November 20, 2008

California Climate Coalition

The California Climate Coalition is a coalition of California industries and cleantech companies who have joined together to develop recommendations for California's AB32 program. On May 15, 2008, the Coalition issued a comprehensive proposal, entitled "California First – a Proposal to Accelerate Low-Carbon Technology Deployment and Bring California into a Global Carbon Market." The proposal contains detailed recommendations regarding how California can best start its program to reduce greenhouse gas emissions, how it can integrate its program with regional and a national program over time, and how it can accelerate the development and deployment of advanced low-carbon technologies. The comments set forth below should be viewed in the larger context of the Coalition's integrated proposal and of the general design principles attached to that document. This proposal can be found at the Coalition's web site at *www.caclimate.org.*

The Draft Scoping Plan does an excellent job of identifying opportunities to reduce greenhouse gas emissions from various sectors. It covers the entire economy and sets tonnage targets consistent with AB32. There is a great deal that it does not do, however, and a large number of as-yet unaddressed but critical program details that must be addressed if this unprecedented program is to succeed. We set forth below for your consideration several specific recommendations.

1. **California Should Promptly Establish and Implement an Integrated Investment Strategy:** To launch material near-term investment in low-carbon technologies and in the required infrastructure, the state must do more than set tonnage reduction targets. It should also do the following. Some of these recommendations are likely to require legislation.

   a. ***Set Priorities*** - the state should promptly identify strategic regional infrastructure needs and formally declare that there is an over-riding need for expediting related projects. The state should require that all state, regional and local actions be consistent with these priorities.

   b. ***Integrate Decision-Making for Priority Projects*** – the state already has some mechanisms for integrating the permitting of identified priority projects. This process should be enhanced to establish a single expedited public process for considering all environmental, energy and transportation issues by all agencies and departments with jurisdiction over the project. For identified priority projects, this process should be in lieu of proceedings that otherwise would be held by individual agencies, commissions or departments. The state either should establish a new agency for this purpose or designate a lead agency.

   c. ***Harmonize CEQA with AB32 Goals*** – Working with the State Office of Planning and Research, the Board should develop California Environmental Quality Act guidelines that recognize the environmental and energy benefits of projects and investments that comply with the AB32 program. Because GHG is a global rather

than local pollutant, statewide guidelines -- rather than myriad local variations -- are the most efficient and equitable way to insure that projects contribute to GHG reductions. Benefits such as improved energy efficiency, reduced carbon intensity, improved regional energy and transportation balance should be recognized as significant factors in any CEQA analysis; and AB32-compliant projects should be exempt from CEQA review for the purpose of evaluating or mitigation greenhouse gas emissions impacts.

d. ***Attract Near-Term, Large-Scale Investment*** - To attract large-scale capital investment in priority projects, the staff should develop and the Board should expeditiously approve protocols to certify the greenhouse gas-reduction benefits of desired projects in or serving California. A program to pre-certify these greenhouse gas reductions would help investors to monetize those benefits and warrant rapid investment.

    - *Innovative Technology Credits* - For an appropriate subset of California-serving projects that meet strategic state objectives (i.e., technology game-changers) and can satisfy appropriate financing, technology-readiness and performance criteria, the state should issue emission reduction credits in advance of performance. These credits should be immediately tradable into the strategic sector for which the project offers technology-advancement benefits (e.g., the low carbon fuel standard, the renewable portfolio standard, the motor vehicle program). Conceptually, this is similar to forward-pricing when introducing new products. Advance credit generation offers the potential for jump-starting priority investment before the market yields carbon prices high enough to warrant such investment. Using an appropriate share of the revenues generated by monetizing priority project benefits, the state should insure against technology failure by investing in available global carbon reductions at the lowest available cost.

e. ***Integrate Scheduling*** – the AB32 program should recognize the extent to which there are likely to be competing regulatory demands for scarce capital and labor. The program should provide sufficient flexibility for businesses to prioritize investments and schedule compliance activities to address multiple program demands.

f. ***Capture California Co-Benefits*** – the best way to encourage state, local and regional investment and to capture the co-benefit opportunities (e.g., in criteria pollutant reductions) associated with climate-related investment is to encourage that investment directly. The approach recommended above is the best, most direct and most immediate way to ensure such investment. The Board should recognize that other approaches, such as limiting overall market access to offsets, are likely to be counterproductive to the extent they make it more difficult for the state to link up with other jurisdictions and to establish a truly national and global carbon market. A well-functioning global market will, in the long run, provide the best assurance that we can achieve our climate protection goals.

