



AB 32 Implementation Group



Working Toward Greenhouse Gas Emission Reductions
And Enhancing California's Competitiveness

WHEN YOU ARE STUCK IN A HOLE, THE FIRST THING TO DO IS STOP DIGGING

By Shelly Sullivan, executive director of the AB 32 Implementation Group

When you are stuck in a hole, the first thing to do is stop digging. While California suffers a 12% unemployment rate, a chronic state budget deficit and only slow economic growth, unnecessary new regulatory costs on employers will only dig the hole deeper.

That's why the AB 32 Implementation Group is gravely concerned about the status of the California Air Resource Board's (CARB) proposed "cap-and-trade" regulation. On October 20th the CARB Board will consider design details of the proposed cap-and-trade regulation and decide if the rule should continue to the next step in the regulatory process.

Our complaint is that the proposed design of the cap-and-trade rule would impose costs on employers that go way beyond what is necessary to achieve the environmental goals of AB 32. Even a well-designed cap-and-trade rule, with a focus to protect jobs and the economy, will have a major impact on the California economy. The proposed rule with its costly and unnecessary provisions could be devastating.

CARB has time to fix the rule and get it right. CARB delayed start of the market for a year because many elements of the rule are unfinished. Now CARB should use this time to make necessary adjustments so that cap-and-trade is a useful, not dangerous, tool for achieving our environmental goals.

A well-designed cap-and-trade rule will give businesses flexibility to achieve

greenhouse gas emission reductions at the lowest cost possible. This is crucial since California is the only state planning to start a cap-and-trade program. It is very likely that California companies suffering new costs will lose customers and market share to out-of-state competitors. For this reason, protecting against leakage of emissions and jobs should be the most important design issue for CARB.

CARB has recognized the need to protect California's industries by proposing 100% direct allowance distribution to companies up to a "benchmark" amount. Yet CARB has designed the benchmark to give fewer allowances than a typical company needs to operate in the state.

The current cap-and-trade proposal continues to arbitrarily set the benchmark for industry sectors at 90% of the industry average, which would require regulated entities to purchase 10% of their allowances at the start of the program. CARB's proposal to withhold 10% of emission allowances (the 'haircut') is an unjustified tax on business that will lead to leakage of production and jobs while failing to reduce GHG emissions required under AB 32. The 10% haircut puts California companies at an immediate competitive disadvantage and runs contrary to CARB's recognition of a 'soft start' transition intended to mitigate economic and emissions leakage. So long as California continues to move forward by itself in a cap-and-trade program, the risk of economic leakage remains high; CARB must take every

step to avoid this scenario. The best way to avoid these impacts and to mitigate risk to energy intensive trade exposed industries is through the free allocation of allowance. 100% allowance allocations will provide the necessary transition to a lower-carbon economy, and allows businesses to stay competitive and keep investments in the State.

Imposing a 10% tax on business via CARB's haircut proposal does nothing to 'maximize the environmental benefits' requirement under AB 32, and it is not needed to ensure the stringency of the overall cap – emission reductions will still be achieved by the 2020 goal. The tax proposed by CARB contradicts the AB 32 requirements of 'minimizing costs' and 'maximizing benefits' for California's economy in the design of emission reduction measures. The tax will negatively affect all California businesses, in addition to the anticipated fuel, energy and other cost increases that will be passed down to businesses from upstream providers. The downside of this approach is immense; ultimately, as California's economy suffers so too will employment, as an impact on business means an impact on jobs. Employers will be forced to reduce productions or lay off employees as the cost of compliance will make California less competitive with out-of-state businesses. With a 12% unemployment rate it is irresponsible to ignore the adverse economic impacts of the haircut by continuing to move forward with this egregious tax proposal.

The AB 32 Implementation Group (AB 32 IG) is concerned that CARB intends to fill the allowance reserve, which was intended to be a cost-containment mechanism, with allowances from the haircut. These are allowances that should otherwise be freely allocated in order to minimize emissions leakage. Instead, CARB is proposing to profit

at industry's expense by selling the reserve allowances at arbitrarily high prices, a major concern for the AB 32 IG. This proposal negates the purpose of an allowance reserve as a cost-containment measure by increasing program cost with no overall program benefit.

Adding insult to injury, the proposed rule will make the market price of allowances more expensive than necessary. CARB will limit the use of "offsets", or emission reductions achieved at projects located away from an industrial site. Those reductions could be cheaper, available when they are needed, and would avoid higher costs at the industrial site. CARB has strict rules about what qualifies as an offset. But CARB would make innocent buyers responsible to replace offsets that "fail" despite being approved by CARB under their own regulations.

CARB promised to slowly phase-in cap-and-trade to allow businesses time to adjust to the rule – to make new investments to reduce emissions and avoid new costs. We agree with that approach. Other states will join cap-and-trade if the regulation is workable and not harmful to the economy. The more participation we attract, the more benefits will be reaped by our energy efficient economy.

We urge the CARB to fix the flaws as it moves forward with the cap-and-trade rulemaking. We request that CARB commit to a schedule of workshops for rule revisions so stakeholders have an opportunity to provide helpful suggestions for incorporation into the rule.

We have time to get the regulation right before the market opens January 2013, working together we can make sure that occurs.