June 11, 2007

Winston Hickox
Chair, Cal EPA Market Advisory Committee

Lawrence H. Goulder
Vice Chair, Cal EPA Market Advisory Committee

RE: Cal EPA Market Advisory Committee Draft Report
via email climatechange@calepa.ca.gov

Dear Mr. Hickox, Professor Goulder, and Committee members,

We write to offer our views on the Cal EPA Market Advisory Committee's draft report for public review (hereafter, "the draft report"). Although Assembly Bill (AB) 32 clearly designates, as the draft report notes, the California Air Resources Board (CARB) as the ultimate decision maker on this topic, we appreciate your efforts to share your expert opinion and understand that it will be an input for consideration during CARB's policymaking process.

Without pre-judging whether any of our organizations will ultimately support any particular cap and trade program design, we offer these suggestions on the draft report. Many of the undersigned organizations will submit individual letters providing more detail on their recommendations. We are united in the view that if CARB adopts cap-and-trade as an instrument in the portfolio of policies to implement AB 32, it must supplement and not substitute for other key policies. Continuing and expanding the state's other policies to reduce global warming pollution – performance standards, such as the renewable portfolio standard and clean car standards, incentive programs, such as the energy efficiency programs, and other regulatory and educational instruments – is crucial for both the development of an optimal global warming solution strategy and as part of the effort to meet AB 32's requirement that the program complement efforts to reduce air and toxic pollutants. Thus, we are in agreement with the report when it states: "There is a strong economic and public policy basis for other policies that can accompany an emissions trading system" (page 19).

With that said, we leave aside the question of precisely the right division of effort between cap-and-trade and other policies and turn to providing our views on the recommendations contained in the Market Advisory Committee's draft report.

In summary, we:

1. Urge the Market Advisory Committee (MAC) to recommend that setting a tight cap that declines over time be a top priority in designing the program.
2. Support the MAC draft report's rejection of price caps on allowances. This is an important step toward designing a system with environmental integrity.
3. Support the draft report's arguments in favor of auctioning and attention to the principle of promoting the public interest in the allowance distribution process.
4. Urge the MAC to revise its recommendations, to limit the role of offsets as a compliance option.
5. Urge the MAC to provide more specific recommendations to address air quality and other environmental justice concerns.
6. Urge the MAC to provide clear recommendations on how to ensure strong enforcement of reporting and the cap. The MAC's recommendation that emissions and trading data be made public is a good start in this regard.

We urge the MAC to recommend that setting a tight cap that declines over time be a top priority in designing the program.

We are pleased to see that the draft report notes the importance of setting the level of the cap to achieve real emission reductions – a major problem in California's RECLAIM program and the European Union's "pilot" phase – and endorses the view that the cap should decline steadily over time. However, we urge the MAC to augment Chapter 4 (which begins the discussion of the MAC's recommendations for California) with a discussion of the importance of setting the cap tightly to achieve real emission reductions, and to add a clear recommendation that CARB make setting a tight cap a priority in designing the program. We agree with the draft report that the cap-and-trade program, should one be adopted, should not sunset in 2020; any cap-and-trade program adopted needs to continue beyond that year to provide assurances that investments in global warming solutions—many of which are long lived – will be worthwhile (page 21).

We support the MAC draft report's rejection of price caps on allowances. This is an important step toward designing a system with environmental integrity.

The MAC draft report rightly identifies the setting of a certain, quantitative, enforceable limit on emissions as a principal advantage of a cap-and-trade program. This advantage can only be realized if environmental integrity is made a priority. The draft report's rejection of a price cap on allowances (i.e. rejection of a safety valve) is an important step toward constructing a system with environmental integrity. We support strongly the draft report's position that a California cap and trade program should not include price caps on allowances.

We support the draft report's arguments in favor of auctioning and attention to the principle of promoting the public interest in the allowance distribution process.

