To: The California Air Resources Board
Regarding: Preliminary Draft Regulation for a California Cap-and-Trade Program
Date: January 13, 2010
Submitted: Via the California Air Resources Board Website

The Business Council for Sustainable Energy (The Council) appreciates the opportunity to provide comments on the Preliminary Draft Regulation for a California Cap-and-Trade Program released on November 24, 2009.

The Business Council for Sustainable Energy:

- Commends the State of California for its leadership;
- Supports the concept calling for adjustments to the base budgets to account for voluntary investment in renewable sources of electricity generation;
- Supports the offset market and encourages changes to strengthen the market; and
- Supports exclusion of small natural gas customers from the scope of the cap until 2015.

The Council commends the State of California on its leadership in developing regulations to implement AB32 and to reduce greenhouse gas emissions. The Council particularly commends the State for the recognition that significant progress can be made toward emission reduction goals by deploying existing technologies, greenhouse gas offsets, and improving energy efficiency. All technologies at our disposal will be required to tackle the challenge of global climate change; however, between now and 2020, existing clean energy technologies such as renewable energy, energy efficiency and natural gas are the first phase solution to strengthen the economy, meet increasing energy demand, provide energy security, and reduce greenhouse gas emissions.

The Council is also encouraged that the California Air Resources Board (CARB) envisions linking its cap-and-trade program with other Western Climate Initiative (WCI) Partners to create a regional market system. From an industry perspective, it is essential to have regulatory certainty and consistency in order to effectively tackle the challenge presented by global climate change, lower the cost of compliance, and increase global market liquidity. When adopted, we believe the California Cap-and-Trade Regulation will accomplish these objectives, although we believe it can do so more effectively with the changes outlined below.

California's action on this important rulemaking is especially critical since policymakers in Washington, DC, and other states, are closely following the ongoing implementation of AB32.

About the BCSE

The Business Council for Sustainable Energy is an industry coalition that includes businesses and trade associations representing the suite of currently available technology options for reducing emissions of greenhouse gases that contribute to global climate change. The Council and its members have been working consistently with state, federal and international policymakers on market-based measures to reduce greenhouse gas emissions since its inception in the early 1990s. A document with information about the Council is attached for your reference.

Leveraging the experience of our members in renewable and low-carbon energy generation, clean energy technology, greenhouse gas offsets, and project development, the Council respectfully submits the following comments on a few specific provisions of the Preliminary Draft Regulation for a California Cap-and-Trade Program.

Please note that, as a diverse business coalition, not all Council members endorse or take positions on the set of recommendations listed below.

Support for the Voluntary Renewable Energy Market

The Council supports the concept in the Preliminary Draft Regulations calling for adjustments to the Base Allowance Budget for greenhouse gas emission reductions that result from voluntary investment in renewable sources of electricity generation.

The voluntary market for green power, renewable electricity and independently-marketed renewable energy certificates (RECs) is growing because it is helping to meet the public's demand for clean energy. Nationally, the voluntary market is now driving about as much renewable energy technology as the markets created by statutory compliance obligations. A primary motivation for voluntary renewable energy purchases is to reduce the buyer's greenhouse gas footprint. The ability to market this benefit—the ability of individuals, companies, government entities and non-profits to reduce electric sector emissions—is a key to the market's success.

California holds a critical position in the voluntary renewable energy market and while there are discussions about the appropriate level of allowances for the voluntary market the Council is encouraged by the concept outlined in the Preliminary Draft Regulation to earmark allowances in a holding account and reserving them for voluntary purchases of renewable energy credits. The Council also notes the approach outlined in the Preliminary Draft Regulation for estimating the budget adjustment needed for the voluntary renewable market and the ex-post true up of budget allowances that may result from an over estimation of expected reductions from voluntary renewable purchases.

Support and Strengthen the Offset Market

The Council commends CARB for affirming that offset projects can reduce costs to comply with AB32, while spurring innovation in areas of the economy not subject to greenhouse gas regulations. While the Council encourages covered entities to undertake internal emission reduction activities, such as deploying renewable energy and energy efficiency to the greatest extent possible, our members view offset purchases as an important complementary tool to help covered entities manage compliance costs, widen the scope of environmental benefits, deploy existing and new clean technologies and land management practices, that have not yet achieved market penetration, and lower economic costs for energy consumers.

The key is to ensure that emission reductions from offsets are real, additional, quantifiable, independently verified, permanent, and used only once—all criteria reflected in the Preliminary Draft Regulation. CARB has an excellent opportunity to use the regulatory process to strengthen the carbon offset market and to clarify a series of offset issues regarding geographic limits, project types and approved methodologies, online start dates, credit issuance, and linkage to external offset systems. The Council offers its views on these subjects below.

1. *Percentage Requirements*

The preliminary draft regulations would restrict offsets to four percent of what a covered entity must submit at the end of each compliance period, which is equivalent to 49 percent of all emissions reductions but is enforced on a per entity basis. The Council supports policies which encourage regulated entities to directly reduce emissions. However, the Council does not believe that the preliminary draft regulation should place overly restrictive limits on the use of offsets for compliance by covered entities. Regulated entities should be able to supplement and control costs in achieving greenhouse gas emission reduction requirements through the reasonable use of offsets. CARB should also consider softening the penalty in the Preliminary Draft Regulation and should not, for example, call for any penalty for inadvertent, minor over-subscriptions of the four percent limit.

