Stephen D. Burns
Manager,
California Government
Affairs

Chevron Corporation
Policy, Government and
Public Affairs
1201 K Street, Suite 1910
Sacramento, CA 95814
Tel (916) 441-3638
Fax (916) 441-5031
stephen.burns@chevron.com

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Mr. Kevin Kennedy
Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, California 95812

Subject: Chevron Comments on June 22 Cost Containment Workshop

Dear Mr. Kennedy:

We appreciate the opportunity to provide comments on the California Air Resources Board's (ARB's) proposed implementation of a cap and trade program under AB32 as discussed during the June 22, 2010 public workshop (the "workshop"). We are encouraged by ARB's efforts to seriously consider cost containment mechanisms. Chevron supports the inclusion of cost containment mechanisms including price collars, banking and borrowing of allowances, and those that support a robust supply of offsets; all of these can be effective ways to mitigate the negative impacts of climate change policies on consumers, businesses and the economy.

There are two proposed policies raised in the workshop which we believe must be supported through transparent and objective policies:

- <u>Expansion of offset limits to reduce costs and ensure environmental integrity –</u> This provides a fundamental solution to high prices while preserving the integrity of the cap; only by expanding offset limits can existing policies ensure adequate offset supply.
- <u>Allowance reserve or allowance windows must be designed with sufficient liquidity, objective preset prices, and a mechanism for replenishment through the government purchase of offsets; this is the only way to avoid supply shortfall and subsequent price spikes.</u>

<u>Expand offset limits</u>

The workshop discussed expanding offset limits to 8% at a trigger price to control costs temporarily until allowance prices drop. We strongly support this proposal because expanding the allowable use of offsets allows the market to function freely while containing costs. Essentially all of the economic studies on the topic show that offsets are the best market-based alternative to reduce costs and to limit leakage; such a policy will both protect California consumers and keep California industry competitive. It is superior as a cost containment mechanism compared to an allowance reserve as long as a sufficient supply of offsets exists.

Simply adopting this policy may improve the market outlook for project developers, which may lead to additional projects that improve the future supply of offsets. However, offset supply may be constrained as a result of the significant uncertainty and expected delays due to the lack of currently-approved offset protocols. Please see our July 9, 2010 letter which proposes that ARB address this issue by directly accepting all CAR protocols and other robust approved offset protocols without imposing duplicative approvals or adding further conditions.

Design any allowance reserve program objectively, transparently and without shrinking supply

The workshop proposed an allowance reserve funded by allowances from current or future periods, and does not propose to use offset credits. The workshop also proposed a “soft price collar” for triggering the availability of reserve allowances. We are concerned with the lack of clarity around the process as well as the timing to determine the trigger prices for opening and closing the reserve. Overall, it appears that ARB continues to consider policies that are not tied to hard economic indicators or to a preset price. Obligated parties need transparency on the allowance allocations, reserve allowance supply and cost cap triggers so that they can plan appropriately and develop optimal compliance strategies. Any reserve program developed based on subjective decisions that are made only at the time of need will impair the ability of the market to function due to lack of transparency and an omnipresent uncertainty with respect to even near-term future market conditions.

The allowance window or allowance reserve must be designed to provide sufficient reserve liquidity. The design must include unfettered access to reserve allowances whenever market prices reach levels that make it necessary to reduce allowance prices below the collar ceiling price. Even if reserve allowances are available in sufficient supply, they can effectively provide a mechanism to mitigate costs if they are accessible to entities that require them.

We believe that the functionality of the reserve is tied to the source of the allowance supply. We cannot recommend either supplying the reserve from current or future allowances since both ultimately shrink supply, which will drive up market prices. Essentially, if ARB does not allow allowance reserve replenishment from outside of the AB32 cap (e.g., through the purchase of offsets from auction proceeds), then the use of the proposed reserve as a cost containment process is fundamentally flawed.

We look forward to working with ARB to develop a sound cost containment program that expands offsets, incentivizes offset creation and does not impact long term market liquidity so that the State can contain costs and meet the goals of AB32.

Best regards,

via e-mail

Stephen D. Burns