

## **Overview: The Western Climate Initiative's Cap-and-Trade Program Design Recommendations**

The Western Climate Initiative (WCI) was launched in February 2007 by the governors of Arizona, California, New Mexico, Oregon, and Washington, signaling a long-term commitment to significantly reduce regional greenhouse gas emissions. Since the WCI first formed, the states of Montana and Utah and the Canadian provinces of British Columbia, Manitoba, Ontario, and Quebec have joined the partnership. The WCI Partners share a commitment to identify, evaluate and implement collective and cooperative ways to address climate change through a regional reduction of greenhouse gases (GHG).

To this end, the WCI Partners are recommending the implementation of a market-based cap-and-trade program. This program is an important component of a comprehensive regional effort to reduce GHG emissions by 15 percent below 2005 levels by 2020. If approved, the new, multi-sector program would be the most comprehensive carbon-reduction strategy designed to date. It would cover nearly 90% of the region's emissions, including those from electricity, industry, transportation, and residential and commercial fuel use. Together, the seven states and four provinces represent over 70 percent of the Canadian economy and 20 percent of the U.S. economy.

Based on extensive study of existing programs, economic analysis and extensive stakeholder consultation, the cap-and-trade design is intended to lower the cost of achieving emission reductions and mitigate the economic impact on consumers and businesses.

The low-carbon economy that the cap-and-trade program will help create is expected to produce a variety of tangible gains throughout the region. The program will slash GHG pollution, spur growth in new green technologies, help build a strong clean-energy economy, and reduce dependence on foreign oil.

### **The Rationale**

#### *Why Cap and Trade?*

It is the best means of reducing the GHG emissions that cause global warming while simultaneously providing industry with incentives that will encourage alternative, renewable energy sources and technologies.

A cap-and-trade program sets a clear, mandatory, enforceable limit on GHG emissions and then allows the market to identify the most cost-effective ways to achieve the limit. The state or provincial government sets an absolute aggregate limit (or "cap") on GHG emissions from a sector or multiple sectors. Tradable emissions "allowances," or permits, are then distributed in an amount that equals the total emissions permitted by the cap.

These allowances can be distributed by auction and/or be allocated at no cost. Partner governments will specify which entities and facilities must surrender allowances to cover their emissions.

#### *Learning from Other Programs*

In crafting its cap-and-trade program, the WCI Partners carefully assessed the designs and performance of programs such as the U.S. Environmental Protection Agency's Acid Rain program and the European Union's Emission Trading Scheme. The design recommendations take into account lessons learned from existing programs and reflect the diversity of the WCI Partner economies, including energy production and consumption patterns.

## **The Program in Brief**

### *What Will Be Covered*

The WCI cap-and-trade program will cover emissions of the six main greenhouse gases<sup>i</sup> from the following sectors of the economy:

- Electricity generation, including imported electricity
- Industrial and commercial fossil fuel combustion
- Industrial process emissions
- Gas and diesel consumption for transportation
- Residential fuel use

### *A Phased Introduction*

Covered entities and facilities will be required to surrender enough allowances to cover emissions that occur within each three-year “compliance period”.

The first phase of the cap-and-trade program begins on January 1, 2012, covering emissions from electricity, including imported electricity, industrial combustion at large sources, and industrial process emissions for which adequate measurement methods exist. The second phase begins in 2015, when the program expands to include transportation fuels and residential, commercial and industrial fuels not otherwise covered.

### *Allowances, Banking, and Offsets*

By including features such as allowance banking and offsets, the design recommendations support a strong and balanced cap-and-trade program that takes advantage of a broad set of economic opportunities from reducing greenhouse gases.

A limited number of allowances will be available to entities and facilities covered by the program. It is important to note that emissions allowances are not considered property rights. Rather, they are permits that authorize firms to emit a specified amount of greenhouse gases.

Companies covered by the rules will be able to purchase allowances at auction, buy and sell them on secondary markets, or bank them for future use.

In certain cases companies also will be able to purchase a limited number of offset credits that reflect reduced carbon emissions elsewhere. They may also be able to purchase allowances from other comparable cap-and-trade programs approved in the future.

### *Eye to the Future*

The WCI Partners have designed a pioneering stand-alone regional cap-and-trade program that will immediately begin to address climate change in the absence of broader national or international standards. But the Partners also recognize that long-term compatibility is key.

The WCI cap-and-trade program is designed in such a way that it can provide a model for, be integrated into, or work in conjunction with any future U.S. or Canadian emissions-reduction programs. The WCI Partners will continue to advocate for national and international greenhouse gas emission reduction programs that are consistent with the WCI cap-and-trade design principles.

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<sup>i</sup> The six main greenhouse gases are carbon dioxide (CO<sub>2</sub>), methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF<sub>6</sub>).