IETA
INTERNATIONAL EMISSIONS TRADING ASSOCIATION

August 11, 2008

Mary Nichols, Chair
California Air Resources Board
1001 'I' Street
Sacramento, California 95814

Dear Chair Nichols,

I am writing to provide the comments of the International Emissions Trading Association (IETA) on the June 2008 California Climate Change Draft Scoping Plan. I hope you will consider IETA's perspective as the California Air Resources Board works to produce a final Scoping Plan to implement California's global warming law, AB32.

IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our 181 member companies include some of America's and the world's largest industrial and financial corporations, including global leaders in oil, electricity, cement, aluminum, chemical, paper, and banking; as well as leading firms in the data verification and certification, brokering and trading, legal, and consulting industries. IETA is dedicated to the establishment of effective market-based trading systems for greenhouse gas emissions by businesses that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. A complete list of our members is attached.

I. Harmonization with regional and federal markets

IETA believes the best way to address climate change is through enactment of a nationwide cap-and-trade system linked to a global market. We are concerned that the development of overlapping and potentially contradictory state and regional greenhouse regulations would fail to capture the full ability of market mechanisms to reduce greenhouse gas emissions. In addition, a patchwork approach to regulating GHG emissions would increase compliance costs and lead to economic distortions.

Nevertheless, IETA recognizes that the federal government's pace of progress towards developing a nationwide cap-and-trade system creates an incentive for states to develop regional emissions markets, and that California is well on its way to doing so. As California continues to develop its program, we strongly urge the state to keep in mind that climate change is a global problem that will ultimately require coordinated national and international action.

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Emissions trading delivers economic efficiency by discovering and exploiting differential costs. This efficiency helps consumers and businesses and provides greater environmental benefits for a given expenditure of societal resources.

Costs are reduced through the use of larger markets, including linking between different markets, since larger markets are inherently more efficient, liquid, and competitive. In addition, larger markets provide a broader pool and greater variety of abatement costs, providing greater opportunities for low-cost emission reductions. A broader carbon market will reduce social costs and deliver more efficient and effective environmental solutions.

We are pleased California is working with other states, as well as Canadian provinces and Mexican states, in the Western Climate Initiative (WCI) to develop a regional greenhouse gas trading program. We are further pleased that the Scoping Plan has set an explicit goal of linking the California program with other WCI partner programs to create a regional market.

We recommend that California include a similarly explicit recommendation that the state and regional program set a goal of ultimately merging into a federal program. California should work to include design elements that would enable rapid harmonization with future federal requirements. For example, the US Environmental Protection Agency is currently developing regulations for a nationwide emissions reporting program. We encourage California to work with EPA to ensure consistent state and federal emission reporting requirements, and to ensure consistency with other EPA requirements as they are developed.

We also encourage California to help advance the concept of a single global carbon market by accepting allowances from other rigorous state, regional, and international cap-and-trade systems. Linking emissions markets across the US and around the world will provide a broader geographical scope and greater liquidity, and will encourage the most cost-effective reductions of greenhouse gases.

II. Balance between market-based solutions and command-and-control

We are pleased that CARB has proposed to include emissions trading under a cap-and-trade program as part of the solution to addressing California emissions. However, IETA strongly believes that CARB has not reached the right balance between market mechanisms and a command-and-control approach.

The most effective way to address climate change is through the effective use of market mechanisms. Emissions markets provide incentives for both consumers and industry to reduce emissions and take actions that minimize costs. When properly designed, emissions markets allow effective discovery of a price for carbon, act as a powerful incentive to minimize overall social costs, and enable the private sector to invest resources in the most efficient and effective manner in order to protect the climate.

The Draft Scoping Plan relies on command-and-control measures to achieve 80% of the required emission reductions, and cap-and-trade for only 20%. This approach creates a redundant set of regulations that will undermine the power of the market and increase costs.

For companies and sectors falling within the cap-and-trade program, these additional regulations have no value in reducing carbon emissions beyond what would be reduced by cap-and-trade alone. These regulations assume the government is better able to identify technologies and approaches to reducing emissions than the market or individual companies.

In addition, there may be unintended and potentially deleterious impacts resulting from the creation of redundant regulatory measures and carbon fees as part of a broader program in which cap-and-trade is used as the backstop. For example, if the regulatory measures outlined in the Scoping Plan fail to achieve the expected reductions, there could be a significant last minute rush to achieve compliance through the cap-and-trade program. This scenario could create an unanticipated shortage of allowances, which would either drive up prices and compromise the ability of industry and utilities to obtain allowances and continue operating, or compromise the ability of the state to achieve its emissions goals, or both.

