting data.

So what does this all mean?

The program is set up to provide greater free allowances in the early years, with a year-by-year reduction toward 2020. Any allowances a subject entity doesn't receive for free must be purchased at the State auction, through offsets credits, or from another market participant. CARB has set a minimum auction price of $10/metric ton. The regulation specifies different factors for various industries and also requires facility specific information to complete the calculation, therefore the amount of free allowances differs for each facility every year. Also, the regulation only provides information out to the year 2020.

Though on the surface it might seem somewhat straightforward, the Cap and Trade program gets complicated quickly. This additional complexity comes from the many other aspects of the Cap and Trade program--offset limitations, enforcement, market tracking, changes to mandatory reporting, offset protocols, environmental/economic analysis, and more. All of these program facets have an interplay and will be discussed by staff and the Board before a final program emerges.

Since, CARB has not finalized the allocation methodology (and other program details), there is still an opportunity to effect change at the staff and Board levels. The Board meeting itself is expected to be long, contentious, and is historically a difficult place to get detailed points across. Because of this, the best opportunity to have your comments and concerns heard will be in the form of written submittals in advance of the meeting. All written comments are due by December 15, 2010.

For additional information on how the Cap and Trade's new regulatory requirements will affect you, or for assistance in drafting comments or participating in CARB's rulemaking process, contact Jon Costantino at 916-552-2365 in the Energy, Environment & Natural Resources practice group at Manatt, Phelps & Phillips, LLP.