2. **Transition to WCI/National Program**: California and the Western Climate Initiative can take well-deserved credit for advancing greenhouse gas reduction strategies. But ultimately the goal should be to integrate these programs into a broad national program.

3. **California's Hybrid Market Will Pose Unique Challenges:** The Draft Scoping Plan represents a different type of market design, essentially a hybrid of regulatory mandates, caps and emissions trading. This approach will pose special challenges that are likely to require unrestricted access to offsets and the development of early warning signals and contingency strategies.

a. ***Recognize that the Overlay of Facility Caps on Top of Sector Mandates Will Make Access to Offsets Vitally Important*** – The Draft Scoping Plan is not a traditional cap and trade proposal. The economic literature regarding traditional emissions trading programs shows that a cap and trade program can significantly reduce overall program costs, often upwards of 25%, by allowing sources to select the most cost-effective means of reducing emissions and meeting the cap. The Draft Scoping Plan takes a markedly different approach. In significant respects, the Draft Scoping Plan ***prescribes the means*** by which it would meet the state's 2020 target. Although we have not yet seen all of the program details, the Plan clearly suggests that many sectors will need to meet mandatory performance requirements wholly independent of meeting the cap. Because the Plan will overlay caps on top of individual sector mandates, rather than permitting sources to select the means of reducing GHGs, many of the cost savings typically offered by a cap and trade design will not be available even though the program will contain some "trading" elements.

Another potential consequence of the program's hybrid design may be to reduce the availability of allowances for some sectors. Under the proposed plan, for example, industrial facilities must achieve a 35 million metric ton (MMT) reduction, but they are not likely to have access to many of the GHG-reductions that might have been available if the ARB did not impose independent program mandates. A power plant, for example, must reduce emissions beyond those achieved by the state's renewable power and energy-efficiency programs. And a refinery will face reductions on top of those achieved as part of the low carbon fuel standard. The net effect of the independent mandates thus is to remove from the market many if not most of the types of reductions (e.g., fuel switching, energy-efficiency) that most other GHG programs have relied on to keep carbon prices low. Because the identified (and independently mandated) reduction strategies will not be accessible generally in the market in the form of excess allowances, sources subject to the further reduction requirements will need to find other ways to reduce their emissions on site or to purchase offsets. In many cases, facilities may not be able to find other cost-effective on-site reduction opportunities. Assuming that the ARB does not wish industrial facilities to comply merely be curtailing their operations, the program will need to provide an adequate supply of GHG reduction credits from outside the cap and trade program (i.e., offsets). The hybrid nature of the proposed program thus makes such sources particularly dependent on access to offsets.

b. ***Work with Other Jurisdictions to Establish Appropriate National and International Offset Integrity Criteria*** – While the hybrid nature of the proposed program will make access to offsets vitally important, we agree that the ARB should work with other jurisdictions to establish appropriate criteria for ensuring the integrity of offsets. The ARB should:

- ensure that credit accounting is valid (e.g., with replicable emission measurements and enforceable commitments); and

- use appropriate carbon intensity or performance standards as additional criteria to ensure progress, but these should be selected and implemented in concert with existing national and international bodies to ensure a uniform and effective global market. Any such future criteria should not jeopardize the trading and use of existing certified reductions.

No other limits on offsets should be imposed. In addition to the reasons noted above, regulated entities will need unrestricted access to offsets particularly in the early years given the difficulty of meeting early year targets.

c. ***Develop Early Warning Signals and a Contingency Plan*** – As we have discussed with the staff, the program should contain a contingency plan in the event the future does not unfold as planned. Any number of unanticipated events could occur, including the inability to build adequate transmission access for renewable power, the failure of one or more states or provinces to adopt implementing regulations to establish a full regional trading program, the failure of low carbon fuels, motor vehicle or energy storage technologies to develop on schedule, or any number of other factors. The Board should direct staff to develop early warning systems to identify any such failures at the earliest possible stages and to develop in advance the appropriate contingency measures to address such events. These early warning signals and contingency actions should be designed and published in advance through formal rulemaking so that the market knows the rules of the game.

