ENVIRONMENTAL DEFENSE FUND
finding the ways that work

August 11, 2008

Mary D. Nichols, Chairman
California Air Resources Board
1001 I Street
Sacramento, CA 95812
(916) 445-5025 (Fax)

RE: Draft Scoping Plan Comments – Program Design

Dear Chairman Nichols,

Environmental Defense Fund (EDF) applauds the California Air Resources Board (CARB) on the release of the *Climate Change Draft Scoping Plan: A Framework for Change*. The draft Scoping Plan represents an important milestone in California's implementation of the landmark Global Warming Solutions Act of 2006 (AB 32), the first state-level cap on the greenhouse gas pollution that causes global warming.

EDF respectfully submits the following comments in response to the draft Scoping Plan, and looks forward to collaborating with CARB and other stakeholders in the coming months as further materials, including the evaluation supplements, are made available.

Sincerely,

Derek Walker
Director, California Climate Initiative
Environmental Defense Fund

AB 32 Program Design

The measures set forth in the draft Scoping Plan offer a sensible balance of market mechanisms and traditional regulatory policies.

Cap-and-Trade Overview

The multi-sector cap-and-trade program recommended in the plan will provide the environmental certainty and generate the cost-effective emissions reductions required by AB 32. The scope of the cap-and-trade, which will expand to cover nearly 85% of California emissions by 2020, will ensure an efficient and environmentally effective market in which regulated entities have tremendous incentives to cut their pollution quickly and have the flexibility to do so at lower cost than would be possible through conventional direct regulations alone.

Over the next two years, CARB and an array of interested stakeholders will undertake a comprehensive assessment of appropriate market design features. Thorough examination of the successes and shortcomings of current cap-and-trade systems, including the SO2 trading program, the European Union's Emissions Trading Scheme (ETS), and the Regional Clean Air Incentives Market (RECLAIM), must be a focal point.

The cap-and-trade system must complement existing air quality controls, creating a full regulatory program that addresses both greenhouse and non-greenhouse gas pollutants and delivers substantial environmental benefits to all residents and communities of California. EDF concurs with the Market Advisory Committee (MAC) conclusion that the greatest reductions in non-greenhouse gas pollutants (e.g., criteria pollutants) are very likely to occur in the most polluted areas. CARB should seek to provide further detail on potential criteria and toxic air contaminant reductions to be achieved via the cap-and-trade system.

Allowances

While some administrative allocation of allowances may be appropriate in the near-term, EDF agrees with the MAC report that auctioning is the preferred method of distributing allowances. The value of allowances issued or sold under the cap-and-trade system can be used to generate additional emissions reductions and ensure fairness both for California residents and the regulated businesses.

The list of possible uses of revenue in the draft Scoping Plan (pp. 46-47) is a useful starting point for the discussion. Ultimately, priority should be given to uses that achieve direct greenhouse gas reductions (and co-pollutant benefits), protect low-income residents from regressive economic impacts, and ensure that the overall program maximizes benefits and minimizes costs to Californians.

Offsets

EDF supports the inclusion of high-quality offsets in the AB 32 cap-and-trade system. Offsets offer tremendous potential to inspire innovation in sectors of the economy, including agriculture and forestry, that are large sources (or stores) of greenhouse gases but lack the necessary emissions measurement systems for inclusion under the cap.

In our April 17, 2008 letter to Kevin Kennedy, EDF provided detailed responses to several questions about offsets posed by CARB in a white paper. We noted that an offsets program "not only drives reductions outside of the cap in cap-and-trade programs, it rewards innovators who develop new solutions to reduce GHGs, can facilitate reductions of traditional pollutants in over-burdened communities, and can be used to lay the groundwork for including non-capped sectors within a broader cap." Furthermore, we discussed criteria for recognizing reductions via offsets:

> "AB 32 laid out fundamental criteria for recognizing emissions reductions in California (§38562 - real, permanent, quantifiable, verifiable, and enforceable). These criteria track closely the nationally and international accepted standards aimed at ensuring the environmental integrity of projects, protecting consumers of offset projects, and creating and maintaining confidence of an offset market. Environmental Defense Fund therefore believes that whatever approval process is used by CARB, meeting these fundamental criteria (AB 32 and internationally accepted criteria) for offsets must be an integral part. That is, CARB must require that every offset project used within AB 32 for compliance purposes must be:
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> - Real (actually achieve GHG reductions),
> - Additional (beyond the business as usual case such that the reductions would not have occurred otherwise),
> - Permanent (or have provisions to guarantee the emissions reductions generated will be recouped in the event of a reversal),
> - Measureable (with accuracy),
> - Verifiable (using disinterested third parties),
> - Enforceable (with authority by the government to require the emissions reductions are maintained)."

Carbon Fees

EDF strongly believes that a cap-and-trade system is a more reliable and effective means of incentivizing the substantial emissions reductions required under AB 32 than a carbon fee. However, modest carbon fees to cover administrative costs of AB 32 implementation may be acceptable, particularly if allowance revenue is not available.

The two key features of a cap-and-trade system: (a) an enforceable 'cap' on emissions which guarantees that emissions will go down, and (b) flexibility to seek out and implement low-cost reductions, does not exist with a carbon fee. Without these two features, there is no guarantee of

reaching environmental performance goals, and there is limited ability for society to utilize to their fullest extent available cost-minimizing strategies.

In addition to higher compliance costs and less reliability about outcomes, there is no guarantee that a fee would be set at a level that would inspire sufficient emissions reductions.

Policies that put a price on GHG emissions, including fees, may have direct regressive economic impacts that hit low-income households hardest. The theoretical justification for any environmental impact fee is that the revenues will be used to mitigate the harm caused by the emissions. Yet, with GHG emissions fees, there is no guarantee that the revenues generated will be utilized to effectively mitigate impacts associated with the emissions, or that the mitigation will happen with geographic or temporal proximity to the harm.

Furthermore, a carbon fee (or tax) is likely to be politically unachievable. The difficult fiscal climate in California combined with the urgency need to keep AB 32 implementation on track argues against pursuing a carbon fee (or tax) that requires a 2/3 supermajority vote for passage.