

Mary D. Nichols, Chairman  
California Air Resources Board  
Senate Select Committee on Environment,  
Economy & Climate Change  
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Thank you Madame Chair and Members.

In recent years we have made great strides in moving California down the path to a clean energy future. This success is in large part a result of the collaboration and partnership we have enjoyed with the legislature during this time.

You have delivered a number of key policy advances like:

AB 1493 (Pavley), which set the nation's first vehicle standards for greenhouse gas emissions;  
Assembly Bill 118, which is helping drive the development of cleaner fuels;  
Senate Bill 375, that is moving us toward more sustainable and livable communities;  
And, Senate Bill 2X, which drives major investment in California's abundant renewable energy resources like wind and solar.

There are, of course, many more.

These are exactly the kinds of policies that have made California a global hub for investment in clean technology, and that will deliver significant health and environmental benefits to all Californians for decades to come.

And of course there is AB 32. As we move into the sixth year of our efforts to implement this groundbreaking legislation, the words “AB 32” have become synonymous with California’s global leadership role in the fight against climate change.

AB 32 requires California to cut statewide greenhouse gas emissions to 1990 levels by 2020. To achieve this goal, we are utilizing a suite of programs across virtually all sectors of the economy to accelerate innovation in cleaner and more advanced technologies.

For example, earlier this year we passed a package of regulations that will change the makeup of California’s vehicle fleet over the next 15 years and pave the way for a zero emission fleet by 2050. In the process, they will deliver significant public health benefits and save consumers billions of dollars at the pump.

And just last Friday the Governor announced that \$120 million dollars in legal settlement funds owed to California would be dedicated to establishing thousands of public electric vehicle charging stations across the state.

Other major elements of the state’s comprehensive plan to implement AB 32 include our now statutorily required 33% Renewable Electricity Standard; Senate Bill 375; Energy Efficiency Standards for buildings and appliances; and the Low-Carbon Fuel Standard.

I am pleased to be here this afternoon to update you on another important part of our effort – the cap and trade program.

The cap and trade program will allow California to harness the power of the market to achieve our clean energy and environmental goals.

The program works by establishing a hard cap on about 85 percent of total statewide greenhouse gas emissions. ARB will issue allowances equal to the total amount of allowable emissions over a given compliance period. One allowance equals one metric ton of greenhouse gases. Over time, as the cap declines fewer allowances will be available ensuring that we meet our AB 32 target.

Under the program, companies do not have individual or facility specific reduction requirements. Rather, all companies covered by the regulation are required to turn in allowances in an amount equal to their total greenhouse gas emissions during each phase of the program.

The program gives companies the flexibility to trade allowances with others or take steps to cost-effectively reduce emissions at their own facilities. Companies that emit more will have to turn in more allowances. Companies that can cut their emissions will have to turn in fewer. But as the cap declines, total emissions must be reduced.

In the first phase of the program most allowances will be provided for free to all major sources like refineries, cement plants, and the electricity sector. And, companies will also have the ability to purchase any allowances they need at regularly scheduled auctions.

Starting in 2015, the transportation fuel and residential and commercial natural gas sectors will be included in the program.

The cap and trade program will provide an economy-wide price signal that we are serious about powering our economy with truly clean, advanced, and sustainable technologies. And it also makes it clear that investment in these technologies will be rewarded.

As you know, when it comes to creating innovative new technologies, Californians are among the best in the world.

So, where are we in our efforts?

As I noted last when I was here last June, the first compliance period for the cap and trade program is for 2 years and begins on January 1, 2013. This means that covered entities will be responsible for reducing their emissions starting next year. In anticipation of this, we have been working very hard to make sure all pieces of the program are in place and fully operational.

I'm pleased to let you know that we are on track.

However, as we have also said on a number of occasions, we will only launch this program in full when we are entirely confident that every piece of it is fully developed and ready to go. This includes both the system we are putting in place to distribute allowances, including some of them by auction, as well as the enforcement and market oversight elements of the program.

We have made rigorous market oversight and strong enforcement a priority in the design of this program.

The program has multiple elements to deter any attempts at market manipulation or other fraudulent activity. These elements include rigorous documentation and financial assurance requirements for program participants; a unified registry for allowance and offset tracking; and specified holding and purchase limits for allowances.

We also recognize that the success of this program is contingent upon a high level of stakeholder confidence in the system. That is why we have integrated multiple transparency components into the program.

This includes provisions for the regular release of public information about the operation of the market; the creation of an independent market surveillance committee; and the retention of an independent market monitor whose job is to monitor each auction and be on constant lookout for any symptoms of irregularity.

We have developed these components with extensive input from a number of leading economic, legal and regulatory design experts. They will give us a robust set of tools to prevent and detect any irregularities in the market and take swift corrective action if necessary.

As I noted, even though we are initially providing most allowances for free, we will auction a portion of the allowances. The auction is an important mechanism to promote market transparency, and it also gives companies additional incentive to find innovative ways to cost-effectively reduce emissions.

