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Cliff Rechtschaffen
Senior Advisor to the Governor
State Capitol, Suite 1173
Sacramento, California 95814

RE: **Attorney General's Advice to the Governor Concerning Linkage of California and Quebec Cap-and-Trade Programs**

CONFIDENTIAL ATTORNEY-CLIENT COMMUNICATION / ATTORNEY WORK PRODUCT

Dear Mr. Rechtschaffen:

Pursuant to Government Code section 12894(f) and at the request of the Governor, we are providing advice and analysis to you about the four findings (Findings) that the Governor must make prior to any linking of California's Cap-and-Trade Regulatory Program (California Program) with the Quebec Cap-and-Trade Regulatory Program (Quebec Program). The first and third of those Findings require that the program to be linked have environmental and enforcement regulations that are "equivalent to or stricter than" the California Program's regulations. The second Finding requires that California be able to enforce its laws to constitutional limits, and the fourth Finding requires that there be no "significant liability" imposed on California for any "failure" associated with linking to the Quebec Program and related participation in the Western Climate Initiative, Incorporated (WCI, Inc.).

As set forth below, there is an adequate basis to make the four affirmative Findings required by Government Code section 12894(f).

BACKGROUND

A. Statutory Background

Government Code section 12894(f) requires the Governor to make all of the following Findings to enable each proposed linkage of another jurisdiction's cap-and-trade program with the California Program:

1. The jurisdiction with which the state agency proposes to link has adopted program requirements for greenhouse gas reductions, including, but not limited to, requirements for offsets, that are equivalent to or stricter than those required by Division 25.5 (commencing with Section 38500) of the Health and Safety Code.

2. Under the proposed linkage, California is able to enforce Division 25.5 (commencing with Section 38500) of the Health and Safety Code and related statutes against any entity subject to regulation under those statutes, and against any entity located within the linking jurisdiction to the maximum extent permitted under the United States and California Constitutions.

3. The proposed linkage provides for enforcement of applicable laws by the state agency or by the linking jurisdiction of program requirements that are equivalent to or stricter than those required by Division 25.5 (commencing with Section 38500) of the Health and Safety Code.

4. The proposed linkage and any related participation of the State of California in the Western Climate Initiative, Incorporated, shall not impose any significant liability on the state or any state agency for any failure associated with the linkage.

B. Regulatory Development and the History of Linkage

Beginning in 2007, California and the states of Arizona, New Mexico, Oregon, and Washington created the WCI[1] as a forum to discuss and set an overall regional goal to reduce greenhouse gas (GHG) emissions consistent with each state's goal. WCI served as the incubator for ideas for establishing a multi-jurisdictional, multi-sectoral GHG emissions reduction program, consisting of linked programs. Over time, four Canadian Provinces joined the WCI (British Columbia, Manitoba, Ontario, and Quebec). The work-product of the WCI, resulting from a multi-year effort, including public consultations, is a series of documents that set forth the consensus among the jurisdictions about the recommended regulations for a sub-national cap-and-trade

[1] WCI, the name used by the group of cooperating jurisdictions, is to be distinguished from WCI, Inc., the non-profit corporation created by some of the WCI jurisdictions to handle infrastructure contracts for the cap-and-trade market.

market as well as other important components such as offsets, mandatory reporting of GHG emissions, infrastructure, and linking.

The California Program regulations promulgated by the Air Resources Board (ARB) drew upon the WCI work and were developed over a period of years to be environmentally rigorous and to allow linking with similarly rigorous programs in other jurisdictions. Quebec's regulations are similarly based on the WCI program and policy documents.

ANALYSIS OF FINDINGS

A. Finding 1: Comparability of GHG Reductions in the California and Quebec Programs

Based on our review, the California and Quebec Programs to reduce GHG emissions appear to be both comparable and compatible. As noted, they both draw from the collaborative WCI body of work and regulatory recommendations. California and Quebec environmental agency representatives substantially contributed to the work that created the detailed WCI program recommendations.

Based on our review of the Quebec and California regulations, ARB's Discussion of Findings[2] provides a well considered and well supported comparison. ARB evaluated the two Programs in several categories related to GHG reductions (emissions reduction targets; role of cap-and-trade in achieving GHG reduction targets; and key program rules and regulations). (Discussion of Findings at pp. 3-9.) The Attorney General's Office (AGO) agrees with ARB's conclusion that the Quebec Program is equivalent to, or stricter than, the California Program on all critical points.

