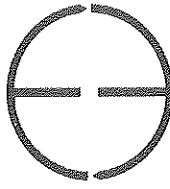


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January 11, 2010

Kevin Kennedy, Assistant Executive Officer
California Air Resources Board
1001 I Street, 6th Floor
Sacramento, CA 95814

**Subject: Comment Letter – November 24, 2009 Preliminary Draft
Regulation For A California Cap-And-Trade Program**

Dear Mr. Kennedy:

The California Council for Environmental and Economic Balance (CCEEB) is a non-partisan, non-profit organization of business, labor and community leaders that seek to achieve the State's environmental goals in a manner consistent with a sound economy. On behalf of CCEEB, we want to thank the California Air Resources Board (ARB) for the opportunity to comment on this Preliminary Draft Regulation (PDR) for a Cap and Trade Program.

I. General Comments

In general, the CCEEB believes that it is important for California to recognize current international, national and regional climate policy efforts as it develops a California Regulation to implement a California Cap and Trade Program. This program will not exist in isolation and cannot be expected to function in isolation. As such it should be crafted in a manner that will allow it to function consistent with other programs rather than as an iconic stand-alone, California-only program with requirements and scope that go beyond other international, national and regional programs. This is a global issue and needs to be dealt with as such. If this program is not designed to dovetail into other programs, we are concerned that it will lead to excessive costs and leakage as potential trading and linking partners do not emerge because of additional stringency and cost.

As a general concept, CCEEB also believes that the Regulation must be designed to be implementable on the first day of compliance. There must be a reasonable compliance path for every covered entity.



Implementation deadlines

The November 24, 2009 PDR sets forth several urgent compliance deadlines including initial surrender, auctions, reporting, and true up periods without providing initial deadlines or indication of completion dates by ARB for tools, systems, organization, guidance, verifications, registrations and certifications required by regulated entities. All of the tools and mechanisms enumerated or alluded to in the PDR should be in place in advance of implementation or expected compliance. Without having the market mechanisms in place, covered entities will be unable to properly plan and prepare to enter an undefined market. In order to guarantee a working market ARB should develop a workplan with completion deadlines for the tools, policies, and other mechanisms needed to comply with the PDR.

Workload

ARB has assigned itself significant workload developing complex systems in addition to being the primary clearinghouse for all verifications and certifications required in this regulation. Additionally, all covered entities, offset providers, 3rd party verifiers and other market participants must be registered through the ARB. At least 20 new approval processes that affect 600 sources affectively allow the ARB and EO to modify this regulation after adoption. In addition these processes will create a significant bottleneck in access to and operation of the market. With the State's fiscal crisis and the three day a month furlough it is unlikely the ARB will be capable of independently completing the paramount task of creating and managing all aspects of a Cap-and-Trade market. ARB should seek alternatives that provide the necessary quality assurance without duplicating efforts other organizations, such as accepting EU credits.

EO/ARB discretion

The PDR directs the ARB and Executive Officer (EO) to make significant decisions in verifying and certifying almost every aspect of the marketplace, as well as decisions to terminate or limit use of compliance instruments. These decisions and discretion left to the ARB and EO create a marketplace that can be easily manipulated will be rife with uncertainty. A predictable and stable market should be absent of human variables that have been assigned to the ARB and EO in the PDR. ARB should commit to creating a market that is complete from the onset. Allowing this regulation to develop with additional regulation after implementation will lead to unnecessary strain and unpredictability on covered entities and the market. Covered entities must be able to rely on market forces to predict or plan for market behavior. Any manipulation allowed in the PDR will make prudent management of credits and offsets virtually impossible. Where EO discretion is authorized, criteria for the decisions should be established with public input. ARB and EO should have minimal involvement in the market in order to achieve the best results. All planning and decision making on behalf of ARB and EO need to take place during the regulatory process.

Linkage

Prior to adoption of this regulation ARB should diligently seek out trading partners who have effective markets. Linking to existing markets will allow covered entities to enter into a larger market and have options in compliance paths. Without trading partners from the onset the number of available offsets will be limited and could cause significant costs. Linkage should reduce leakage.