As specified in the regulation, the state will hold regularly scheduled auctions on a quarterly basis that will give companies additional opportunity to acquire allowances they will need for compliance purposes.

Last year, when my board adopted the regulation, we planned to hold the first auction in this August.

However, given our commitment to getting this program smoothly launched from the start, we plan to revise the schedule to hold the first auction on November 14th of this year.

This will not impact the timeline for the full program launch in January 2013 or the total number of allowances auctioned this year.

And, because companies will not need to turn in any allowances until November 2014, they will have ample time and opportunity to acquire the allowances they will need for compliance purposes.

Holding the first auction in November will also allow us to perform a number of important activities before then, including efforts to maximize stakeholder readiness.

In the next few months we will be launching and testing both the allowance tracking system and the auction platform. This will allow us to work very closely with stakeholders to ensure they are fully trained and familiarized with both systems in advance of the first auction.

We also plan to hold a fully simulated “practice auction” for stakeholders in August of this year. And, we expect to have the results from market simulation exercises we are undertaking that will provide additional valuable insight and information in advance of the first auction.

While our foremost priority has and will remain getting the cap and trade program up and running smoothly, we also have the opportunity to strategically invest funds from the auction of allowances in furtherance of the goals outlined in AB 32. Strategic investment of these funds can and should be another important tool we can use to move California toward a low-carbon future in a way that protects California consumers and ratepayers.

In addition to supporting efforts to cut greenhouse gas emissions, a thoughtful and coordinated investment plan will deliver major economic, air quality, and public health benefits for Californians, including in the most disadvantaged communities in our state.

The Governor's Budget for Fiscal Year 12/13 lays out a framework for strategic investment in areas like clean and efficient energy, low-carbon transportation and infrastructure, and natural resource protection. The Budget describes a number of important programs and policy goals that could be supported with auction funds.

We have also been working closely with the Public Utilities Commission in their ongoing proceeding to ensure that the value of allowances in the electricity sector is used for ratepayer benefit while also maintaining the appropriate price signal for utilities to continue to move toward lower-carbon alternatives.

A number of stakeholder groups, expert advisory committees, and of course many of you in the legislature have already given careful - and in some cases very detailed - thought to the way that a strategic investment plan in carbon-reduction could be crafted and implemented to maximize economic, environmental and clean energy benefits for the state.

To ensure that we are able to make the most informed and thoughtful investment decisions, we will be holding a public workshop soon to consider additional ideas, thoughts and input on this topic.

This will support the state effort to develop an effective investment plan and enable us to quickly invest these funds after we know the precise amount following the November auction. In light of the key role that you will play in this process we very much look forward to your participation.

I'd like to turn now to another important part of our efforts to implement the cap and trade program - collaboration with our partners in the Western Climate Initiative.

In AB 32, you gave ARB specific direction to work with others, including other states and nations to “facilitate the development of integrated and cost-effective regional, national and international greenhouse gas reduction programs.” We have and continue to take that direction very seriously.

Over the past several years we have worked closely with a number of other US states and Canadian provinces in the Western Climate Initiative. Our work in the WCI has spanned a range of efforts.

Work is currently underway on a proposal for consideration by our board in June of this year to link California’s cap and trade program with Quebec. Like California, Quebec is hard at work on developing a rigorous and carefully designed cap and trade program. If the proposal is adopted, we would take the necessary steps to formally link our programs.

With other of our Western Climate Initiative partners including Quebec, we have also recently established the non-profit entity WCI, Inc.

WCI, Inc. will provide cost-effective administrative and technical support services for California and other WCI partners cap and trade programs. It also allows us to maintain full regulatory authority and policy control over our state cap and trade program and all other aspects of AB 32.

WCI, Inc. also provides the opportunity to join forces with other like-minded states and provinces in the effort to address climate change. In doing this, we can leverage a broader range of resources and expertise to develop a set of sophisticated program infrastructure components including the allowance tracking system, auction and allowance distribution operations, and



market monitoring features – all of which will help make California’s cap and trade program more successful.

And it gives us the ability to expand the opportunity for California businesses to achieve cost-effective emission reductions and create greater market demand for low-carbon and clean energy technologies, so many of which are being developed right here in California.

As I noted at the outset, we are now into the 6th year of our efforts to implement AB 32. We have made considerable progress. But we continue to have a long way to go. And despite our success thus far, the challenge we are seeking to address in climate change has become even more pressing.

That is why we must continue working together to create and use the whole array of tools we are going to need to successfully meet this challenge. The cap and trade program we are soon to be launching is one of them.

As is often the case in California, we are once again leading instead of following. Fortunately, it is a position we are comfortable with, and as our track record shows, something we are good at.

I look forward to continuing to work with you to ensure that this program, like the many others that are helping us to create a clean energy economy in California is successful.

Thank You.

**(Please note: Prepared remarks may slightly differ from testimony delivered to Committee)**