

**Center for Resource Solutions * Environment California
Environmental Defense Fund * Natural Resources Defense Council
Sierra Club California * Union of Concerned Scientists**

May 29, 2009

VIA EMAIL: ccworkshops@arb.ca.gov

Sam Wade
California Air Resources Board
1001 "T" Street
Sacramento, CA 95812

Re: Setting the cap in California's cap-and-trade program

Dear Mr. Wade,

On behalf of the undersigned organizations, we would like to submit the following comments relating to the establishment of the cap in California's cap-and-trade program. As you know, the level of the cap is a crucial decision, since it is the fundamental driver of the program's environmental performance. Unfortunately, it is also a decision that past programs have gotten wrong. Closest to home, the RECLAIM program was over-allocated for years, which is one reason that the concept of cap-and-trade has been subject to particularly strong criticism in California.

We have organized our letter around the questions you posed.

Examine the proposed WCI cap-setting methodology and give us your comments. How should this method be expanded upon?

Project 2012 best estimate of expected actual emissions for narrow scope sources:

We are troubled by CARB's proposal to set the cap in 2012 at the level of expected actual emissions, i.e. a level that achieves no reductions. The implication of setting the cap at expected actual emissions is that the price of allowances will be close to zero. (We recognize that the price could still be slightly positive due to the incentive to bank allowances cheaply for use in the future, and that CARB will use three-year compliance periods). Given the inherent uncertainty in estimating future business-as-usual emissions, we urge CARB to err on the side of setting the cap below expected actual emissions to prevent an over-allocation that would undermine the program's ability to achieve emissions reductions in the initial years of the program, and could well undercut political support for cap-and-trade as a policy approach. In addition, we urge CARB to consider a price floor (i.e. reserve price) to ensure that the cap-and-trade program is actually contributing to the transition to a low carbon economy.

Project 2015 best estimate of expected actual emissions for broad scope sources:

The forecast of expected actual 2015 emissions for "broad scope" sources will be similarly important. We encourage CARB to carry out the 2015 forecast for broad scope sources prior to program implementation, but also to allow for the cap to be "trued up" as 2015 approaches in order to prevent over-allocation.

Establish the 2020 level for broad scope sources:

Given that CARB is required to reduce economy-wide emissions to 427 MMT CO₂e by 2020, we note that CARB must forecast emissions expected in uncapped sectors in order to

establish the 2020 cap for the cap-and-trade program. This is a very important task that will involve significant uncertainty because reductions in non-capped sectors will come from complementary policies. We recognize that the Scoping Plan proposed a preliminary 2020 cap of 365 MMT and included 5 MMT of extra reductions in uncapped sectors as a quasi-insurance policy in case complementary policies underperform. However, we suggest a more systematic treatment of these uncertainties to determine the best 2020 cap level for the cap-and-trade program.

Please comment on potential approaches to projection of future emission levels.

As we mentioned above, CARB's determination of expected actual emissions in 2012 and 2015 will have a fundamental impact on the cap-and-trade program's environmental performance. In order to project future emissions levels, and therefore the level of the cap, we encourage CARB to first develop a white paper that investigates how such estimates have been accomplished in other regulatory settings, the relative success of such estimates, and the research literature on forecasting future emissions.

CARB's April 28 presentation on cap setting suggested a variety of reasonable factors to consider in forecasting future emissions: economic growth, population growth, and expected reductions from policies and voluntary action. CARB should also consider federal policies, stimulus investments, and anticipated future innovation, which is challenging to predict, but should be anticipated and included.

CARB should also keep in mind that a degree of subjectivity is inherent and unavoidable, which necessitates that CARB utilize common sense as a litmus test in its quantifications. For example, when Alan Greenspan testified before Congress he said that the Federal Reserve could have never predicted that housing prices would fall because they had never fallen in the past. Meanwhile, others were pointing out the looming housing bubble and credit problems long in advance of when they emerged.¹ Mr. Greenspan's remarks are an example of being too tied to quantification of past patterns and ignoring obvious signs that may not be easily incorporated in predictions.

Please comment on approaches to compliance pathway analysis methodology

We observe that the level of abstraction inherent in macroeconomic models means that these models are probably not going to provide a vehicle for a convincing compliance pathway analysis. As such, this will likely have to be a bottom up exercise, i.e. one that represents specific technologies available (and reasonably anticipated in the future) and variation in existing abatement costs across firms (i.e. heterogeneity in firm level costs).

Thank you for taking the time to consider our comments. We look forward to continuing to work with you and other CARB staff on these efforts.

Sincerely,

Chris Busch, Ph.D., Center for Resource Solutions

¹ Andrews, Edmund. "Fed Shrugged as Subprime Crisis Spread," The New York Times 18 Dec. 2007

Bernadette Del Chiaro, Environment California

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