April 18, 2008

Re: Offset Comments to ARB Office of Climate Change

Dear Office of Climate Change staff:

Pacific Gas and Electric Company (PG&E) strongly supports the use of offsets as an indispensable tool in abating greenhouse gases in a cost-effective fashion. Recently released EPA analysis on Lieberman-Warner indicates that unlimited access to offsets decreases the cost of compliance 85% compared to a scenario with no access to offsets.[1]

PG&E believes that there should be no geographic or quantitative limits on offsets, as long as the offsets meet rigorous standards. Offset protocols should be thorough, and offsets which meet the protocol standards should not be subject to further arbitrary or case-by-case discounting. As protocols will be rigorous, there is no need for California to have MOUs with the government agencies where offset projects are located.

Regulators should give entities the regulatory certainty to start engaging in offset projects immediately, prior to the launch of the cap and trade market, so that entities have strong incentives for early GHG reduction action. Offset project lead time can be substantial. Regulatory certainty will enable offset projects to get needed investments and allow entities access to offsets lower down on the supply curve. Starting the regulatory process of protocol acceptance will enable access to more offsets quickly. As we have seen in California, once the State created a Registry, mandated the creation of a project protocol, and endorsed the use of that project protocol, the offsets market grew substantially.[2]

For this reason, PG&E suggests that the ARB launch a separate process to: (1) review in an aggressive time-frame the many existing protocols and (2) formally adopt offset protocols. This track should occur while the rest of the AB 32 elements are in development. The process should enable project participants to act using existing protocols as soon as possible.

1. Should California have an offsets program for compliance purposes?
PG&E was pleased to see the universal consensus among parties at the offsets workshop that offsets should be an indispensable component of any greenhouse gas emissions (GHG) reduction program.[3] Of the three choices outlined by the ARB, PG&E supports unlimited use of offsets.

PG&E agrees that allowing the use of offsets as a compliance mechanism will:

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[1] http://www.epa.gov/climatechange/downloads/s2191_EPA_Analysis.pdf. Scenario 4 is 29% of the cost of Scenario 2. Scenario 5 is 1.93% of the cost of Scenario 2. Therefore, Scenario 4 is 15% of the cost of Scenario 5.
[2] CCAR Forestry Protocol
[3] The majority of parties supported unlimited use of offsets. A few parties supported the use of offsets with limits, but even these parties still supported the use of offsets.

- Enable real GHG reductions more cost-effectively while managing the overall costs of the cap and trade program;
- Reduce the risk and transition costs associated with the early years of the cap and trade program and enhance confidence in the program by providing flexible compliance options;
- Spur technology development and innovation in sectors, sources, and locations not included in capped sectors;
- Provide environmental and social co-benefits, such as reduced air pollution, habitat preservation, and/or job creation, in sectors/sources not included in the program; and
- Help develop more accurate reporting methodologies for categories of offset projects, which may later be included in the GHG cap.

PG&E does not agree that offsets have some of the risks identified in the ARB whitepaper: increased administrative costs and decreased incentive to innovate in capped sectors. As stated above, offsets will serve to decrease costs by giving entities flexible compliance options and increasing market liquidity. Further, allowing offsets without limitation will not stifle innovation in the capped sectors. The act of monetizing GHG emissions will encourage innovation to find cheap reduction opportunities all over the world- both inside the capped sectors and outside. Regulated sources have every incentive to achieve emission reductions in their capped sources in a cost-effective manner. If market failures on innovation persist, they should by addressed by incentives and intensities targeted at technology markets, not by limiting offsets and the cap and trade tool, which addresses environmental market failures. Specific policies to address technology innovation will be far more effective and less expensive than limiting quality GHG reduction opportunities.

Using GHG cap and trade as a surrogate for addressing other policy issues holds the potential of undermining interstate and international trade of GHG offsets. Given the increased costs that national modeling shows would result, the ARB should be restrict use of offsets only very gradually and only after experience with offsets suggests that restrictions would help achieve the primary goal of GHG policy – i.e., to achieve the most reductions at least cost for the long run.

PG&E urges ARB to provide expedited approval of offset protocols long in advance of 2012, the effective date of AB 32, so that entities (within and without capped sectors) have an incentive to begin the planning and investment to get projects on line given the long lead time for project development. Offset and trading markets in regulated commodities do not develop overnight; they require long ramp-ups and systems development and investment to gain the necessary interest and liquidity.

2. What should the project approval and quantification process be for approving projects?
PG&E strongly supports ARB efforts to quickly develop an initial set of approved protocols based on the 100+ existing protocols. As stated above, the ARB should immediately implement a process to survey those protocols. There should be a timeline developed for protocol review and use. After approval, entities should be able to use these protocols for offset development even before the start of the cap and trade. Entities should be able to bank these offsets for compliance. Such a regulatory process would give market participants the certainty needed to invest in real GHG reductions as soon as possible.

