



The Honorable Linda Adams  
Secretary for Environmental Protection  
California Environmental Protection Agency  
1001 I Street  
Sacramento, CA 95812

Dear Secretary Adams:

On behalf of the International Emissions Trading Association (“IETA”), I write to provide comments on the Preliminary Draft Regulation for a California Cap-and-Trade Program (“PDR”). I hope you will consider IETA’s perspective as the California Air Resource Board (“CARB”) promulgates draft cap-and-trade regulations and amendments to the Mandatory Reporting Regulation (MRR).

IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our 170 member companies include some of America’s and the world’s largest industrial and financial corporations—including global leaders in oil, electricity, cement, aluminum, chemical, paper, and banking; as well as leading firms in the data verification and certification, brokering and trading, legal, and consulting industries. A list of our members is attached.

First and foremost, IETA extends its appreciation for your leadership in working to develop a cap-and-trade program. IETA is dedicated to the establishment of effective market-based trading systems for greenhouse gas emission by businesses that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. The PDR includes many provisions that would help create a market capable of maximizing both environmental and economic benefits.

Although IETA strongly believes a national cap-and-trade is the best means of reducing greenhouse gas emissions in a cost effective manner, IETA commends CARB for their leadership in developing a framework that will both encourage and provide useful lessons in the development of a federal program. As you continue to revise the PDR, IETA offers the following recommendations:

#### **A. Offsets**

An unprecedented transformation in California’s industrial and transportation infrastructure is needed in order to meet the goals of AB-32. This transformation will require tremendous capital investments to sustain the research, development, and deployment of advanced energy systems and clean technologies. IETA believes a properly structured cap-and-trade program—with a robust offset market—will best ensure needed reductions in U.S. GHG emissions are met at the lowest possible cost. To that end, IETA recommends:



- 1. Eliminating the Quantitative Usage Limit:** IETA recommends removing the quantitative usage limit that prohibits covered entities from meeting more than 3.9% of their compliance obligation with offsets. As written, the PDR would place a cap on the percentage of offsets available to individual covered entities. Since the PDR already ensures that only real, permanent, and verifiable offset credits are allowed into the market, arbitrary usage limits will only prevent further reductions of GHG emissions in a cost-effective manner.

Economic analyses by the U.S. Environmental Protection Agency (“EPA”) and others have shown that incenting a robust market in offset reductions (*i.e.*, emissions reductions from diverse sources outside a mandatory cap) can dramatically reduce the overall cost to taxpayers and consumers when meeting the goals of global warming legislation. Indeed, without offsets, the cost of compliance could be over  $2\frac{1}{2}$  times higher than with unrestricted use of offsets.<sup>1</sup> Accordingly, offsets provide critical cost-containment and price stability by providing flexibility to covered industries to find the lowest available cost emissions reductions across a range of options.

- 2. Recognizing Certified Emission Reductions (CERs) approved under the Clean Development Mechanism (“CDM”).** As currently written the PDR would first require a separate Memorandum of Understanding (“MOU”) between California and the developing countries. CARB should accept CERs directly without imposing additional requirements that may slow the process.
- 3. Adjusting the Offset Eligibility Date for Additionality.** IETA believes that all environmentally rigorous offset projects established prior to California’s Cap-and-Trade Program should be eligible for offset credits. Currently, the PDR limits issuance of offset credits to projects that commenced after December 31, 2006. In order to ensure an adequate supply of environmentally rigorous offsets, IETA recommends allowing any project meeting CARB regulations and methodologies be eligible for offset credits—so long as the project was placed in service prior to 2000.
- 4. Providing a broad “positive list” of eligible offset project types based on existing protocols, as well as a clear process for introducing new project types.** The draft regulations should include a “positive list” of offset projects types that possess well-understood and accepted methodologies. Such a list will provide clarity to project developers that qualifying projects of certain types would be considered, and would also ease administrative burdens for project managers, particularly when dealing with common and well-understood project types. This type of list is consistent with California’s approach and obligations under the Western Climate Initiative as well.

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<sup>1</sup> U.S. EPA, Analysis of the Climate Stewardship and Innovation Act of 2007 (McCain-Lieberman, S. 280) (July 16, 2007); U.S. EPA, Analysis of the Low Carbon Economy Act of 2007 (Bingaman-Specter, S. 1766) (Jan. 15, 2008).



In addition, without such a list, the efficacy of the carbon offset market as a compliance tool will be minimized during the period where the appropriate governing agency promulgates additional regulations. In turn, that limits the ability of offsets to act as a cost-mitigation tool in the first few years of the program.

- 5. Including the destruction of ozone-depleting substances and anesthetic gases offset projects:** Projects that involve the destruction of GHGs should be included alongside projects that “reduce, avoid, or sequester” GHG emissions. The destruction of GHGs reaps high environmental benefits at low economic cost. The PDR considers “whether to allow offset project types that reduce GHGs that are not specifically called out in AB-23 (such as the destruction of ozone depleting substances that are no longer in production)”. This is also consistent with the inclusion of such gases in the EPA Reporting Rule. IETA recommends including the terms “destruction/destroy” as an offset project type as well.
- 6. Not limiting the geographic scope of offsets.** IETA does not believe there should be an arbitrary geographic limitation on offset credits. GHGs are non-localized global pollutants. Given the ability of CARB-approved offsets to reduce global GHG concentrations, regulations should not distinguish between offset projects based on political borders. Moreover, allowing offset projects to be developed beyond California’s political boundaries will increase the potential supply of offsets, thereby contributing to a lower overall cost of compliance for compliance entities – and lower costs for California consumers. In addition, expanding the geographic scope of offsets will further encourage other regions to participate in carbon-reducing practices.

