Issue Analysis[1]: Resource Shuffling in California's Greenhouse Gas Emissions Cap-and-Trade Market

by

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The Emissions Market Assessment Committee (EMAC) was formed to provide independent analysis and advice to the California Air Resources Board (CARB) and staff on implementation of California's greenhouse gas (GHG) cap-and-trade (C&T) market. One immediate issue with this market concerns the definition of resource shuffling.

Under California's GHG C&T program, resource shuffling is explicitly prohibited, but is currently not precisely defined.[2] Conceptually, resource shuffling is a change in the designated source of an imported product (such as electricity) by a purchaser in California that is not accompanied by a change in the mix in production or level of emissions in regions exporting to California. The California cap-and-trade (C&T) program, and other regulations, will create incentives for California purchasers of imported wholesale electricity to change their designated sources to reduce the measured GHG emissions associated with the electricity they sell to California consumers. California regulators are concerned that this change in the emissions of imported power will not significantly alter the emissions of generation in the western market overall.

Attempting to reduce GHG emissions from electricity consumed in California with a California-only policy when a significant fraction of the electricity consumed in California comes from imports is challenging. There are many economic reasons for entities to engage in trades that also reduce the emissions associated with power delivered to California. It would be very difficult to distinguish between transactions motivated by resource shuffling as opposed to other incentives. At the same time, uncertain liabilities associated with imports to California could discourage, and therefore raise the cost of, power imports into the state. While we recognize the benefit of enforcement sanctions against clearly undesirable behavior, we also believe that it is important to recognize the limitations, and unintended consequences, of such an approach.

For these reasons, we believe an explicit prohibition against resource shuffling should affirmatively identify those behaviors that CARB will classify as resource shuffling and explicitly state that all other behaviors will not be classified as resource shuffling. Clarification

[1] Issue analyses reflect the views of the EMAC at the time they are released. They are written in order to inform stakeholders of the EMAC's views in a timely manner and to invite feedback from interested parties. The EMAC will update its views as new information arises and circumstances change.

[2] "Resource shuffling is prohibited and is a violation of this article," per Subchapter 10 Climate Change, Article 5, Sections 95800 to 96023, Title 17, California Code of Regulations.

should prevent large and straightforward-to-identify shuffling yet not significantly increase the cost of complying with the state's GHG emissions cap and not unduly disrupt markets for allowances or electricity. Such an approach would reduce ambiguity and minimize potential disruptions to wholesale power markets.

In an August 16, 2012 letter responding to Commissioner Moeller of the Federal Energy Regulatory Commission, Mary Nichols, Chair of the California Air Resource Board, indicated that CARB may "make adjustments to ensure that emission reductions that occur in the electricity sector as a result of California's cap and trade program are not offset by increases in emissions elsewhere." We believe any process for making allowance adjustments should be clearly specified and made with as much advance notice as possible, before the first auction of emissions allowances takes place. Any adjustment process should also clarify what will be done with any emissions allowances whose distribution is changed because of these activities. Failure to specify the details of any adjustment process in advance creates great uncertainty among market participants as to the value of permits and exposes CARB to significant litigation risk from market participants receiving emissions allocations.

We believe that the efficiency and integrity of the emissions market requires a clear definition of what types of transactions are considered resource shuffling. In our experience, a straightforward definition that that allows compliance to be verified on an ex post basis is superior to an administratively burdensome approach that increases compliance costs with the C&T program and reduces the amount of energy and GHG allowance trading because of fears by market participants of being found in violation of the resource shuffling prohibition. To the extent CARB decides to make allowance adjustments, we believe the efficiency and integrity of the emissions market requires the mechanism for making any such adjustments be clearly specified well in advance of the first allowance auction.