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To: Air Resources Board (ccplan@arb.ca.gov)
From: Bob Epstein, Environmental Entrepreneurs (Bob@e2.org)

Cost Containment in a Greenhouse Gas Cap-and-Trade System

Environmental Entrepreneurs (E2) is pleased to provide comments on the questions raised at the Stakeholder Workgroup Meeting on April 25th, 2008 on Cost Containment in a Greenhouse Gas Cap-and-Trade System.

E2 supports cost containment mechanisms that provide compliance flexibility for capped entities **without undermining the cap.** All cap-and-trade design elements must ensure the integrity of the 2020 emissions reduction cap.

All emerging markets require some kind of active oversight and management to ensure stability and liquidity. The carbon market is no different. E2 believes that in the early years of California's carbon market, an active market manager such as The California Carbon Trust (similar to the Federal Reserve) will create the stability, liquidity, and flexibility needed to reach the 2020 reduction target in a cost-effective manner without undermining the integrity of the cap. New equities have been actively managed for decades until they establish sufficient volume. This management has benefitted the economy, businesses, and consumers.

1. What type of cost containment mechanisms should California consider for a potential cap-and-trade system?

The California Carbon Trust Would Negate the Need for Price Ceilings

- Price triggers distort the market. Cost containment mechanisms should be triggered based on supply and demand, not on price points.
- The creation of The California Carbon Trust will reduce the need to create price floors and ceilings. When the over-supply of allowances and credits could significantly lower the price of carbon, then the California Carbon Trust would purchase the credits to stabilize the price. When the under-supply of available allowances or credits would creates price spikes, the Trust would step in and sell some of its approved emission reduction credits.
- E2 opposes a price ceiling because issuing more allowances when the price reaches a certain point will undermine the cap. Rather than issuing additional allowances when the price reaches a certain point, the California Carbon Trust could sell emission reduction credits from approved projects, representing real reductions.

- A price ceiling will discourage the market from investing in lower carbon technologies.
- Investors want regulatory certainty. If the cap can be undermined when a ceiling is reached, this will discourage investment in California's cleantech sector.

<u>CARB Should Adopt a Three-Year Compliance Periods</u>

E2 supports a three-year compliance period. In addition, we support the concept of a "floating compliance" period if properly implemented. If structured properly, a floating compliance period would add flexibility and liquidity to the market because entities would be meeting different compliance periods and would buy and sell allowances at different times. This would prevent all the capped entities from having to buy and sell allowances at the same time.

<u>CARB Should Allow Banking, With Time Limits</u>

E2 believes that allowing covered entities to hold extra allowances to use in a future year for compliance can encourage earlier investments to reduce greenhouse gas emissions. Some significant emission-reducing investments in the energy industries are capital-intensive rather than incremental, so banking provides an important means to encourage these significant investments. ***Time limits on banking are needed to ensure the efficacy of the program.***

A floating three-year compliance period would provide many of the same flexibility benefits for longer-term investments as would banking with time limits.

<u>CARB Should Not Allow Borrowing from Future Compliance Periods</u>

Allowing covered entities to borrow from future compliance periods in order to emit more in a given compliance period (and then surrender the additional allowances in a later compliance period) could discourage early action. Some sectors will need flexibility to smooth the variations in emissions that occur due to factors out of their control. In particular, the electricity sector's year-to-year emissions can vary significantly due to weather conditions and the availability of hydroelectric power. A multi-year compliance period can provide this flexibility.

If borrowing is allowed, it should be limited to avoid delays in emission reductions. Borrowing emission credits to meet compliance should not be made easy or free. Borrowing should only be used to meet compliance as a last resort and should not be used as an investment mechanism. Entities that want to borrow emission credits must prove their "credit worthiness" by showing how they will reduce emissions to make up for the borrowed credits. Borrowed allowances should provide some additional benefit to the state.

2. Is there a need to establish an independent market oversight body?

Yes, an independent market oversight body should be created. We agree with the ETAAC recommendation to create The California Carbon Trust. The California Carbon Trust (CCT) could be an active market manager that could address the stability and liquidity issues inherent in all emerging markets. The CCT could also provide flexibility through its cost-containment role of seller and buyer of emission reduction credits and allowances.

The ETAAC recommendation listed 4 functions for The California Carbon Trust:

1) Achieve Additional GHG Reductions outside the cap of a cap and trade system.
2) Dedicate Resources to Fund Projects to Achieve AB32's Environmental Justice Goals
3) Actively Manage the Early Carbon Market and Mitigate Price Volatility
4) Encourage Research, Development, Demonstration, and the Deployment of new technologies.

We believe that all 4 functions are important to meet the 2020 and 2050 targets and serve to help contain costs. However, all 4 functions do not necessarily need to be housed in the CCT.

3. Which systems should be considered for linkage with a potential California cap-and-trade system?

California should only link to systems that have compatible cap and enforcement systems.

E2 is available to provide further consultation on any of these points at any time.

Sincerely,

Bob Epstein
Co-Founder
Environmental Entrepreneurs