



**FPL Energy**

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**FPL Energy, Project Management Inc., Comments in Response to Air Resources Board Program Design Technical Stakeholder Workshop Meeting Presentation on Cost-Containment Mechanisms, presented on April 24, 2008**

FPL Energy, Project Management Inc., (FPLE) would like to thank the California Air Resources Board (ARB) for the opportunity to comment on the potential use of cost containment mechanisms in California's greenhouse gas cap and trade program. The following document is submitted in response to the ARB's request for comment expressed during the April 25, 2008, "Program Design Technical Stakeholder Working Group Meeting". FPLE supports the use of the proposed multi-year compliance period, unlimited banking of allowances, use of offsets for compliance, and the utilization of an oversight board. We reserve the right to submit comments on those aspects of a cap and trade program at a future date. The comments submitted today will focus on FPLE's support of cost containment mechanisms that include a price ceiling and a price floor for auctioned allowances as well as support for the use of a safety valve.

## **Introduction**

FPLE urges the ARB to keep in mind that the ultimate goal of climate change legislation and specifically AB32 is to reduce carbon emissions in order to reverse global climate change. The theory behind utilizing a market mechanism to reduce carbon emissions hinges on a carbon price driving changes in behavior. As the cap on emissions tightens, the carbon allowances available for compliance will become scarce and their value increases. If the cost of carbon rises sharply, compliance costs will spike. This has the potential to reduce the amount of capital available for investment in research and development projects, renewable energy projects, and initiatives to replace higher emitting equipment with more efficient equipment. Without capital to invest in these initiatives, advancements in carbon reduction technologies could be slowed or impeded. Extreme price increases to consumers or “rate shock” is likewise unacceptable and could erode public support for the program. The overall structure of the program needs to promote change while it protects consumers from “rate shock”. FPLE recommends ARB employ cost containment mechanisms in order to reduce the risk and impact of potential large cost increases to consumers, regulated entities, and investors.

## **Price Ceiling**

Cost control mechanisms should be used in a way that does not impede the market function of a cap and trade program while protecting against extreme cost fluctuations that could result in unintended economic harm. In order to accomplish this, the carbon allowances should be auctioned utilizing a gradually increasing price ceiling. It is critical to

set the ceiling high enough for the price signal of carbon to promote changes in behavior but low enough to prevent catastrophic economic impacts and political backlash. Since the upper limit of the carbon price is regulated to gradually increase over time, consumers and regulated entities are afforded an opportunity to adapt to the price of carbon and avoid any harmful economic consequences. The risk of unpredictable price fluctuations would be eliminated and investment decisions could be made with some level of confidence because the potential worst case impacts of a carbon cap and trade program would be known. Also the price ceiling will limit the potential “rate shock” to consumers while allowing the price of carbon to filter into the economy.

## **Price Floor**

FPLE feels ARB should implement a price floor to facilitate investment in carbon reduction projects. If a minimum price of carbon allowances is set, it will give investors in clean generation technologies and offset projects some level of confidence their product will have value in the future carbon market. Establishing some guaranteed value for carbon will limit risk to investors that would otherwise impede moving forward with these projects. This price floor should also be increased in parallel with the price ceiling and bracket the cost of carbon. As the market matures the price of carbon will stabilize. FPLE supports the utilization of a price floor cost control mechanism as a means to bolster investment in carbon reduction projects and potential offset projects.

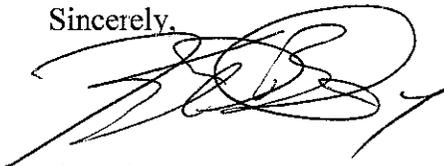
## **Safety Valve**

Finally, FPLE feels ARB should implement a safety valve into the cap and trade program. Controlling the cost of carbon allowances may not be enough. If the cap is too stringent there may not be enough viable emissions reduction options or offsets available to enable emitters to meet their compliance obligations. This shortfall in carbon allowances would drive up the cost of carbon without any assurance that emission sources still would be able to meet their compliance obligation. Since there is not currently a viable commercial scale emissions control technology available, some emitters may have no other choices but to either stop production or incur administrative penalties. A safety valve would allow a temporary expansion of the cap for a given compliance period by allowing the purchase carbon allowances from future compliance periods. If the safety valve is triggered, an oversight board could then adjust the future glide path of the capped allowances in order for the program meet the 2020 carbon reduction goals and ultimately the 2050 carbon intensity target. ARB must not lose sight of the fact that the program should be structured to meet their long term goals. This mechanism must never be used as a crutch that allows emissions sources to shirk compliance obligations, therefore the terms that would allow the triggering of this safety valve must be well defined and rigorously monitored. FPLE feels a cost control mechanism incorporating a safety valve would provide necessary compliance flexibility in the event the emissions cap level is not reasonably attainable. Also, a safety valve protects emissions sources against unpredictable and unavoidable shortfalls in the availability of carbon emission allowances.

## Conclusion

It is important to maintain the integrity of the carbon price signal in order to change behavior. Because there currently are not any commercially viable carbon emissions control technologies available, a cap and trade system structured exactly like the U.S. EPA's Acid Rain program is not well suited to facilitate carbon emission reductions. A strict cap of carbon allowances without cost control mechanisms could result in high and/or volatile carbon prices. This would expose the California economy to potentially harmful risk and could discourage the much needed investment in low-carbon emitting alternatives. A sharp carbon price increase would be costly for existing carbon-intensive processes and ultimately consumers. Also, if the price of carbon dropped sharply it would discourage long-term investments in emissions reducing technologies. For these reasons, FPLE urges the ARB to seriously consider the use of a price ceiling and price floor when auctioning carbon emissions allowances as well as using a safety valve cost control mechanism that would allow a temporary expansion of the cap against future carbon allowances.

Sincerely,



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