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Mr. Kevin Kennedy
Office of Climate Change
Air Resources Board
1001 I Street
Sacramento, CA 95812

**RE: Sempra Energy Comments on
Implementing a Quantitative Limit on the
Use of Offsets in a Cap-and-Trade Program**

Dear Mr. Kennedy:

Sempra Energy submits these comments in response to staff's request for comments at the workshop on *Implementing a Quantitative Limit on the Use of Offsets in a Cap-and-Trade Program*. Like most topics related to cap-and-trade, issues relating to applying an offset limit are interrelated with many other cap-and-trade design topics such as length of compliance period, allowance reserves, and cost containment measures. We will no doubt have additional comments regarding offset limits in other contexts as the program develops. These comments will focus on a limited number of issues raised at the workshop.

1. **Size of the Market.** While the stated purpose of the workshop was to evaluate how to implement a limit, rather whether there should be a limit, several presentations were made that addressed the appropriate limitation. We will not address that issue in these comments, but note that the smaller the market, the greater the risk of price volatility. In the first compliance period, only the electric sector and the industrial sector are included, with the electric sector known to be more variable due to weather and hydro conditions. Also, at this time, it is not clear whether cap-and-trade implemented under AB 32 will be limited to California-only capped sectors of electricity and large industrial sources or whether the larger WCI or national cap-and-trade program will come to fruition by 2012. A smaller market early in the program suggests a greater need for flexibility in the early years.
2. **Point of application of limit.** Any offset limit should be applied as a usage limit to the entity requiring offsets as long as offsets can be traded and/or banked. This is a simpler approach than attempting to establish a limit on the overall supply of offsets. A supply limit with a first-come-first served approach could create speculative queuing with parties crowding to get in the queue; that creates uncertainty for the offset providers. Also, speculative queuing also creates uncertainty for regulated entities as to whether the projects will come to fruition since offset providers may need to get in the queue early, before the viability of their project was determined. Further, it could skew offset prices as more expensive projects may be first to get in the queue during the compliance period. Sempra

Energy also opposes the option labeled “hybrid supply limit approach” since it adds more complexity and appears likely to raise compliance costs.

3. **2012 vs. Business-as-Usual.** The Scoping Plan states: “the use of offsets and allowances from other systems are limited to no more than 49 percent of the required reduction of emissions.” Sempra understands the logic of the Scoping Plan requiring a balance of reductions from capped entities and the opportunity for low cost reductions. Sempra believes that applying a possible 49% limitation to the capped sectors reduction obligations measured from business as usual in 2020 is the most cost-effective approach and achieves the goals of the Scoping Plan. (We recognize that an example graph taken from WCI showing the 2012 limitation appeared in the appendix to the Scoping Plan, page C-22. However, the distinction between the two approaches was not highlighted or discussed at the time. Also, the graph could be interpreted as applying only to entities existing in 2012 as a simplification).

4. **Flexibility.** The workshop presentation included the question of how the limit should be divided among compliance periods. Sempra Energy believes that the degree of flexibility in the early years of the program will depend on other parameters of the program. Flexibility could be provided through rolling multi-year compliance periods (allowing an entity to retire year one allowances and start a new 3-year compliance period) or borrowing from the next compliance period (directly or through an CARB bank), but failure to provide flexibility in those ways might suggest more flexibility in the use of offsets across compliance periods.

Thank you for the opportunity to comment on these issues.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'S. Wade', written over a horizontal line.

c: Mr. Sam Wade