



Air Resources Board



Matthew Rodriguez
Secretary for
Environmental Protection

Mary D. Nichols, Chairman
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Edmund G. Brown Jr.
Governor

July 25, 2014

The Honorable Henry T. Perea
California State Assembly
State Capitol, Room 3120
Sacramento, California 95814

Dear Assemblymember Perea:

I am writing in response to your recent letter regarding fuels under California's Cap-and-Trade program.

Your letter is especially timely, given the growing and overwhelming scientific consensus that our climate is undergoing radical and irreversible changes because of the buildup of CO₂, methane and other greenhouse gasses. Left unchecked, this poses a profound threat to the health and well-being of our citizens and to all living things. The *National Climate Assessment* and the *Fifth Assessment Report of the Intergovernmental Panel on Climate Change* detail the most recent evidence.

California is recognized as one of the key leaders in the world taking the steps necessary to slow down climate change. Our Cap-and-Trade program is just one part of a broader set of initiatives designed to reduce our greenhouse gas emissions. Bringing fuels under the cap is important because petroleum-based transportation fuels are almost forty percent of California's greenhouse gas emissions.

The Cap-and-Trade program is designed to reduce harmful climate pollution by putting limits on emissions but allowing businesses to buy and trade allowances through a market system that ensures that greenhouse gasses are reduced in the most cost effective way possible. The price of the allowances reflects the costs imposed by carbon emissions and at the same time serves to encourage the production of cleaner fuels. Individual companies will choose their own specific compliance strategies to reduce emissions and make cleaner, lower carbon fuels available at the most competitive price. Climate policies in place since 2006 have shown their effectiveness in the decline of California's per capita gasoline consumption.

The energy challenge facing California is real. Every Californian needs to take immediate action to reduce energy consumption. For a list of simple ways you can reduce demand and cut your energy costs, see our website: <http://www.arb.ca.gov>.

California Environmental Protection Agency

It is important to note that fuels were added under a carefully phased schedule adopted in 2011 after a multi-year development process. This process included dozens of public workshops, hundreds of meetings with stakeholders, coordination with other State agencies, briefings and discussions with members of the Legislature and extensive consultation with leading economic and regulatory design experts.

To remove fuels from the program at this late date would be disruptive and a major setback. It would also have a deleterious effect on the market because many businesses have purchased millions of allowances and adjusted their business activities in reliance on the assumption that fuels would be included starting in 2015.

The nature and design of the Cap-and-Trade program provides that any cost from bringing fuels under the cap will occur over time. In fact, unless there were to be unlawful collusion on the part of industry, any price impacts should vary among oil companies, reflecting their different costs of compliance. Those companies which produce more efficiently or which have a mix of cleaner fuels will be in the best position and have less of a need to purchase allowances.

Any volatility resulting from Cap-and-Trade will be far less than California's historic experience. I would point out that since January 2011, there have been 23 separate instances where retail gasoline prices fluctuated by 10 cents or more per gallon in a week. In fact, so far this year, California's gas prices have varied by more than 60 cents a gallon.

In point of fact, the Cap-and-Trade program works to encourage the production of cleaner fuels and provide consumers with more choices which will help to reduce the historic price volatility of fuel. It specifically provides for a state-maintained allowance reserve and contains provisions that allow companies to bank allowances and purchase future allowances. In addition, ARB has consistently demonstrated a willingness to adjust the Cap-and-Trade program as necessary to mitigate any adverse or unanticipated economic impacts.

ARB chose not to issue free allowances for transportation fuels because doing so would undermine important incentives for industry to move toward the production of cleaner and less polluting fuels.

Finally, it is important to point out that the recently passed SB 535, requires that one-quarter of funds raised from the sale of cap and trade allowances benefit disadvantaged

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communities, which are disproportionately affected by pollution and climate change. Moreover, the budget just approved by the Legislature requires that at least 15% of cap and trade expenditures be annually directed toward transit operations, such as expanded bus and rail services and capital improvements to integrate state and local rail and transit systems. An additional 20 percent will be spent on promoting affordable housing and other projects designed to increase the use of transit.

Given the costs of climate change and the success of our Cap-and-Trade program to date, I believe it would be against the public interest to exempt or delay bringing fuels under the Cap-and-Trade program. I would, of course, welcome any additional information you might wish to share.

Sincerely,



Mary D. Nichols
Chairman

cc: The Honorable Susan Bonilla
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The Honorable Cheryl Brown
California State Assembly
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The Honorable Adam Gray
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The Honorable Isadore Hall III
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The Honorable Freddie Rodriguez
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The Honorable Rudy Salas, Jr.
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Jennifer Gress, Ph.D.
Legislative Director