Additionally, ARB is considering broadening the scope of the cap-and-trade program to include transportation and natural gas fuel deliverers at the start of the first compliance period rather than phasing them in 2015. Expanding the scope ahead of the WCI and without other cap- and-trade markets in place will increase the cost of doing business in California, resulting in increased leakage and complicating the potential for linkages to other programs. The WCI reasoned delaying the inclusion of transportation and natural gas fuels so that “adequate quantification methods”¹ can be established before reporting and emissions’ tracking is demanded through the program. Even if California establishes that it has adequate quantification methods for including fuels, other WCI members do not and therefore California would be moving ahead in isolation.

Offsets

The PDR is overly restrictive and relies entirely upon the ARB/EO’s discretion to determine who, what and where quality offsets are provided. Instead of quantitative restrictions on the use of offsets the PDR should focus on the quality of offsets. ARB should adopt the standards of current operable trading partners in order to create a marketplace that has available offsets and does not require a ceiling. There should not be a floor price for offsets as a low cost indicates an abundance of offsets and achievement of Cap-and-Trade goals.

Dispute resolution

A major concern with the absolute discretion assigned to the ARB/EO in the PDR is the lack of a dispute resolution process. The magnitude of these decisions will define how this program is carried out and significant decisions need to be made within the regulatory process. In order to allow due process for the affected parties CCEEB suggests incorporating a transparent and independent dispute resolution process. This process will allow all affected parties to find resolutions without entering into time consuming and expensive litigation.

In event of delinking, reversal or other discrediting of offsets a grandfathering clause should be added allowing previously approved offsets to be used.

Reversal of offset credits

The obligation to replace offset tons due to reversals should be treated differently depending on the cause of the reversal. For intentional reversals, such as when a forest offset developer decides to harvest the offset forest, the developer who is making the business decision should be responsible for replacing the lost carbon sequestration. For unintentional reversals due to causes such as forest loss due to fire, pests, or disease, the lost carbon should be replaced from a reserve held back when credits are issued for such projects. The obligation should, at no time, be placed on buyers or users of offset credits.

Additionality – “...would otherwise occur.”

ARB should define “...would otherwise occur” with objective criteria. Undefined this term allows the goals to be moved if technology or offset projects exceed expectations. Ambiguity in this case will punish good actors for achieving the overall goals within this regulation by manipulating allowances and credits credited through offset projects. An objective standard will allow covered entities to work within a structured market; achieving the overall goals of ARB and California while allowing opportunities to benefit from innovation.

§ 96240 (c)(5) includes as additional “any portion of GHG emission reductions or avoidances, or any GHG sequestration resulting from public grants or government grants.” In many instances, public grants and government grants are provided to incentivize targeted goals. It makes no sense to lend a helping hand by one mechanism and take it away with another. This type of language adds to the restrictive nature of offset creation, and should be removed.

Baseline Allowance

In an effort to avoid concerns that too many allowances would be issued under the Board-approved 2020 "Business as usual" (BAU) and the Scoping Plan, the PDR proposes to use 2012 levels as the baseline for setting the cap. While it is possible the impact of the recession may affect the actual allowance demand in 2012, it is also clear that not accounting for any growth in California between 2012 and 2020 will result in an overly restrictive cap where allowances and offsets would be limited far below demand. California (and any federal program) will measure the success of this program over the long-term subject to economic cycles. Micro-managing the cap based on short-term economic adjustments will impede businesses' ability to determine uniform price signals.

Day 1

CCEEB urges ARB to have verified offsets, third party verifiers, approvals, IT systems, linkages, organization, dispute resolution, and early warning systems in place from the onset of this regulation. ARB should develop a workplan with clear completion

deadlines of tools, organization, policies, and systems that must be in place for the regulated entities to comply with this regulation. As this regulation is being developed specifics should be explicit and transparent. Alignment with current international, national and regional programs would be the best opportunity for a California Cap-and-Trade program work. Without aligning definitions and policies California will be isolated and this program will suffer significant leakage.