We observe that there is some difference in how California and Quebec treat invalidated offsets. In the event of invalidation, Quebec puts the liability on the offset project "promoter"; if that fails, Quebec insures environmental integrity of the program by retiring a valid offset from an environmental integrity account (a pool of offsets) to which it requires offset projects to place 3% of their offsets. In general, California places liability on the entity that holds the offset or that has surrendered it for compliance. However, California employs a buffer pool for forest sequestration projects, which appears to make the California Program somewhat of a hybrid. Neither invalidation approach has yet to be put into practice. Both approaches are designed to be equally effective in upholding the environmental integrity of each Program. Thus, it is reasonable to deem them "equivalent" as they are both designed and reasonably expected to accomplish the same goal.

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[2] See "Discussion of Findings Required by Government Code section 12894" ("Discussion of Findings"), available at www.arb.ca.gov/regact/2012/capandtrade12/2nd15dayatta6.pdf.

Accordingly, there is an adequate basis for the Governor to issue Finding 1 in the affirmative.

B. Finding 2: California's Ability to Enforce Its Laws and Regulations

After the proposed linking, California will be able to enforce Division 25.5 (commencing with Section 38500) of the Health and Safety Code and related statutes against any entity subject to regulation under those statutes, and against any entity located within the linking jurisdiction to the maximum extent permitted under the United States and California Constitutions. This follows because linking creates no apparent limitation on California's legal authority to enforce its laws against (1) entities subject to, or participating in, the California Program and (2) entities in Quebec that have the constitutionally required minimum contacts with California.

The AGO agrees with ARB's analysis in its Discussion of Findings (see pp. 8-9). As to the first part of this Finding relating to entities with California compliance obligations, linking will allow these entities to use (that is, surrender to ARB) Quebec compliance instruments (allowances and offsets) to satisfy their California compliance obligations. All entities that have California compliance obligations must be registered with ARB. As part of that registration, each entity consents to be subject to California's jurisdiction. Following linking, there is no change or impact on California's ability to enforce Division 25.5 (AB 32) against entities with California compliance obligations, whether or not they chose to use Quebec compliance instruments. California has full authority to ensure compliance by regulated entities with Division 25.5. Accordingly, the first part of this Finding concerning California's regulated entities can be made in the affirmative.

The second part of this Finding is that linkage does not interfere with California's ability to enforce its laws against "an entity within the linking jurisdiction" – here Quebec – to the extent currently allowed by law. This part of section 12894 impliedly acknowledges the Constitutional limitations on California's ability to extend the reach of its law enforcement beyond its border.

The extent of California's ability to enforce outside of its borders can be summarized as follows. Normally, an entity located outside California is not subject to jurisdiction in California or the application of California law unless the entity has "certain minimum contacts" with California, such as doing substantial business in California or causing some form of injury or negative effect directed at someone in California. (See *International Shoe Co. v. Washington* (1945) 326 U.S. 310; *CollegeSource, Inc. v. Academyone, Inc.* (9th Cir. 2011) 653 F.3d 1066.) An entity can also explicitly consent to jurisdiction in California (waiving U.S. Constitution jurisdictional limitations). (See *J. McIntyre Machinery, LTD. v. Nicastro* (2011) 131 S.Ct. 2780.) Any Quebec entity with a compliance obligation in California must register with the California Program and explicitly consent to jurisdiction in California. Further, if a Quebec entity, not registered with the California Program, were to take actions aimed at entities in California (e.g., selling forged allowances to a California entity with compliance obligations), a court

could find that the Quebec entity was subject to California's jurisdiction for such substantial conduct directed at California based on the specific facts of the case. (See, e.g., *Calder v Jones* (1984) 465 U.S. 783; *Bancroft & Masters, Inc. v. Augusta National Inc.* (9th Cir. 2000) 223 F.3d 1082; *Yahoo! Inc. v. La Ligue Contre Le Racisme et L'Antisemitisme* (9th Cir. 2006) 433 F.3d 1199.) These U.S. Constitutional issues determine the reach of California's jurisdiction, and they are not affected by the linking regulation. Following linking, there will be no change or impact on California's ability to enforce Division 25.5 (commencing with Health and Safety Code section 38500). Similarly, Quebec will be able to take its own enforcement actions against entities in Quebec (see Finding 3 below).

Accordingly, there is an adequate basis for the Governor to issue Finding 2 in the affirmative.