In addition , the direct regulatory components outlined in the Scoping Plan could mandate reductions that may otherwise be achieved using alternative, more cost-effective means under cap-and-trade. If the "low-hanging fruit" opportunities are regulated away in California at a higher cost, the cap-and-trade component of the Scoping Plan would lose much of its ability to effectively reduce costs. Furthermore, such interactions would make it difficult to discover the true price of a ton of carbon, therefore complicating decision-making for both capped entities and offset project developers.

Since the primary objective of the draft scoping plan is to reduce greenhouse gas emissions, IETA strongly recommends that California reduce or eliminate command-and-control measures that do not reduce emissions beyond the cap-and-trade system alone. While IETA recognizes that California has other important objectives beyond reducing greenhouse gas emissions, IETA recommends unrelated objectives be separated from the scoping plan and considered under separate regulations.

III. Offsets.

IETA believes the use of environmentally robust offsets is an effective means to reduce greenhouse gas (GHG) emissions outside a cap-and-trade system while controlling the costs of regulated firms complying with emissions targets. Since environmental markets are purely regulatory in nature, it is important that a balance be maintained between supply and demand and sufficient liquidity be available in the market. Fundamentally, IETA believes this objective is best achieved with a strong supply of offsets. A robust offset program, including a rigorous approval process, ensures reductions achieved outside the cap are environmentally equivalent to those within a regulated firm's own assets.

IETA believes the proposed use of offsets in the draft plan, while limited to 10%, could nevertheless help reduce energy costs for California consumers, improve California business competitiveness, and prove to be an important means of reducing emissions in otherwise unreachable sectors. However, IETA believes California could substantially increase these benefits by improving upon and expanding the allowed use of offsets.

IETA is concerned that the Draft Scoping Plan understates the benefits of offsets while overstating the benefits of mandated emissions reductions in the absence of offsets. For example, on page C-19 the plan states that "allowing offset projects from outside California to count for compliance under AB32 could reduce the amount of reductions occurring within the state, and which would reduce the local economic, environmental and public health co-benefits from GHG emission reduction." This statement ignores the costs to consumers, businesses, and society of mandated emissions reductions from regulated sectors. Required emission reductions from capped sectors, in the absence of the ready availability of quality offsets, will increase consumer's electricity, natural gas, and gasoline prices, increase the cost of doing business in California, and could well cost California jobs by causing some businesses to go out of business or shift their production outside the state. While emissions reductions can also result in benefits, it is inappropriate to consider only the benefits and not the costs.

IETA strongly recommends that California recognize the full suite of benefits that offsets can provide. These include:

- **Offsets allow the greatest emissions reductions in the least time for a given expenditure of societal resources.** Since, once released, greenhouse gases can remain in the atmosphere and continue to cause warming for 100 years or longer, maximum benefit is gained by eliminating the greatest quantity of emissions as quickly as possible. The use of high quality offsets provides an efficient means of eliminating tons in the near-term, while the new technologies that will eventually transform our economy and achieve long-term reductions are developed and deployed.

- **Offsets have tremendous potential to reduce costs.** According to an analysis by EPA on federal legislation, allowing full use of all offsets meeting strict compliance criteria would reduce the cost of a cap-and-trade program by 85%. Conversely, not allowing any offsets could increase costs by a whopping $647 billion -- amounting to increased costs of more than $2000 for every person living in the United States. Many of these increased costs would come in the way of more expensive electricity, natural gas, and gasoline, and would be felt hardest by low income Americans, who already spend a much greater proportion of their income on energy bills than middle-class Americans.

- **Offsets will help maintain California competitiveness and jobs in a global marketplace.** Allowing full use of offsets would help California businesses stay competitive by keeping both energy costs and compliance costs down. For example, offsets provide a means of reducing emissions without forcing the premature retirement of capital assets. Offsets will help keep jobs in California by helping prevent a shift of manufacturing capacity to other states or overseas, which would not only cost California jobs, but also fail to reduce emissions as the activity causing emissions is simply shifted elsewhere as well.

- **Offsets promote innovation and broad participation in the carbon market.** Offsets allow all sectors of the economy, including foresters and farmers, to earn revenue for the emission reductions they achieve, while at the same time stimulating innovation in areas that are outside a cap. Offsets also provide an effective method of linking carbon markets across the nation and across the world -- taking us one step closer to a global solution to a global problem.

In order to make use of the full ability of offsets to reduce costs and protect the climate, IETA makes the following six recommendations:

1. **Allow all offsets that meet environmental criteria.** IETA believes all offsets meeting robust environmental standards should be available for use. Placing arbitrary limits on the availability of offsets, such as 10% as mentioned in the draft plan, restricts the ability of offsets to reduce both emissions and costs, while doing nothing to improve the ratio of high-to-low quality credits. IETA recommends California provide for the periodic review and analysis of this number, and allow for its upwards adjustment as allowance price and economic conditions warrant. Furthermore, IETA recommends any quantitative limit, if there is one, be taken as a percent of the total emissions budget of the state.