II. Section Specific Comments

(4) **Additional** – The use of “...would otherwise occur”; avoids implying financial additionality. ARB should define this term with objective criteria as suggested earlier.

(12) **Base Allowance Budget** – ARB should take into account the current economic downturn and make sure to set the allowance budget in a manner that allows for economic recovery. ARB should set the cap at a level in 2012 based on where projections would have been without the recession.

(14) **Biomass** – Needs more clarity and should support a definition that would reference the “Renewable Energy Program: Overall Program Guidebook,” 2nd Ed., California Energy Commission, Report No. CEC-300-2007-003-ED2-CMF, January 2008. This definition broadly covers solid waste industry and provides sufficient opportunity for production of renewable fuels that are very much needed in the implementation of AB32. In addition, this definition does not include biogas; therefore, we recommend that ARB include a definition of biogas to explicitly include landfill and digester gas. The definition of biogas should be defined consistent with definition of biogas in LCFS.

As defined in LCF is: “Biogas (also called biomethane) means natural gas that meets the requirements of 13 CCR §2292.5 and is produced from the breakdown of organic material in the absence of oxygen. Biogas is produced in processes including, but not limited to, anaerobic digestion, anaerobic decomposition, and thermo-chemical decomposition. These processes are applied to biodegradable biomass materials, such as manure, sewage, municipal solid waste, green waste, and waste from energy crops, to produce landfill gas, digester gas, and other forms of biogas.

(38) **Conservative** – Remains subjective despite being added on top of existing and objective criteria. This term should be explicit using objective terms that are easily interpreted

(48-50) **Electricity Deliverer, Electricity Generating Facility, Electricity Importer** – As defined there is no language to distinguish cogeneration. For consistency with other regulations ARB should cross-reference with the reporting rule.

(56) **Enforceable** – ARB assumes that protocols must be approved by the Board. Adoption of Climate Action Reserve (CAR) approved protocols should be sufficient for this regulation.

(57) **Covered Entity** – Clarify if the intent is for facilities or corporations.

(70) **Greenhouse gas sequestration** – Should be amended to clarify that in general terms, it includes geologic sequestration:

*(70) “Greenhouse gas sequestration” or “GHG sequestration” means, in the context of offset credits, the process through which agricultural and forestry practices and **geologic process**, remove carbon dioxide from the atmosphere. In general terms, GHG sequestration also means the fixation of carbon in a carbon sink through biological, **geologic** or **other** physical processes.*

(84) **Margin of Safety** – Suggest a definition or if it is unnecessary.

(85) **Market Index** - Prior to adoption there should be an agreed upon market index ARB will use. As stated this allows additional discretion and the opportunity to change indexes after implementation.

(92-93) **Natural Gas, Natural Gas Liquid, Natural Gasoline** – Propane should not be included in this section.

(96-102) Use existing definitions and approvals used by the Climate Action Reserve as opposed separate and discrete processes.

(127) **Renewable Energy** – Both the U.S. House-passed Waxman Markey bill (HR2454) and proposed the U.S. Senate Boxer-Kerry (S 1733) bill establish a federal Renewable Portfolio Standard that recognizes waste-to-energy as a renewable energy source, joining twenty four states and the District of Columbia that also define waste-to-energy as renewable. In addition, policy-makers have recognized municipal solid waste as a renewable fuel, including the American Recovery and Reinvestment Act of 2009, and as contained in Section 203 of The Energy Policy Act of 2005. Therefore, CCEEB recommends that Waste-to-Energy facilities that manage municipal solid waste be added to this definition.

Subarticles

§ 95820 **Covered Entities** (Discussion of concepts, pg. 26-27 of PDR) – Some entities fit into more than one category and clarification is necessary in these cases. Additional clarification is needed if an entity is listed as “covered” but does not meet the threshold (25,000 MT).