C. Finding Three: Comparability of Enforcement of Laws in the California and Quebec Programs

Both the California and Quebec Programs are protected by enforcement regulations and other laws that appear to be comparable and compatible. Both Programs contain provisions dealing with fraudulent and manipulative conduct, and each Program aspires to deter illegal conduct through oversight, substantial penalty authority, and the possibility of criminal enforcement for fraudulent and deceptive conduct. As summarized in ARB's Discussion of Findings (see pp. 9-11), there are reasons to find that Quebec's enforcement scheme is more strict than California's statutory and regulatory scheme (e.g., Quebec's regulations appear to carry greater financial penalties than California's regulations). The AGO agrees that these factors support an affirmative determination for Finding 3.

It appears that the Quebec enforcement scheme is comparable to California's enforcement scheme; accordingly, there is an adequate basis for the Governor to issue Finding 3 in the affirmative.

D. Finding Four: Significant Liability for Failure of Linkage and Related Participation in WCI, Inc.

The fourth required finding is that "[t]he proposed linkage and any related participation of the State of California in the Western Climate Initiative, Incorporated, shall not impose any significant liability on the state or any state agency for any failure associated with the linkage."

Linkage is defined in Government Code section 12894(e) as "an action taken by the State Air Resources Board ... that will result in acceptance ... of compliance instruments issued by any other governmental agency...." Existing limitations to, and immunities from, liability available to the state and its employees (e.g., for discretionary actions such as adopting a regulation) will apply in any litigation challenging the basic policy decision to link, and will continue to apply after linkage. (See, e.g., Gov. Code,

§§ 815, subds. (a) and (b);[3] 818.2,[4] 820.2;[5] 821;[6] see also *Barner v. Leeds* (2000) 24 Cal.4th 676, 684-685; *Caldwell v. Montoya* (1995) 10 Cal.4th 972, 981; *Johnson v. State of California* (1968) 69 Cal.2d 782, 793,794.) (See Discussion of Findings at p. 11.)

The European Union's Emission Trading System (EU ETS) provides the most relevant precedent, as it is the largest linked, multi-sector cap-and-trade program in the world. Linkage with Quebec does not raise the risks associated with the observed "failure" in the EU ETS. Based on public reports, the EU ETS initially linked national cap-and-trade programs that each had its own infrastructure and level of cyber-security protection. According to the public reports, nations with the weakest security (the weak link jurisdictions) were subject to illegal behavior that affected the system. The EU ETS has moved to correct the problem by drawing all national programs into a single, uniform, and secure system.

Any jurisdiction that wishes to link with the California Program, such as Quebec, will need to be a member of WCI, Inc. and will use the California-developed infrastructure for the combined Programs. The creation of a single-market infrastructure for any California linked program is intended, in part, to remove the possibility of a jurisdictional weak-link in the cyber-security of the linked program. WCI, Inc.'s participation in a linked market thus does not appear to impose any additional liability on California; rather, it is designed to *enhance* security from a type of failure that has been associated with linked markets. (See Discussion of Findings at p. 11-12.)

In sum, the comparable rigor and structure of the two Programs' regulations, discussed above, indicates that the acceptance of Quebec compliance instruments in California will not be the source of a "failure associated with linkage."

For the foregoing reasons, there is an adequate basis for the Governor to issue Finding 4 in the affirmative.

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[3] "Except as otherwise provided by statute: (a) A public entity is not liable for an injury, whether such injury arises out of an act or omission of the public entity or a public employee or any other person. (b) The liability of a public entity established by this part (commencing with Section 814) is subject to any immunity of the public entity provided by statute, including this part, and is subject to any defenses that would be available to the public entity if it were a private person."
[4] "A public entity is not liable for an injury caused by adopting or failing to adopt an enactment or by failing to enforce any law."
[5] "Except as otherwise provided by statute, a public employee is not liable for an injury resulting from his act or omission where the act or omission was the result of the exercise of the discretion vested in him, whether or not such discretion be abused."
[6] "A public employee is not liable for an injury caused by his adoption of or failure to adopt an enactment or by his failure to enforce an enactment."

CONCLUSION

As of this date, we are not aware of any facts asserted or arguments made in public comments in response to the proposed ARB linking regulations that provide a basis for finding in the negative on any of the four required statutory Findings. Accordingly, for the reasons set out above, we believe that the Governor has adequate information to issue the four affirmative Findings required by Government Code section 12894(f), thereby permitting linkage. Please contact us should you have questions.

Sincerely,

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Deputy Attorney General

For KAMALA D. HARRIS
Attorney General

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