

October 23, 2013

Dr. Steven Cliff
Chief, Climate Change Program Evaluation Branch
California Air Resources Board

**Re: Proposed Amendments to the California Cap-and-Trade Program
(September 4, 2013 Proposed Regulation Order)**

Dear Dr. Cliff,

Thank you for the opportunity to comment on the proposed amendments to the carbon market regulations.

Section 95852(b)(2): Emission Categories Used to Calculate Compliance Obligations

I am writing to raise serious concerns regarding the Board's proposed amendments to the rules on resource shuffling in § 95852(b)(2) of the September 4, 2013 Proposed Regulation Order. Please find my detailed comments in the attached San Jose Mercury News OpEd¹ and Stanford Law School working paper.²

In brief, I am concerned that the proposed exemptions to the prohibition on resource shuffling would violate the Board's obligation to minimize leakage under California Health & Safety Code § 38562(b)(8). As a number of studies have recently shown, a strong rule on resource shuffling is required to avoid substantial leakage in the electricity sector.³ Yet several of the proposed safe harbor provisions are so broad that almost any electricity sector transaction could be structured to fit within them, effectively negating the prohibition on resource shuffling.

The exemptions for out-of-state coal power contracts are particularly problematic. The proposed amendments unambiguously exempt divestment of these contracts from the prohibition on resource shuffling, without a corresponding requirement that underlying

¹ Danny Cullenward, "Don't Let Accounting Tricks Dominate the California Carbon Market." San Jose Mercury News OpEd (October 22, 2013), available at: http://www.mercurynews.com/opinion/ci_24354840/danny-cullenward-dont-let-accounting-tricks-dominate-carbon?source=rss.

² Danny Cullenward and David Weiskopf (2013), Resource Shuffling and the California Carbon Market. Stanford Law School Environmental and Natural Resources Law & Policy Working Paper, available at: <http://www.law.stanford.edu/organizations/programs-and-centers/environmental-and-natural-resources-law-policy-program-enrlp>

³ For example, see James Bushnell, Yihsu Chen, and Matthew Zaragoza-Watkins (2013), Downstream Regulation of CO₂ Emissions in California's Electricity Sector. Energy Institute @ Haas Working Paper #236, available at: http://ei.haas.berkeley.edu/pdf/working_papers/WP236.pdf.

facilities retire or otherwise reduce their emissions. The calculations in the attached Stanford Law School white paper show that the associated leakage risks constitute between 47% and 193% of the cumulative mitigation expected under the cap-and-trade market through 2020, depending on the success of complimentary policies and the use of the allowance price containment reserve.⁴ Simply put, the potential for leakage at this scale threatens to undermine the integrity of the carbon market, and cannot be reconciled with the statutory requirement to minimize leakage.

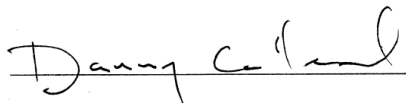
In addition to documenting these concerns in detail, my co-author David Weiskopf and I also provide a fully developed alternative regulatory structure that implements a new, market-based mechanism. Our proposal would greatly reduce the potential for leakage related to resource shuffling while permitting covered entities to engage in a range of transactions that would have been impossible under the existing regulations. Of course, additional refinements with input from key stakeholders would only improve the approach we describe; the point is that it is both feasible and desirable for the Board to investigate a different approach to resource shuffling in order to minimize leakage.

Furthermore, the legal case for establishing a stronger rule has improved significantly since the proposed amendments were drafted. The extensive discussion of out-of-state emissions impacts in the context of the dormant commerce clause and extraterritoriality doctrines in *Rocky Mountain Farmers Union v. Corey* provides strong support for including out-of-state emissions impacts in state-level carbon market regulations.⁵

Finally, some have argued that federal rules addressing greenhouse gas emissions from existing sources under the Clean Air Act will take care of the problem of resource shuffling. These rules have not yet been drafted, however, and should not be taken for granted. While future federal regulations could reduce leakage risks, it would be a mistake to avoid the resource shuffling problem on promise of future EPA action.

I strongly urge the Board and Staff to consider the significant implications of a weak rule on resource shuffling and modify its approach to fully address the leakage problem. Thank you for your consideration.

Respectfully,



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Affiliation for identification purposes only; I am writing in my personal capacity.

⁴ See Cullenward and Weiskopf, supra note 2, at § 4 for details.

⁵ Opinion available at <http://cdn.ca9.uscourts.gov/datastore/opinions/2013/09/18/12-15131.pdf>.