ARB should clarify the point of regulation for fuels to provide further detail on what is considered “upstream of where combustion occurs.” Currently, the definition of “fuel importer” as the “the majority owner of a product when it first enters California,” would capture fuel contained in tanks powering mobile sources entering and exiting the state should not be included as they would be administratively complex and duplicative.

§ 95830 **Inclusion Thresholds for Covered Entities** – Needs further clarifications as 25000 MT currently conflicts with § 95820.

§ 95840 **Opt-In Participant** – Contains conflicting positions on whether or not to allow opt-in participants to bank or retire allowances.

§ 95850 **Compliance Instruments** – Decisions to terminate or limit compliance instruments' authorization to emit, should be based on pre-developed objective and enumerated criteria and not at EO discretion.

§ 95860 **Compliance Instruments** – ARB should allow compliance instruments issued by other external greenhouse gas emissions trading systems (GHG ETS) or GHG offset crediting systems such as the EU GHG ETS or WCI.

§ 95870 **Registration and Tracking System** – Inconsistent throughout the PDR. Consistency, conformity and clarification are required for the Draft Regulation. Additionally, EO review for approval should have a maximum period of time and should be specified within the regulation to ensure entities can plan for timely compliance.

§ 95890 **Annual Base Allowance Budgets** –As conceptually proposed, the EO may issue allowances at any time, thereby adjusting trading prices. These decisions should not be at the discretion of the EO and should be made prior to adoption of the regulation. When, how much, and to whom allowances are issued by the EO must be clearly defined in regulation.

§ 95910 **Administrative Adjustments** – This foregoes a structured and workable market design by allowing features that can manipulate the market in the future. Adjustments will erode the value of banked allowances and discourage good actors. Administrative adjustments can have significant impact on the market. Such adjustments should only be used in very limited circumstances, such as when the scope of the cap has changed. Administrative adjustments should be based on criteria that have been established with public input in regulation.

Subarticle 7 – **Initial vs. Final True-Up** – It is unnecessary for two true-ups.

Compliance Cycles – The compliance cycle requires submittal of verified emissions earlier than currently required under the Mandatory Reporting Regulations. Non-utility facilities rely on receiving utility factors for their facility report. Therefore utility verifications must occur earlier than Q2. A 3-year cycle allows borrowing and is more manageable for most covered entities. A one-year cycle is discouraged unless provisions for borrowing are incorporated.

§ 95950 **Emission Used to Calculate Surrender Obligations** –ARB is considering several options for calculating the surrender obligations for transportation fuels. Surrender obligations should be calculated so that there is a level playing field for all fuel.

Page 15 of the PDR, fugitives are included as not having a surrender obligation. ARB adds this language to § 95950.

ARB should also consider exclusions for municipal solid waste facilities as they handle “must manage” waste that would have a lower carbon footprint than the alternate management method, landfilling.

§ 95960 **Timing for Calculation of Covered Entity’s Surrender Obligation** – ARB should not adopt Option 2 as it is unnecessary and complicates compliance for covered entities and good actors.

§ 95970 – **Quantitative Limit on Offsets and Allowances** – Prior to limiting compliance instruments ARB should complete and release the study specified in ARB Resolution 08-47. Until the economic analysis and studies enumerated in the ARB Resolution 08-47 are complete and public all compliance instruments without limitations should be fully considered including unlimited offsets. The study on offset use should evaluate the impact of a range of offset use, including 0%, 4%, 20%, 50%, and 100%.

ARB approval adds additional burden and workload especially in consideration to other required approvals in this draft (offsets, linkage, MOUs, etc.). Sub-section A includes limits on both, offsets and allowances from other areas in the 4% offset usage limitation. This seems to be unnecessarily restrictive. CCEEB suggests clarifying that the 4% restriction only applies to offsets, not external allowances in bilateral or unilateral linkages. Additional limitation of 4% needlessly drives up costs of compliance and creates significant leakage.

