



OFFICE OF THE GOVERNOR

April 8, 2013

Mary Nichols
Chair, California Air Resources Board
1001 I St
Sacramento, CA 95814

Re: Request for Findings under SB 1018

Dear Chair Nichols:

On February 22, 2013, the California Air Resources Board (CARB) requested that I make findings, as required under Senate Bill 1018 (Government Code section 12894(f)), relating to the proposed linkage of California's cap-and-trade program with Québec's cap-and-trade program. These findings are a necessary step if California and Québec link their programs and pursue a joint auction in the future.

Based on my review of materials in the administrative record, comments received by outside parties, and the advice provided by Attorney General Harris (copy attached), I find that the four requirements of Government Code section 12894(f) have been satisfied.

Finding 1: Gov. Code sec. 12894(f)(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.

AB 32 requires that greenhouse gas (GHG) emissions in California be reduced to 1990 levels by 2020. Québec has an enforceable emissions reduction mandate that is stricter, requiring that GHGs be reduced by 20% below 1990 levels by 2020.

Québec's cap and trade program is similar or identical to California's in all material respects, including mandatory emissions reporting that must be verified by a third party; a tracking system to keep track of all allowances; limits on the amount of allowances or offsets an entity can hold;

provisions to guard against unauthorized or fraudulent transactions; and a reserve of allowances that can be made available if needed to contain prices.

Québec employs the same criteria as California for determining what constitutes a valid offset (they must be “real, quantifiable, permanent, enforceable, additional and verifiable”) and the same limitations on the extent to which offsets can be used to satisfy a regulated entity’s compliance obligation. Québec uses a somewhat different mechanism than California for providing insurance against the potential failure (and invalidation) of an offset, but Québec’s approach of a “buffer account” is sufficient to ensure that any invalidated offsets are replaced, as California’s approach requires. Québec has been more restrictive than California in the number of protocols that it has adopted. It has adopted three protocols, two of which are very similar to California’s (for ozone depleting substances protocol and livestock waste digesters). Québec has also adopted a protocol for recovery of methane gas from small landfills that California has not, but that protocol adheres to the criteria followed by California (noted above) for ensuring the integrity of the offsets.

Finding 2: Gov. Code sec. 12894(f)(2). Under the proposed linkage, the State of 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.

The linkage will not impose any limits on the State’s ability, consistent with constitutional requirements, to enforce AB 32 against entities located inside or outside of California. Entities that have compliance obligations under California law will remain subject to California’s jurisdiction. Entities in Québec that sell allowances in California will remain subject to California’s jurisdiction to the extent that this is permissible constitutionally; linkage will not diminish California’s authority in this area. Entities that register and participate solely in Québec’s program and do not participate in California’s program cannot be subject to California’s jurisdiction consistent with constitutional limits, but these entities will be subject to regulation by Québec. (Attorney General Harris’ letter provides more detail about the constitutional limits of California’s ability to enforce its laws outside of the State.)

Finding 3: Gov. Code sec 12894(f)(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.

Québec’s statutes and regulations provide for equivalent enforcement of its cap and trade program. Québec has a full complement of civil, criminal and administrative authorities in the

event of noncompliance that are comparable to (and in some cases more stringent than) California's enforcement tools, as well as similar information gathering requirements.

Of central importance, in Québec as in California, in the event that a regulated entity is out of compliance with its cap and trade obligations, the entity is required to make up for non-compliance by surrendering three allowances or offsets for every one missed, in addition to replacing the original number of allowances or offsets missed. The non-discretionary nature of this obligation makes it particularly effective as an enforcement tool. The government may impose additional penalties (which are actually higher in Québec than in California) and trading restrictions on the entity that is out of compliance. Québec also has a robust set of enforcement authorities to guard against fraud and misrepresentation that is comparable to California's authorities.

Finding 4: Gov. Code sec. 12894(f)(4). The proposed linkage and any related participation of the State of California in Western Climate Initiative, Incorporated, shall not impose any significant liability on the state or any state agency for any failure associated with the linkage.

First, linking with Québec is a discretionary policy decision and, as the Attorney General explains; immunities limiting lawsuits against the State for such actions would apply here—both to the decision to link and after linkage.

Second, linking is unlikely to lead to any significant liability because Québec will follow rules that are as stringent as California's. As the Attorney General concludes, because of the "comparable rigor and structure" of the two programs, acceptance of Québec allowances or offsets will not be the source of a failure associated with linkage. The Attorney General further finds that the structure of the proposed linked market is "designed to *enhance* security from a type of failure that has been associated with linked markets." (Emphasis in original.)

The State's related participation in WCI, Inc. would not result in any significant liability. If anything, shifting certain technical support functions to this nonprofit entity could impose a barrier to any liability being imposed against the State (if there was indeed a basis for such liability in the first place).

Additional Steps

These findings represent the statutory minimum that must be satisfied in order for California to link its program with Québec. CARB has amended its linkage regulation to provide that linkage with Québec will not become effective until January 1, 2014. In the interim, CARB and the Québec Ministry of Environment will test and evaluate their auction platforms and trading systems to ensure that they are fully compatible and ready to be implemented, and that linkage

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can be accomplished without disruption to California's program. CARB and the Québec Ministry of Environment also have developed an understanding detailing procedures for ongoing coordination between the two programs, including monitoring changes to offset protocols or adoption of new protocols (copy attached). Before linkage becomes effective, CARB should specify a process for review and public input of changes in a linked jurisdiction's program to ensure that the programs remain of comparable stringency and integrity. CARB shall report to the Secretary of Cal/EPA and to the Governor's office by November 1, 2013 on the progress of the above efforts and whether there are any impediments to linkage occurring in January, 2014.

Sincerely,

A handwritten signature in black ink, appearing to read "Edmund G. Brown, Jr.", with a large, stylized flourish extending from the end of the signature.

Edmund G. Brown, Jr.