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California Proposes Revised Cap-and-Trade Regulations Providing for Linkage with International Cap-and-Trade Market

Joint California/Quebec Auction Scheduled for November 2012

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California is on the verge of opening a greenhouse gas/carbon trading market that may ultimately rival the European Union's carbon trading market as the largest organized carbon market in the world. The state has recently proposed modifications to the regulations governing its nascent carbon cap-and-trade market that would clarify a number of processes, and would also establish a formal link between California's cap-and-trade program and a similar carbon cap-and-trade program in Quebec, Canada. Comments on the newly proposed regulations are required to be filed by June 28, 2012 with the California Air Resources Board of the California Environmental Protection Agency ("CARB").

California's long-awaited cap-and-trade program was mandated in 2006 as part of California's landmark Global Warming Solutions Act of 2006, generally known as "AB32." AB32 requires that greenhouse gas ("GHG") emissions in California be reduced to 1990 levels by 2020, and the state aims to reduce emissions to 80 percent of 1990 levels by 2050. In accordance with AB32, CARB adopted final regulations instituting a GHG cap-and-trade program in October 2011.

The cap-and-trade program emissions limitations will cover 360 businesses representing 600 facilities that are collectively responsible for 85 percent of California's GHG emissions. The limitations will be imposed in two phases: (i) in 2013 the regulations will limit GHG emissions of major industrial sources and electric utilities; and (ii) in 2015 distributors of transportation fuels, natural gas and other fuels will also become subject to the regulations.

The Quebec cap-and-trade program stems from "Bill 42 – An Act to amend the Environmental Quality Act and other legislative provisions in relation to Climate Change" ("Bill 42"), passed in 2009. Bill 42 is in some ways even more ambitious than AB32, seeking to reduce GHG emissions in 2020 to 20 percent below 1990 GHG emission levels. The Quebec cap-and-trade program will cover approximately 75 companies (mainly aluminum and mining companies), with restrictions applying to large covered emitters in 2013 and restrictions applying to all other covered emitters beginning in 2015.

To effect the linkage between the California cap-and-trade program and the Quebec cap-and-trade program, CARB on May 9, 2012 issued proposed revisions to the regulations governing California's cap-and-trade program. A copy of the proposed revisions is available [here](#). In addition to revisions relating to the linkage with Quebec, CARB has proposed a variety of other significant changes, including revised requirements for consolidated accounts of corporate affiliates; changes to auction and trading procedures; new registration requirements, including strict new "know your customer" rules; and modifications to the compliance instrument transfer process.

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Linkage with Quebec is expected to increase liquidity in the carbon markets and provide market participants with additional trading options. In a joint press release, California and Quebec expressed their expectation that other regions -- particularly the Canadian provinces of Ontario and British Columbia and other entities that have been involved in the Western Climate Initiative in North America -- will link to the California and Quebec cap-and-trade programs.

CARB is planning to hold a practice carbon cap-and-trade auction in August 2012, although a specific date has not been set. California's first binding carbon cap-and-trade auction, which will be a linked auction with Quebec, is currently scheduled for November 14, 2012.

With compliance obligations pending under AB32, covered entities and a wide variety of other prospective market participants are already taking actions to update their business practices to ensure compliance with the market behavior rules and other requirements of the regulations. Businesses are also making investments to reduce any applicable compliance costs and to take advantage of the new market opportunities afforded by the cap-and-trade program.

For detailed information about the California or Quebec cap-and-trade programs, including the proposed modifications to the California regulations, or for assistance filing comments on the proposed regulations before the June 28, 2012 deadline, please contact the authors or your K&L Gates representative.

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