Subarticle 8 **Distribution of Allowance Value** – CCEEB has concerns with the EAAC recommendations, moving immediately towards 100% auction. EAAC looks at transition for electricity consumers, but not at cap-and-trade participants (utilities, facilities). ARB should minimize auctions in the beginning, to allow entities sufficient transition time to make a smooth transition into a low carbon California.

Initially in order to minimize market liquidity difficulties, non-obligated parties should not receive free allocations.

Subarticle 9 **Auction Design and Distribution of Auction Proceeds** – Timing needs to be worked out to enable registration. All enabling tools, registration system and approval systems should be in place prior to the adoption of this regulation.

§ 96040 **Auction Operation and Registration, Discussion of Cost Containment** – § 95870 contains registration dates, as such, approval for entry and holding account must happen before May 2011, so approvals will need to be complete by January 2011. ARB should ensure that all approvals will take place and covered entities will have sufficient time to register and receive approval in advance of the first auction.

Fundamentally disagree with cost containment as proposed in this section. If this regulation seeks to create a true market then it should be allowed to behave as such. **Offsets will contain costs.** As currently written there is too much uncertainty to encourage investments. Additionally, there needs to be transparency in relation to how revenues will be used. Revenues should be limited to programs described within the AB 32 Scoping Plan in order to best contain costs. All proposed systems, triggers and tools should be known in advance and predictable.

Subarticle 10 **Free Allocation Method** - ARB should provide a sufficient transition period from now (start point) to where they want to arrive (e.g., 100% auction).

§ 96080 **Trading** – There should be no limit on how many allowances a facility purchases. Additionally, ARB should not impose purchase limits, market holding limits or restrict the amount of compliance instruments a facility can obtain based on reported emissions. These restrictions effectively hinder a free market.

Although some reporting may be appropriate, bilateral trades of offset contracts should not have to clear through a commercial clearing mechanism. Offset projects are most often unique projects with unique risks and therefore offset contracts are not suitable to standardization.

§ 96090 **Banking** – should be allowed in order to allow covered entities to plan for future development and for California to be able to foster future innovation.

§ 96150 **Linkage, general requirements** – With consideration of the 4% offset limit it does not appear as though there will be any approved or compatible trading partners. If trading partners link, California will be a net buyer of allowances, driving up prices in other systems. This section appears to be drafted in order to specifically exclude linkage to existing GHG ETS.

§ 96160 **Approval of External GHG ETS** – Use existing standards for regulatory consistency.

§ 96170 **Requirements for Approval of GHG Offset Crediting Systems** – Unclear on whether this section approves a system or project types or protocols. CCEEB suggests approving CAR and others within the regulation.

§ 96180 **Types of Linkage** – Any approved external GHG ETS or GHG crediting system should not be subject to 4% limit. This section should address in more detail how unilateral linkages will work.

§ 96190 **Agreement** – External GHG ETS or GHG crediting systems entering into an MOU with CA should not have to adopt new CA centric provisions. ARB should accept current systems that are established and performing. The current external GHG ETS or GHG crediting systems have worked through many of the issues surrounding the

development of a new market and adoption of these standards will assist CA's progression into a Cap and Trade market.

§ 96200. **Eligible Allowance Vintages** – Clarify this section as the intent and necessity are unclear.

§ 96210. **Suspension of Linkage** – If a linkage is suspended there will be a need to provide those who count on that linkage some relief, e.g., grandfathering provision. Without a grandfathering provision this section creates significant market uncertainty in cases of rule changes.

Subarticle 13 **Offset Credits** – Suggest clarification of ARB role in the offset market. ARB should not approve credits individually if ARB has already approved an external crediting system that has approved these same credits.

§ 96220. **General Requirements for Offset Credits** – Suggest an adoption timeline so that covered entities are able to comply on day 1.

§ 96240. **Requirements for Approval of Offset Quantification Methodologies** – Process for adoption of offset quantification methodologies should minimize bureaucracy. There are concerns that approval takes a long time and without sufficient lead time covered entities will be unable to plan compliance paths.

