COMMENTS ON ARB'S PRESENTATION ON COST CONTAINMENT OPTIONS IN A CALIFORNIA CAP-AND-TRADE PROGRAM ON JUNE 22, 2010

Submitted by:

Coalition for Emission Reduction Projects (CERP)

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California Air Resources Board
Cap-and-Trade Program

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I. Executive Summary

The Coalition for Emission Reduction Projects (CERP) appreciates this opportunity to provide comments on the Air Resources Board (ARB) June 22nd staff presentations on Cost Containment Options in a California Cap-and-Trade Program. CERP supports reliance on environmentally rigorous offsets to provide cost-containment in the California cap-and-trade program. In order to achieve the desired emission reductions at the least cost to California households and businesses, CERP supports the elimination of or, at a minimum, an increase of the offset usage limit that has been proposed for regulated entities.

Among the cost containment options discussed at the June 22nd workshop, CERP supports the proposal to create an allowance reserve and to release "offset usage rights" when allowances are sold at the reserve "price collar." This mechanism would provide immediate cost containment by releasing allowances into the market but would also generate longer term cost containment by bringing additional offsets into the system. At the same time, this approach avoids the potential downsides involved with "borrowing" alternatives.

II. Introduction

CERP is a coalition of companies that develop and finance GHG offset projects as well as companies that expect to be subject to GHG regulation and want the ability to use offsets to meet their compliance obligations. Some of our members operate within California as offset project developers and investors; others anticipate being subject to allowance surrender requirements. All of our members support the goal of ensuring that California creates an environmentally rigorous and highly functional offset system as a model for other regional and federal cap-and-trade programs.

CERP's mission is to educate policy-makers and the general public about the benefits of using offset credits from GHG emission reduction projects[1] in uncapped sectors of the economy and in other countries as a means of meeting emission reduction goals. Utilizing offset projects expands the universe of mitigation opportunities, which can substantially lower the costs of mitigating the risk of climate change.

CERP aims to be a constructive voice in ongoing policy design efforts. Our members have diverse interests and views on climate change policy, but are united around the following principles:

[1] Unless otherwise stated, references in these comments to "offset projects" or "emission reduction projects" describe projects involving the reduction, avoidance, sequestration, or destruction of GHG emissions.

- Limiting GHG emissions is best accomplished through a market-based program.

- Any GHG regulatory program should allow regulated entities to meet their reduction requirements through the use of offset credits from a range of domestic and international emission reduction activities.

CERP believes that offset credits only should be available for projects that achieve emission reductions that are additional, permanent, independently verified, enforceable, and measurable.

A list of CERP's members is provided in Appendix A to these comments. CERP's recommended policy principles on offsets are provided in Appendix B to these comments.

III. Comments

A. An Offset Usage Limit Increases the Costs of Reducing Greenhouse Gas Emissions

CERP supports reliance on environmentally rigorous offset projects and credits as a means of providing cost containment for the California cap-and-trade program. One of the key design hallmarks of a cap-and-trade program is the inclusion of large emission sources within the cap, and the use of an offsets program to integrate emission reduction project opportunities in uncapped sectors of the economy. By directly regulating only the larger emission sources, a cap-and-trade program dramatically reduces administrative costs—while using a market price signal to leverage efficient emission reductions throughout the uncapped sectors via offset projects. Because certain emission reduction opportunities in the uncapped sectors of the economy can be implemented at significantly lower costs than in the capped sector, offsets dramatically reduce the costs of a cap-and-trade program. For example, the Congressional Budget Office's analysis of the Waxman-Markey federal climate legislation, H.R. 2454, projected annual savings from offsets to be approximately 70%.[2]

Offsets also serve as a bridge to the low-carbon economy of the future. Many of the "breakthrough" technologies needed to significantly reduce GHG emissions from capped sectors have yet to be developed or deployed. A cap-and-trade program with a gradually declining cap creates an incentive to develop these technologies. While those technologies are being brought to market, offset projects can provide the verifiable and actual emission reductions needed to meet current compliance requirements. A significant component of the cost containment provided by offsets

[2] CONGRESSIONAL BUDGET OFFICE, THE USE OF OFFSETS TO REDUCE GREENHOUSE GASES 8 (Aug. 3, 2009).

is their ability to give regulated entities flexibility in the timing of internal emission reductions.

By ensuring that emission reductions are made where and when they can be achieved at least cost, a cap-and-trade program with offsets achieves the desired environmental result at least cost to the California economy.

By limiting offsets usage to slightly under 4% of entities' compliance obligations – as ARB has proposed in the draft regulations – ARB is limiting the cost containment that offsets can provide, and increasing the costs of the cap-and-trade program for households and businesses. CERP appreciates the desire to ensure that regulated entities reduce their on-site emissions; however, if the low-carbon technologies needed are not yet commercially available or cost-effective, and if cost-effective emission reductions can be made by non-regulated entities in the near-term, forcing regulated entities to make the emission reductions on-site only will achieve the same environmental result at a much higher cost. To be clear, as the cap tightens over time, regulated entities will be required to reduce their on-site emissions. However, by utilizing the most cost-effective emission reductions in the early compliance periods through offsets and allowance trading, the cap-and-trade program provides critical time for the low-carbon technologies to be developed and deployed, reducing the costs of mitigating climate change. For these reasons, CERP opposes the 4% offset usage limit.