## **B. Carbon Market Oversight:**

IETA supports the stated objective of CARB to obtain comprehensive and timely information on compliance instrument transactions in order to monitor the trading of the regulated allowance market and derivatives markets. To that end, the following recommendations will ensure an efficient, fair, and open market.

- 1. Provide Full Access to Market-Based Tools:** Provide market participants with full access to essential market-based risk management tools—including over-the-counter (“OTC”) trades. In order for a carbon market to deliver reductions at the lowest possible cost, market oversight rules must permit a broad use of essential market-based risk management tools. CARB is considering the promotion of trading of CA GHG allowances on approved trading facilities. However, requiring all trades to be conducted on a formal exchange may limit the ability of covered entities to properly manage their compliance cost—which in turn can increase cost for consumers. We are concerned that any initiatives by CARB to promote exchange trading would limit the types of essential transactions necessary to achieve compliance at the lowest possible cost. The OTC



market exists to provide customized services tailored to meet the individual needs of companies. This restriction could stifle the development of important products that are tailored to particular compliance needs. The scale of the investment required to transition to a low-carbon economy is simply too great to limit carbon price and risk management to standardized exchange-traded products.

2. **Distinguish between offset contracts and allowance derivatives.** Contracts for the development of offset projects should not be subject to proposed clearing requirements. These transactions are typically not for guaranteed delivery, prohibiting their ability to be cleared through an exchange. Further more, these transactions most often involve small and medium sized businesses, including farmers, ranchers, foresters or offset developers, that do not have the capital for initial or variation margin necessary to transact through a clearinghouse.
3. **Provide for transparent and efficient trading markets.** IETA supports CARB's desire to obtain comprehensive and timely information on compliance instrument transactions. However, CARB suggests in the PDR that trading facilities report all transactions to the Board and that the Executive Officer review each transaction for regulatory compliance before approving for transfer. IETA strongly believes that this additional review by CARB will add an unacceptable layer of regulatory uncertainty to CA GHG transactions that will negate the transparency, efficiency, and financial assurance afforded by exchange-traded or cleared OTC transactions. Trading markets can only deliver on their promise of reducing overall costs of compliance if they function efficiently and if trading counterparties can transact with a level of certainty. IETA, therefore, recommends that CARB not institute a regulatory review and approval process for transfer and instead utilize a robust registry and transfer system similar to that used by the EPA for the transfer of allowances under Federal SO<sub>2</sub> and NO<sub>x</sub> allowance programs.
4. **Allow clearinghouses to set position limits and margin requirements.** Clearinghouses, in consultation with the appropriate California regulatory body, should set position or "holding" limits for regulated allowances and derivatives. Setting position limits in regulation would be unprecedented and inefficient. Clearinghouses need the flexibility to adjust position limits as the liquidity of the market fluctuates. Accordingly, IETA recommends relying on the expertise of the relevant clearinghouse, in consultation with proper regulator, to set appropriate holding limits and requirements to prevent market manipulation and excessive speculation. Similarly, the regulator should be empowered to establish an efficient market data collection program that includes information from both exchanges and OTC markets. As CARB correctly points out, the CFTC current has the authority to collect this market data, and IETA suggests CARB pursue an information-sharing arrangement directly with the CFTC.

## C. Allocation & Auctioning of Allowances:

1. **Avoid high initial auctions.** IETA opposes high levels of auctions at the outset of the cap-and-trade program. Given the lack of a global system, an unnecessarily high



level of auctioning could have negative impacts on the competitiveness of California industry and create market distortions in regulated industry sectors. We suggest a gradual approach be utilized, with a careful consideration both of the means of minimizing consumer costs and of the capacity of covered entities to recover allowance cost.

2. **Allocate allowances to covered entities.** IETA recommends allocating allowances to covered entities or covered sectors. The allocation of allowances to non-emitting sources, instead of covered entities, would act as a transfer of marketable assets unaccompanied by any obligation to surrender these allowances for compliance obligation. While IETA recognizes the need to develop new technologies for reducing emissions, a robust carbon market would be a more efficient means of directing resources towards these technologies. Accordingly, IETA strongly advocates that the use of revenues from auctions and the allocation process be rigorously separate—with the sole objective of the allocation process being to initiate an emissions trading program on a fair and efficient basis.
3. **Provide allocations for early action.** IETA recommends that entities having taken proactive steps to reduce their GHG output are properly recognized for early action.
4. **Avoid “earmarking” of auction revenues.** IETA cautions against establishing unprecedented use of auction revenues for purposes beyond the original intent of AB-32. We understand the original intent of AB-32 was for all climate market-related revenues to be devoted only to clean energy development and to GHG mitigation.

IETA is following closely the activities and recommendations of the Economic Allocation Advisory Committee, and will submit formal comments when their findings are released. IETA would like those additional comments to be taken into account by CARB as they may further affect our position on the PDR.

## D. Banking and Borrowing

**1. Banking:** IETA believes banking allowances across compliance periods provides an important means of cost control, and we commend CARB for allowing banking across numerous years. Unlimited banking will provide a level of flexibility that will assist companies not only in long term planning, but also in adjusting to unanticipated events.

**2. Borrowing:** IETA believes that borrowing can also serve as an important means of controlling costs, particularly in the early years of the program when the offsets program may not be robust. IETA supports the provision allowing an unlimited amount of interest-free borrowing from the allocations within compliance cycles.



## IETA Statement on CARB PDR

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January 11, 2010

Once again, on behalf of IETA and our 170 member companies, I would like to thank you for providing the opportunity to comment on the PDR and for your attention to these comments. Please do not hesitate to contact me, or Mark Wilson (wilson@ieta.org) in IETA's San Francisco office, if you have any questions.

Sincerely,

Henry Derwent  
President and CEO