CAR protocols already go through a very thorough process and ARB approval is duplicative. Multiple registries with independent approval create a cumbersome marketplace. Additionally, this section extends the time it takes to approve quantification methodologies. If ARB is approving a system, there is no need to approve everything within that system. ARB approval of quantification is needed, but not so exhaustive that it delays approval prior to implementation of this regulation.

§ 96250. **Requirements for Offset Project Operators** – This reaches beyond system administrators and unnecessarily makes project operators register with ARB regardless of who approves the offset project.

§ 96260. **Registration of Offset Projects for ARB Issued Offset Credits** – Project should have **NO** geographical limitations. This section is unclear on whether this is for ARB-issued credits or ARB-approved credits or if it is project specific. ARB should issue credits for a project located where there is no system in place.

p.68 box **Regulatory Additionality for Projects Outside of CA** – Projects outside of CA should not be held to the same level of stringency as CA. This will preclude many projects and removes option for emission reductions in other locations. Additionally, it will discourage other jurisdictions from enacting regulations.

The timing between project registration to getting receipt for completion and determination is about 9 months (270 days) to get approval, not including registration of

the covered entity, let alone projects, Assuming ARB has a protocol already there is still too much time in process with current implementation deadlines.

There should be a dispute resolution process to allow due process with all the approvals ARB has assigned itself within this regulation.

§ 96290. Monitoring, Reporting and Record Retention Requirements for Offset Projects – A standard of +/- 5% is difficult to maintain even on tightly regulated facilities. Offset projects will have a hard time meeting this certainty.

§ 96300. Verification of GHG Reductions, Avoidances or Sequestrations from Offset Projects – ARB should have verification bodies accredited prior to implementation.

§ 96310. Verifier and Verification Body Accreditation – Consideration should be given to separating verifiers of offset projects and verifiers of emission reductions as these are two different lines of business.

§ 96330. General Requirements for Issuance of Offset Credits by ARB – Prior to implementation ARB should not be the only party that can issue offset credits.

§ 96390. Cancellation of Offset Credits – There should not be retrospective cancellations. Once an offset is approved it should stand. The obligation to replace offset tons due to reversals should be treated differently depending on the cause of the reversal. For intentional reversals, such as when a forest offset developer decides to harvest the offset forest, the developer who is making the business decision should be responsible for replacing the lost carbon sequestration. For unintentional reversal such as forest loss due to fire, pests, or disease, the lost carbon should be replaced from a reserve held back when credits are issued for such projects. The obligation should, at no time, be placed on buyers or users of offset credits.

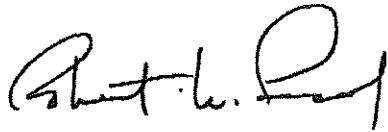
§ 96410 Requirements for Offset Credits Issued by an External Program for Projects Located in the United States or Canada – Acceptable if external program is approved by ARB.

§ 96420 Requirements for Offset Credits Issued by an External Program for Projects Located in Developing Countries – An offset is an offset. By addressing social benefits there is an added another layer of complexity that affects predictable market behavior.

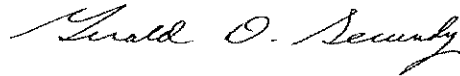
Subarticle 14 Enforcement and Penalties – ARB must develop a dispute resolution process for this regulation. Currently this proposal lacks due process and leaves the sole discretion on all issues and approvals with the ARB.

Again, CCEEB would like to thank the ARB for this opportunity to comment on a Preliminary Draft and we look forward to playing an integral role in the development of California's Cap and Trade Program. If there are any questions please call Robert Lucas at (916) 444-7337.

Sincerely,



Robert W. Lucas
Climate Change Project Manager



Gerald D. Secundy
President

Attachment

cc: Mary Nichols, Chair, and Members of California Air Resources Board
James Goldstene, Executive Officer, California Air Resources Board
Michael Gibbs, Acting Deputy Secretary, Climate Change, Cal/EPA
Jackson Gualco, The Gualco Group, Inc.