California has enrolled in the International Climate Action Partnership (ICAP). At the same time, Congress is debating a wide variety of issues relating to how domestic GHG offsets will be quantified, reported, verified and approved. PG&E advises the ARB to seek and use input from its representatives that are engaged in the regional, national and international dialogue on how projects should proceed.

PG&E has read a great deal of press lately questioning the validity of the CDM process and offsets in general. We believe that these are natural growing pains of this new market and that strict protocols will engender confidence in offset validity. PG&E defers comments on the best way to approve projects but initially favors the hybrid approach, where standards enable fast approval of certain classes of projects while new types of projects are approved on a case-by-case basis, pending the development of standards.

3. Should there be quantitative limits on the use of offsets for compliance purposes? If so, how should the limits be determined?
PG&E does not agree that the use of offsets should be limited. EPA's recent analysis of Lieberman-Warner highlights this extremely important customer cost issue. As stated above, the scenario in which no international credits or domestic offsets were allowed produced results that were 85% more expensive than the scenario with unlimited access. This scenario results in allowance prices in 2020 of approximately $100 per ton. Such prices would cost our customers billions of dollars. Such outcomes would undermine the benefits of a cap and trade system and possibly endanger GHG reduction programs altogether. Arbitrarily setting quantity limits on quality offsets provides no increased environmental protection and serves only to drive up the cost of GHG reduction, frustrating the effort to successfully address the issue of global warming.

We do not support the tiered approach employed by RGGI. Price triggers will not enable participants to have adequate confidence to actually make investments. Only the cheapest projects will get developed, and these are the projects that have the most additionality concerns. Price triggers and percentage limits will stifle GHG abatement options as market participants will face great risk of being able to sell their product.

4. Should California establish geographic limits or preferences on the location of projects that could be used to generate credits with the offsets system?

No, there should be no geographic or quantitative limits on offsets, as long as the offsets meet rigorous standards. PG&E supports allowing quality offsets from all locations without any discounts based on location. Limiting or discounting offsets based on location would increase the cost of the cap and trade system by not allowing entities to pursue possible low cost, real GHG abatement opportunities.

By mandating the use of well designed protocols, the ARB will ensure that all offsets created will be equal. The filter of quality should be the only limit, not the location of the project. As long as the offsets are equally real, permanent, additional, verifiable, and enforceable, the emissions reductions are exactly the same and should not be devalued.

Allowing the use of offsets in locations not subject to a cap and trade starts the process of internalizing the GHG externality and could serve as an incentive for participation in a cap and trade program, stimulating innovation and investment that would not otherwise occur. Limits reduce the market signal to, and potential ancillary benefits from, locations not included in the cap. Forgoing opportunities to lower GHG emissions, wherever these opportunities are, has a tangible, positive impact on the environment and will limit our ability to meet long-term GHG reduction goals.

Imposing state-level restrictions on a market that is already clearly global in nature would appear to be counter to the intent of AB 32, which requires ARB to "make reasonable efforts to promote consistency among other existing and proposed international . . . programs." PG&E feels that geographic limits would defeat what needs to be the overarching intent of AB 32 – to achieve maximum reductions at least cost.

For these reasons, PG&E does not support limiting offsets to regions that sign MOUs with California. Such a stipulation adds a layer of regulation unrelated to creating quality GHG abatements and creates uncertainty in the offset market.

5. Should California discount credits from offset projects?

No. PG&E opposes discounting of quality offsets. As explained above, we support using a filter of quality standards to minimize risk from projects. Discounting is arbitrary and punishes all projects, regardless of quality. PG&E agrees with the ARB whitepaper that discounting poses challenges to linkage with other programs.

6. When should the start date of offset projects be?

PG&E would like to be able to engage in offset projects as soon as possible, including participating in offset funds. Engaging in projects early is necessary to meet environmental goals. Additionally, we may be able to obtain better offset prices to protect our customers if we are able to act quickly. The US will be competing in a global market to procure offsets. Acting quickly buys environmental and compliance insurance for the future. However, market participants will not engage in these GHG reduction transactions without some assurance that the reduction credits will be of value in the future. The ARB needs to act quickly to approve protocols and provide security to enable offset project development.

7. Modeling Offsets
At the offset workshop, SCE suggested that offsets be modeled at a set price. We feel that this is a valid assumption for national and international offsets. For California, however, we believe that the quantity of offsets is too limited to be modeled in such a fashion. A price and quantity curve should be used for California. PG&E offers to work with the ARB to develop such a curve if the EPA database is not disaggregated by state.

Thank you for your time. If you have any questions, please call Soumya Sastry at 415-973-3295 or Greg San Martin at 415-973-6905.