



April 13, 2007

Winston Hickox, Chair
Lawrence H. Goulder, Vice Chair
Market Advisory Committee
California Environmental Protection Agency
1001 I Street, 15th Floor
Sacramento, CA 95818

Re: Comments for the Cal-EPA Market Advisory Committee

Dear Chairman Hickox, Vice Chairman Goulder, and Committee Members:

On behalf of the Carbon Offset Providers Coalition, we are grateful for the opportunity to submit the attached comments to assist the Market Advisory Committee in fulfilling its vital advisory functions with respect to the design of an environmentally sound, efficient, and fair greenhouse gas regulatory regime for California under AB 32.

The Coalition comprises companies that are leaders in the carbon offset market, including those involved in financing, producing, generating, providing, aggregating and/or marketing greenhouse gas ("GHG") emission reductions for sale as offsets in existing and emerging voluntary and compliance GHG emission trading markets. We offer these comments based upon our experience operating within these compliance markets as well as the voluntary market.

We believe that the emerging market sector represented by this Coalition can make a significant contribution both to the achievement of the objectives embodied in AB 32 and to the economic and environmental well-being of California and Californians, *if* the regulatory regime is constructed properly. We therefore want to share our observations on the general design elements for a GHG emissions reduction regulatory regime that we see as critical to providing a workable framework. We also want to share our views on the specific elements of an offset program that we believe would contribute to both the environmental integrity of the AB 32 program and to the economic efficiency of the reduction measures.

We would be happy to provide further information to you or to the Committee staff if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Roger Williams", is written over a horizontal line.

Roger Williams

Chairman

Carbon Offset Providers Coalition



Comments of the Carbon Offset Providers Coalition for the Cal-EPA Market Advisory Committee

The Carbon Offset Providers Coalition comprises leading companies in the carbon offset market, including those involved in financing, producing, generating, providing, aggregating and/or marketing greenhouse gas (“GHG”) emission reductions for sale as offsets¹ in existing and emerging voluntary and regulatory GHG emission trading markets. The Coalition’s purpose is to ensure that evolving GHG regulatory regimes in the United States are developed in a manner that promotes both environmental integrity and economic efficiency. We offer these comments and suggestions to the Cal-EPA Market Advisory Committee in an effort to assist it with its important advisory duties.

Executive Summary of the Coalition’s Comments

Climate change is an urgent problem that will require all means available to achieve the GHG emissions reductions necessary to stabilize the climate. Consistent with the severity and urgency of the problem, AB 32 established ambitious goals for reducing GHG emissions. We join the growing consensus that believe that market-based cap-and-trade programs that include offsets offer the best way to meet the challenges of climate change and should be utilized in implementing AB 32. Cap-and-trade programs harness the significant power of the marketplace to provide incentives for the development of new technologies as well as encouraging broad participation across the economy. Offsets serve as a valuable tool for reducing GHG emissions in both the short and long-term and work best within a cap-and-trade program.

Offsets provide regulated entities with additional flexibility and compliance options to reduce GHG emissions using existing, proven technologies and resources, while new technologies are developed to reduce reliance on carbon-based fuels and further reduce GHG emissions. While offsets have value in reducing GHG emissions in both the near- and long-term, they have particular value in the near-term, as they will ease the transition to the new carbon-constrained economy. Attempting to force a sudden shift to the new economy by mandating severe GHG emission reductions would be politically infeasible or, if achieved, economically disastrous, as many entities would be unable to make the transition quickly. The severe social costs endured by the Eastern European countries that forced sudden shifts to a market economy stand as an example of the risks of such an approach. No one contends that offsets alone are the

¹ For the purposes of these comments, we use the term “offsets” to refer to uniform, tradable units of GHG emission reductions generated by entities that are not subject to GHG emission limits. We use the term “allowances” to refer to similar uniform, tradable units of GHG emissions allowed under a GHG reduction regulatory regime. Both “offsets” and “allowances” are sometimes referred to as “credits,” though in an effort to avoid confusion we do not use that more general term here.

answer to global warming. Rather, they are one of many valuable tools, and we will need all of the tools at hand to meet the challenges of climate change. By achieving verifiable GHG emissions reductions now, offsets help ensure an efficient allocation of resources, thereby enabling resources to be used to help develop the new technologies that will be necessary to meet the objectives of AB 32, as well as other basic social and economic needs of all Californians.

The focus of the Coalition's comments is the offset program that we believe should be implemented as part of California's GHG regulatory regime. With this in mind, we briefly address key design principles of a GHG regulatory regime, including the importance of a cap-and-trade program and the benefits of offsets within such a regime. We then discuss in more detail important elements that should be incorporated into an offset program. Our comments are organized as follows:

Section I. Two Key Principles for the Design of a GHG Emissions Reduction Regulatory Regime.