2. *Geographic Limitations*

The Preliminary Draft Regulation states that the ARB staff is currently evaluating whether CARB issuance of offset credits should be limited to California, North America or not at all. The Council believes that geographic limitations on offsets could significantly affect the availability of low-cost offsets within the region. This would ultimately cause an increase in compliance costs, hinder the development of the offset market, and limit opportunities for offset developers to invest in the deployment of clean technologies. This would put the region's affected entities at a competitive disadvantage compared to affected sources in other offset markets and open up the potential for leakage. The BCSE thus urges CARB not to limit eligible offsets by project location.

3. *Offset Project Types and Methodologies*

The Council recommends that every effort should be made to decide upon an initial list of approved project types, approved existing baseline and monitoring methodologies, and approved carbon offset programs from which existing and new methodologies will be accepted. BCSE recommends this list include at least the Regional Greenhouse Gas Initiative (RGGI), the Climate Action Reserve (CAR), EPA's Climate Leaders Program, the Clean Development Mechanism (CDM), the American Carbon Registry (ACR), and the Voluntary Carbon Standard (VCS). Only building on existing high-quality offset methodologies and standards will allow for the timely development of an offset system.

4. *Offset Program Administrative Structure and Function*

The Preliminary Draft Regulation requests input of the various roles that ARB could play as the administrator of an offsets system. A very important overarching concern is the need to establish certainty; certainty for project developers, certainty for offset buyers, certainty for market makers, and certainty for the State-wide cap accounting. The regulation should be written so that when it is adopted by the full Board in December, businesses can be certain of what will count and what will not. It is true that flexibility for program assessment and change must be maintained, but the regulation should make clear that any changes will be deliberate, will be predictable and be based upon clear and transparent criteria that are known to all market participants, will not be changed on a timeframe that would jeopardize investments within a compliance period (3 years), and would not call into question credits retroactively.

The Council applauds California for its intent to establish linkages with other state, federal, and international greenhouse gas initiatives. These linkages should demonstrate compatibility, and should be verifiable and transparent. The program should be designed to permit trading with compatible cap-and-trade programs and project-based initiatives elsewhere in the United States at the state, regional or federal level, as well as in other parts of the world.

Further, the Council encourages the ARB to consider an early action program that may include offsets from other regulatory offset schemes and/or high-quality voluntary schemes, including the Climate Action Reserve, American Carbon Registry, and Voluntary Carbon Standard. While the Preliminary Draft Rule establishes December 31, 2006 as the start date for early action credit, the Council believes that all high quality offset projects should be eligible for early action credit regardless of the date they were started, provided project proponents can credibly demonstrate that greenhouse gas reduction was the intent of the offset activity from the start date.

Treatment of Small Natural Gas Consumers in Cap-and-Trade

The Preliminary Draft Regulation raises the question of whether small natural gas consumers should be included in the California Cap-and-Trade Program in 2015, as currently proposed, or from its beginning in 2012.

The Council supports the use of a well-designed cap-and-trade market, and generally favors bringing as many sectors as practical into the program. However, for natural gas, there is a natural division between large consumers and small consumers. We recommend bringing large consumers into the market from the outset, as currently proposed, but do not support bringing small natural gas consumers into the market in 2012.

Small natural gas consumers create a unique situation. They are too small to meaningfully participate in a cap and trade program and have proven extremely responsive to energy efficiency programs in California. While this market segment could be subjected to cap and trade regulation with their energy service provider as the regulated entity, the energy service provider or utility that provides natural gas commodity service to these customers—the entity that would have an AB32 compliance obligation—does not make decisions relevant to the level of greenhouse gas emissions of these customers. However, utilities have implemented energy efficiency programs successfully for this market segment for years in California. The Council believes that this customer segment should not be subjected to cap and trade regulation in 2012. Instead, programmatic regulation (consisting of state appliance and building efficiency codes and standards, complementary utility or third-party customer energy efficiency programs, and point-of-sale energy efficiency programs) should be implemented for this market segment beginning 2012. Cap and trade regulation should be imposed on this market segment in 2015 only if these programmatic measures prove ineffective at achieving California's AB32 goals.

In addition, as a general principle, leaving certain sectors outside the coverage of the program during a transition period until it becomes feasible for them to be covered will also provide additional offset opportunities (greenhouse gas reductions and removal in uncapped sectors). By increasing offset supply, this should erase the financial burden to capped entities (and thus Californians) of the program compliance in the early years.

Conclusion

The Council views the Preliminary Draft Regulation for a California Cap-and-Trade Program as an important vehicle to reduce greenhouse gas emissions in the western region and the Council congratulates the State for its leadership and action. The Council appreciates the opportunity to provide comments and looks forward to providing additional comments throughout the regulatory process in 2010.

If you have any questions or comments about the BCSE, please feel free to contact me or Ruth McCormick in the Council's offices.

Sincerely,

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Attachment

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