B. CERP Supports an Allowance Reserve in Combination with an Offsets Usage Increase Mechanism

Among the cost containment options discussed at the June 22nd workshop, CERP supports the establishment of a "soft price ceiling" for allowances by creating an allowance reserve combined with an increase in allowed offset usage for longer term cost containment. As CERP understands this proposal, the allowance reserve would be created by drawing allowances from current or future vintage years. Reserve allowances could be (1) released from the reserve when a trigger price is reached at auction, (2) sold at a (gradually rising) price window, or (3) directly allocated to covered entities. When allowances are sold or released from the reserve, an equivalent quantity of "offset usage rights" would also be released. An "offset usage right" would allow a regulated entity to use an offset credit for compliance that would not be counted against the entity's offset usage limit—and which would therefore be equivalent to adding an allowance to the overall system. These "offset usage rights" would be tradable, and therefore could be transferred to an offset project developer, giving that developer assurance that it could develop (and sell) a quantity of offset credits equivalent to the quantity of "offset usage rights" held.

Unlike a temporary increase in the offsets usage limit, the above mechanism would give offset developers enough time to develop the needed increase in offset supply[3] while still adding an additional compliance instrument (the reserve allowance) to the system for immediate cost containment.

This mechanism would be fully aligned with the goals of AB 32, as it would achieve the desired environmental outcome while providing cost containment for California businesses and households. The mechanism would also provide the cap-and-trade program with greater capacity to respond effectively to any sudden increases in allowance costs. If allowance prices rise beyond the price ceiling, more allowances will be released into the market, lowering near-term compliance costs. At the same time, the creation and distribution of an equivalent number of offset usage rights will increase the overall quantity of compliance instruments available, which will reduce long-term costs as well.

The potential problem with this mechanism is that its cost containment capacity is limited to the size of the allowance reserve. Although the tradable offset usage right would bring an additional compliance instrument into the overall system, it would not refill the allowance reserve itself. If the reserve is drawn down repeatedly, it might be necessary to increase the long-term offset usage limit in order to maintain costs at a level that will sustain public support for long-term greenhouse gas abatement efforts.

In addition, because the offset usage right is effectively created by a regulated entity having to purchase an allowance at the price ceiling, CERP believes that the offset usage right should be distributed to that regulated entity at no charge.

IV. Conclusion

We appreciate your consideration of our comments, and look forward to working with you to maximize the efficiency and efficacy of the California offset system.

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[3] It takes time – often several years or more – to finance, develop, and register an offset project. Therefore a temporary increase in the offset usage limit may not provide significant cost containment because the needed offset supply would not be available.

Appendix A

Members of the Coalition for Emission Reduction Projects

Alpha Natural Resources

American Electric Power

Blue Source

Camco

C-Quest Capital

C-Trade

Deutsche Bank

Dominion

DTE Energy

Duke Energy

Element Markets

El Paso Corporation

Environmental Credit Corp.

Equator, LLC

John Deere

Leaf Clean Energy Company

Natsource

Noble Carbon Credits

PG&E Corporation

Verdeo Group

Appendix B

CERP Statement of Principles

The mission of the Coalition for Emission Reduction Projects (CERP) is to educate policy-makers and the general public about the benefits of using offset allowances from domestic and international greenhouse gas (GHG) emission reduction projects as a means for regulated entities to meet their compliance obligations under any U.S. GHG cap-and-trade program.

CERP believes that any U.S. GHG regulatory program should adhere to the following principles:

1. Entities regulated under any U.S. cap-and-trade program should have the ability to achieve their compliance obligations through the use of offset allowances from qualifying emission reduction projects.

Regulated entities should have the flexibility to help meet their compliance obligations by using emission reductions from projects that are not otherwise subject to the emissions cap. Multiple studies have shown that allowing use of such offset allowances can: (1) lower costs of compliance for regulated entities and costs of GHG regulation for society as a whole; (2) create greater incentives for development and deployment of emission reduction technologies; and (3) achieve emissions reductions from sources that would not otherwise occur.

2. Offset allowances should be available only for projects that achieve emission reductions that are additional, permanent, independently verified, enforceable, and measurable.

Any U.S cap-and-trade program should include clear and rigorous rules for approval of projects and issuance of offset allowances. A credible authority should oversee administration of the offset program, with support from independent accredited third-party verifiers.

3. The project approval process should be transparent and rely on established, approved project types and methodologies, with clear procedures to approve new methodologies and project types.

The project approval process should achieve three objectives: (1) ensuring environmental integrity; (2) controlling administrative and transaction costs; and (3) providing for investment certainty as early as possible. Adoption of pre-approved methodologies and a preferred list of project types eligible for streamlined approvals will reduce compliance costs and investment risks, thus encouraging greater market participation. Similarly, a streamlined and transparent process for approval of new methodologies will provide necessary incentives for the development and deployment of new technologies.

4. Offset allowances should be available from an expansive set of sectors, activities, and countries.

Any U.S. emissions reduction program should focus on environmental integrity of projects and their compliance with the relevant standards created by the program. All project types that are not otherwise subject to emissions limits and that can comply with the applicable standards should be eligible.

5. Any U.S. GHG regulatory program should allow for the use of offset allowances from international projects.

Climate change is a global environmental issue. As such, geographic location should not limit the ability of a project to qualify under a GHG regulatory program. Indeed, many low cost opportunities for reducing emissions are in developing countries. Accordingly, allowing for the use of reductions from such countries not only will lower the costs of compliance with the U.S. program, it will provide a means of transferring U.S. clean energy technologies and expertise to the developing world. Importantly, allowing use of international offset allowances for compliance purposes provides an opportunity for the U.S. to demonstrate its leadership on the issue of climate change and to engage with the global community in reducing emissions.

6. Entities that implement emission reduction projects prior to the establishment of a U.S. regulatory program, and that meet the applicable standards for project eligibility, should be awarded offset credits.

Entities (not just those subject to emissions limits) that implement otherwise-qualifying projects should be provided offset credits for reductions achieved by those projects prior to enactment of GHG regulatory legislation.