- A. Cap-and-Trade is the Best Model For California.
- B. Offsets Should Be Eligible for Compliance.
 - 1. Offsets are an environmentally beneficial and cost-effective market mechanism for reducing GHG emissions.
 - 2. Offsets provide numerous environmental and economic benefits.
 - a. Offsets offer near-term, environmentally-friendly reductions in GHG emissions that are real, verifiable, and additional.
 - b. Offsets provide flexibility to achieve compliance through lower-cost compliance mechanisms that prevent premature retirement of assets and preserve California's economy.
 - c. Offsets maximize GHG reductions by increasing participation and reducing emissions from non-regulated sources.
 - d. Offsets stimulate innovation.
 - 3. An offset program should be developed now.

Section II. Specific Design Elements for an Offset Program.

- A. A Credible, Balanced Authority Must Establish and Maintain the Qualifying Criteria for Offsets.

- B. Any Project that Meets the Standards for Qualifying Offsets Should Be Eligible for Emission Trading.
- C. The Standards for Additionality Should Be Practical, Environmentally Sound, and Objective.
- D. The Geographic Scope of Qualifying Offsets Should Not Be Limited; Offsets Should Be Recognized Wherever They Are Generated.
- E. Discounting Offsets and Quantitative Limits on Offsets Are Unnecessary.
- F. California's Offset Market Should Be Linked to Other Carbon Markets.
- G. The Project Start Date for Offsets Should Be Established as Early as Possible.
- H. Changes in Regulatory Requirements Should Not Affect Established Offsets.

Section III. Conclusion.

I. TWO KEY PRINCIPLES FOR THE DESIGN OF A GHG EMISSIONS REDUCTION REGULATORY REGIME.

Although the Coalition's primary focus is on the specific details of an offset program that should be established under AB 32, we highlight for the Committee two key design principles that should be integrated into the foundation of a market-based GHG reduction regime under AB 32. We limit our comments at this stage to principles of overriding importance both to our sector and to California: (1) the regulatory framework should be based on a cap-and-trade approach; and (2) the regulatory framework should include a program for the recognition of offsets from project-based GHG reductions.

We offer these comments based largely on our members' experience participating in the existing GHG emissions trading markets. We commend Cal-EPA for its commitment to learning from the experience of the rest of the world in addressing climate change, as demonstrated most recently by Secretary Linda Adams's series of meetings in Europe, and we believe that the experience of our members with these existing programs thus may be of benefit.

A. Cap-and-Trade is the Best Model For California.

GHG emission reductions should be accomplished through a market-driven approach based on a cap-and-trade program that includes as many economic sectors as is reasonably practical and places specified limits on GHG emissions. Market trading is the only proven system that allows businesses to identify the most cost-effective means of reducing GHGs to achieve California's climate goals while minimizing negative impacts on the economy and tax base. At the same time, a cap-and-trade system will provide a level playing field for regulated entities, create opportunities for the market to identify cost-effective reductions to minimize the

economic impact on California, and set a market-driven price signal for carbon that will drive innovation for a long-term solution to the climate change problem.

B. Offsets Should Be Eligible for Compliance.

Entities subject to GHG emissions controls should be permitted to satisfy their reduction obligations through the purchase of qualified, standardized GHG offsets. As discussed below, offsets provide numerous environmental and economic benefits and are equally effective in reducing GHGs, and in many ways are superior to, internal reductions or the purchase of allocations on the emissions market. The specific design elements that we believe will be important in developing a California offset program are discussed in detail in Section II.

1. Offsets are an environmentally beneficial and cost-effective market mechanism for reducing GHG emissions.

Offsets are an environmentally beneficial and cost-effective market mechanism for capturing the environmental and economic value of the verified GHG emissions reductions created by entities that are not otherwise subject to a GHG regulatory regime. In essence, it is a market exchange unit that measures GHG emission reductions achieved by projects using a variety of means. Examples that are recognized in other GHG emissions markets include carbon sequestration, methane capture, energy efficiency, and renewable energy projects. Offsets are distinct from GHG emission allowances that are issued to and traded by regulated entities within a cap-and-trade program. Unlike allowances, offsets normally are generated by projects outside of the GHG regulatory regime which achieve GHG emission reductions beyond what would otherwise occur. Offsets that meet defined eligibility requirements can be purchased by regulated entities and used to meet the emissions limits that apply to them under a GHG regulatory regime.

2. Offsets provide numerous environmental and economic benefits.

The benefits of offsets are many, but we focus on the following four for the purposes of these comments. Offsets provide: (a) immediate, environmentally beneficial reductions in GHG emissions using proven methodologies; (b) flexibility in achieving emission reductions through lower cost compliance mechanisms that prevents premature retirement of assets, preserves California's economic competitiveness, and improves allocation of resources; (c) maximum participation of all sources of GHG emissions, including non-regulated sources, thereby increasing emissions reductions throughout the economy and reducing the overall cost of the regime; and (d) clear, direct financial incentives for innovation.

a. Offsets offer near-term, environmentally-friendly reductions in GHG emissions that are real, verifiable, and additional.