2. **Permit broad sectoral, geographic, and activity eligibility for offsets.** In order to achieve the widest possible reductions with the broadest environmental benefits, all emissions outside the cap should be eligible to receive offsets. Geographic, sectoral, or activity-specific limits encumber the ability of offsets to reduce emissions and provide cost containment.

3. **Recognize internationally fungible compliance offsets.** California should recognize international project-based credits such as Certified Emission Reductions (CERs) approved under the Clean Development Mechanism (CDM). EPA analysis shows that excluding CERs alone would make federal climate legislation 34% more expensive. In addition, including international project-based credits helps developing countries build their capability to participate in the global response, while at the same time providing export and relationship-building opportunities for California businesses in clean technologies, finance, and management. Finally, allowing CERs provides an important leadership opportunity for Californiansto help support developing countries' transition to a clean energy economy.

4. **Provide credit for early action.** Credits for early action should be awarded to qualifying offset projects implemented before enactment of regulation. Recognizing early action promotes immediate emission reductions while also helping control the initial costs of the program. The eligible "project start date" for early action projects should be announced as soon as possible to foster investor certainty, promote prompt reductions, and ensure baseline protection.

5. **Provide multi-year offset crediting periods.** Legislation should provide for multi-year crediting periods, e.g. 10 years. Environmental projects often rely on a predictable stream of revenue over a period of time to recoup substantial upfront investments. Multi-year crediting periods create investor certainty and spur innovation by encouraging larger upfront investments.

6. **Minimize transaction costs.** A California offsets program should minimize transaction costs by applying lessons learned from the CDM and simplifying the rules and administrative processes of the system. Two specific ways of reducing costs are by providing a "positive list" of eligible offset project types based on existing protocols, and, to the extent possible, consolidating existing methodologies using a benchmarked, or "standards-based" approach.

7. **Release greater details of an offsets program structure as soon as possible.** Providing preliminary information on approved project types, methodologies, start dates, and other information would allow project developers to begin investing in emission reductions immediately, helping jumpstart California on its way to meeting the AB32 goals and providing market liquidity in the early years of the program. California should also clarify to what extent it intends to build an offset program based solely on quality, rather than applying arbitrary geographic or numeric limitations.

8. **Support the increased use of offsets within the WCI.** Given the importance of building a successful, cost-effective regional emissions market, IETA recommends California work to increase the scope and availability of offsets within the WCI.

IV. Allocation of Allowances

IETA recommends that CARB carefully consider a portfolio of mechanisms to address the complexities and real-world complications of the allocation process. Many interests have argued for a simple approach that will select a single allocation mechanism, but this does not reflect real-world complications. IETA's experience in other jurisdictions has clearly demonstrated that no single mechanism--auctioning, benchmarking, or grandfathering--can produce universally satisfactory results.

Allocation for a California GHG cap and trade program will need to carefully balance the various policy considerations by using the range of available mechanisms to design the best possible portfolio approach. IETA is concerned that the draft plan inappropriately jumps to the conclusion that auctioning is the preferred distribution method, without a thorough analysis of the pros and cons of different distribution methods. Rapid implementation of very high auctioning levels will produce uncertain outcomes, could increase consumer prices and, given the lack of a national or global system, could have negative impacts on the competitiveness of California industry, both with respect to industries in other states and other countries. IETA recommends that a gradual approach be utilized, with a careful consideration both of means of minimizing consumer costs and of the capacity of covered entities to recover allowance costs.

V. Banking and Borrowing

IETA believes an important means of keeping costs down is to provide for sufficiently long compliance periods. Multiyear compliance periods, in which allowances are fungible across years within the same compliance period, provides a level of flexibility that will assist companies not only in long-term planning, but also in adjusting to unanticipated events. In addition, IETA believes that, in general, allowances should be bankable across compliance periods. Inter-year fungibility between periods, and banking across periods, will dampen price swings and help bring consistency and stability to the market.

VI. Extension of Comment Deadline

Given the sweeping nature of the scoping plan and its appendices, and the potential that the proposed regulations could affect IETA member companies in ways that have yet to be fully identified, we are grateful for the extension of the comment deadline and urge you to carefully consider all comments.

Finally, on behalf of IETA and our 181 member companies, I would like to thank you for providing the opportunity to comment on the draft scoping plan and for your attention to these comments. I would especially like to thank the talented and dedicated staff of both the California Air Resources Board and Cal EPA for their willingness to engage IETA. Please do not hesitate to contact me or David Hunter in our Washington office for additional information regarding IETA's views on these important matters.

Yours truly,

Henry Derwent
President and CEO
International Emissions Trading Association