4. **The State Should Develop Appropriate Mechanisms for Conflict Resolution and Compliance Flexibility:** As the state implements multiple programs to address criteria pollutants, greenhouse gas emissions, energy and transportation goals, these programs may conflict in certain material respects. In such circumstances and when other unanticipated compliance-related issues arise, the state will need a clear and efficient process for helping facilities to resolve inconsistencies and to remain in compliance. One near-term example of this is the AB32 reporting program. As the state already is behind in implementing this program, facilities will need some mechanism to ensure that they can remain in compliance and avoid enforcement penalties.

a. ***Develop a Variance Procedure*** – the ARB should identify and develop appropriate mechanisms, including schedules and appropriate flexibility provisions, such as

variances, to recognize that facilities will face a range of practical challenges in implementing this program.

b. ***Develop a Conflict-Resolution Procedure*** - The regulatory structure should include clear rules, and explicit jurisdictional provisions, regarding the relationship among state and local agencies (e.g., air pollution control districts, local governments). There should be a simple conflict-resolution mechanism for quickly resolving areas of ambiguity that arise as different agencies implement overlapping or competitive programs. For example, proposed Low Impact Development permeability and drainage requirements designed to reuse stormwater and reap GHG benefits associated with lower water demand conflict with the proposed Transportation/Land Use Sector goal of compact, higher density development. The process should include the opportunity for integrated dialogue among the facility, the relevant jurisdictions and the public. The state should establish a high-level board to adjudicate competing disputes regarding jurisdiction among state, regional and local agencies and regarding inconsistent provisions contained in permits and regulations. There should be strict time limits to resolve petitions.

Other Recommendations:

5. **Work Plan**: The ARB should establish, workshop and publish, as soon as possible, but preferably by no later than February 1, 2009, a detailed work plan outlining remaining regulatory actions and identifying areas for program and measure development.

6. **Use of Auction Revenues**: All auction revenues should be directed to greenhouse gas reduction-related investments. An appropriate portion of auction revenues should be returned to regulated facilities for appropriate greenhouse gas reduction-related investments, including community co-benefits, investment in energy-efficiency and renewable technologies and other beneficial programs.

7. **Renewable Energy, Energy Efficiency and Conservation Projects**: the ARB should work with appropriate state agencies to develop a program to supplement the existing PUC energy-efficiency programs so that, in appropriate circumstances, non-utility entities may finance and benefit from renewable energy, energy efficiency and conservation programs and that these investments are recognized in the overall accounting of GHG reductions. Opening these programs to non-utilities will greatly accelerate GHG emission reductions that would otherwise require investments beyond the reach of owners and occupants in the existing built environment. These programs could take place at any facility, including industrial, commercial and residential buildings.

8. **Ongoing Scoping Plan Validation Process**: Several aspects of the scoping plan have yet to be validated. Many of the tonnage target numbers remain uncertain and may need to be adjusted significantly in the years ahead as the base data are validated. The Scoping Plan should recognize the need to refine and adjust the regulatory framework and priorities based on experience and the best available data. The Board should authorize staff to continue to evaluate data, to recommend

appropriate adjustments to measure targets, and to prepare cost-effectiveness rankings based on the validated data to guide regulatory priorities.

9. **Facility Audits**: There is no reason for the program to mandate facility-specific audits or actions. The market is the best mechanism to encourage GHG reductions at major facilities. The market will ensure that facilities take on-site reduction opportunities into account in selecting the most appropriate compliance options. The ARB and the air districts will have extensive data through reporting programs to track the co-benefits of state GHG reductions.

10. **Zero Net Energy Feasibility:** Zero Net Energy (ZNE) targets for commercial and residential buildings should reflect the realities of the marketplace, technology and other GHG goals. Higher density development, which is an essential part of the GHG strategy for land use and transportation, will result in inadequate rooftop space for photo-voltaic (PV) energy panels to support ZNE on these projects. The National Renewable Energy Laboratory reports that achieving ZNE today would cost approximately $50,000 for a 2,500 square foot home. We recommend an approach that considers the cost-effectiveness of key ZNE components and a comprehensive view of GHG reduction strategies and opportunities.