Offsets offer immediate environmental benefits by taking advantage of existing, proven technologies for reducing GHG emissions that do not require substantial investment of time or capital (which will be necessary to achieve AB 32's long-term emission reductions goals). Projects such as carbon sequestration, methane capture, energy efficiency, and renewable energy

are proven methods of reducing GHG emissions that also provide collateral environmental benefits, including natural resources restoration, improved water quality management, reduction of other air pollutants, and also economic support of forestry and farming, sectors that often have been neglected. Many offset projects offer opportunities for clean development in parts of the world that desperately need it. Thus, offsets are entirely consistent with AB 32's environmental justice objectives as well as its environmental and economic objectives. Further, a well-designed offset mechanism, as we discuss in Section II, can address perceived environmental risks by ensuring that only qualified reductions in GHG emissions are used to generate offsets.

b. Offsets provide flexibility to achieve compliance through lower-cost compliance mechanisms that prevent premature retirement of assets and preserve California's economy.

Offsets offer regulated sources of GHG emissions the flexibility to achieve compliance through mechanisms that often cost less than the measures that would be necessary to reduce their own GHG emissions. A concern with any GHG reduction program is that it will force businesses to retire assets before the end of their useful lives or invest heavily in unproven technologies that may provide only marginal GHG reduction benefits. While a cap-and-trade system addresses this concern in part by allowing companies to buy and sell allocations to achieve compliance, a trading program that recognizes only reductions within the regulated community (or within a particular industry sector) still limits compliance options. For regulated entities with prohibitively expensive compliance options, assets with remaining useful life may be prematurely retired or replaced with assets that provide only marginal emission reductions. This stifles California's economy and misallocates limited capital resources. Offsets address this concern by increasing the compliance tools available to regulated sources of GHG emissions and allowing them to utilize the most efficient mechanisms to achieve compliance.

c. Offsets maximize GHG reductions by increasing participation and reducing emissions from non-regulated sources.

Unlike a command-and-control regime or a carbon tax, offsets reduce emissions from sources outside the regulated community and from sources that otherwise may be difficult to target with other abatement mechanisms, thereby maximizing reductions throughout the economy. Offsets also provide clear financial incentives to unregulated sources of GHG emissions that can reduce emissions efficiently by generating offsets that can be sold to and used by regulated sources with higher compliance costs. Similarly, offsets encourage technology developers to create low-cost compliance options. Given the global reality of climate change and its effects on California, reductions throughout the economy will be vital to stabilizing the climate and protecting California's natural resources. Use of offsets increases the type and quantity of GHGs included within the regulatory regime and provides further incentives to reduce emissions wherever emitted.

d. Offsets stimulate innovation.

Offsets provide clear financial incentives for technological innovation over the short- and long-term. Achieving the goals of AB 32 will necessitate development of new technologies and

products to reduce GHG emissions. Businesses that rely heavily on GHG emitting substances and processes will be forced to develop methodologies for monitoring, reporting, and controlling emissions, in addition to reducing their reliance on carbon-based energy. The businesses that are most successful at addressing carbon emissions will become more competitive. Offsets provide direct financial incentives for both regulated and non-regulated entities to reduce GHG emissions and develop technologies necessary to achieve the objectives of AB 32.

3. An offset program should be developed now.

Combating climate change and achieving the goals of AB 32 will require significant technological development and capital investment. Offsets are a formidable tool for reducing emissions through already established methods of reducing GHGs. Enabling the deployment of these projects will generate necessary experience in reducing emissions while more time- and cost-intensive technologies are developed to reduce our reliance on carbon based fuels and technologies. The Coalition acknowledges that offsets are not the sole solution to reducing GHG emissions over the long-term; rather, they are an important part of the solution. Offsets are particularly important in the near-term, however, as they provide real and immediate opportunities to significantly reduce GHG emissions at comparatively low-cost, with both environmental and economic benefits.

Not only is there no reason to delay the early establishment of rules enabling use of offsets in the development of California's GHG regulatory regime, there are compelling reasons to do so now. The viability of a robust offset market will depend in large part on the expectations of investors and project developers. Uncertainty about the terms for offsets or whether they'll even be recognized will both delay and limit the ability of this market to grow and to develop new projects to help address the challenges of climate change. It thus is important to design an integrated GHG reduction regime that takes into account at the outset the role of key elements such as offsets.

II. SPECIFIC DESIGN ELEMENTS FOR AN OFFSET PROGRAM.

Given the merits of offsets, we believe that it is vital that the elements of an offset program be considered now during the overall design phase of the AB 32 regulatory program. The points below highlight the key elements of an offset program.

A. A Credible, Balanced Authority Must Establish and Maintain the Qualifying for Offsets.

As an initial matter, it is vital that the qualification standards and the rules governing the determination of project qualification, monitoring and verification should be established by a regulatory authority (such as CARB or Cal-EPA with the input of the California Climate Action Registry) through an open, consensus-based, public participation process. We view the Committee's work as an important first step in the process, and as a key stakeholder, we look forward to working with the other regulatory authorities as the process moves forward.