The draft report proposes a number of principles for distributing allowances, including reducing costs to consumers, avoiding windfall profits, etc. We support these principles. The draft report further states that based on the other design elements of the program that it recommends, "[the] fundamental objectives of cost-effectiveness, fairness, and simplicity… favor a system in which California ultimately auctions all of its emissions allowances," page 52. We agree. We strongly concur with the draft report's acknowledgement that auctioning provides environmentally-beneficial incentives by implicitly rewarding early action, in contrast to grandfathering, which rewards the biggest polluters and which we fervently oppose. We support the draft report's recommendation that a substantial portion of auction revenue should go to promoting investment in low-GHG technologies and fuels, including energy efficiency, and to increase assistance to low-income consumers. Returning some portion of auction revenue to the people of California via a lump sum per capita return would be an effective way of countering disproportionate economic impacts on low-income households.[1]

We urge the MAC to revise its recommendations, to limit the role of offsets as a compliance option.

If the necessary analytical and monitoring protocols are in place, the use of offsets can lower compliance costs and allow uncapped sectors or uncapped geographic areas to contribute to the achievement of emissions reductions. At the same time, if not designed carefully with proper limitations, offsets can also result in the avoidance of real near-term emissions reductions in high-emitting sectors that are directly capped. Any serious solution for global warming must ensure real reductions from high-emitting sources in California.

The level of the cap, and the level of emission reduction effort that the level of the cap implies, plays a central role in determining the extent to which a role for offsets makes sense. Offsets should only be considered if the cap is set tightly. *If* offsets are allowed, they should be subject to at least the following conditions:

- Limited to a small portion of covered entities' compliance obligation; offsets must not be a means of avoiding making progress toward reduced emissions in sectors covered by a California cap-and-trade program.
- Limited to specific project types in sectors that will provide environmental and economic co-benefits to California, especially co-benefits that will accrue to communities currently suffering from excessive levels of pollution.
- Limited to specific project types that have stringent protocols to ensure the emission reductions are real, additional (beyond business as usual) and permanent.
- Verifiable and enforceable by CARB.

---

[1] The value of lump sum per capita returns for redressing regressive economic impacts is illustrated in the recent report "Trade-Offs in Allocating Allowances for CO2 Emissions" by Terry Dinan of the Congressional Budget Office (CBO Economic and Budget Issue Brief: April 25, 2007). See Figure 1.

Thus, we believe the draft report's recommendation of a limit on the types of offset projects that would be allowed is only a first step toward an offsets policy that maximizes additional environmental and economic benefits for California as AB 32 directs.

Landfill gas capture projects, which the MAC suggests are a good candidate for offsets, provide an example of the type of difficult analytical issues that offset projects raise. Such projects would increase the incentive to divert organic material to landfills rather than recycling and composting by increasing the value of the resulting methane gas.

We urge the MAC to provide more specific recommendations to address air quality and other environmental justice concerns.

The draft report calls in general terms for tighter laws on conventional air pollutants and for CARB to closely monitor the situation to ensure no back-sliding. CARB would benefit from more specific recommendations on avoiding inadvertent creation of toxic or criteria pollutant hot-spots or decreases in regional air quality under a cap-and-trade system. We agree with the following statements on the use of auction revenue as a partial response to air quality and other environmental justice concerns:

- "The Committee believes it is appropriate to use a portion of the allowance value to finance reductions of greenhouse gases and criteria pollutants in communities that bear disproportionate environmental and public health burdens," (page 53).
- "The Committee strongly recommends that California distribute allowances in a manner that …[a]dvances the state's broader environmental goals by ensuring that environmental benefits accrue to overburdened communities," (page 52).

We strongly encourage the MAC to use its remaining time to consult directly with the Environmental Justice Advisory Committee to craft specific, binding, and enforceable recommendations on protecting air quality in disproportionately burdened communities and other environmental justice concerns.

We urge the MAC to provide clear recommendations on how to ensure rigorous reporting, strong enforcement, and transparency.

Mandatory reporting, strong enforcement, and transparency are the foundation of any cap and trade program. We agree with the draft report's recommendations that "the program must incorporate a rigorous system of mandatory emissions monitoring, reporting, and verification." (p. 77). We further agree that "data on emissions and allowance transfers should be made available to the public," (page 16) and that penalties "should be automatic and non-negotiable" with civil and criminal penalties for intentional violations. (p. 72). We urge the MAC to further recommend that the automatic penalties for surrendering insufficient allowances to cover emissions should include a monetary fine and a requirement to surrender a multiple of the allowances not surrendered. Chapter 7 of the draft report provides a good discussion of the issues involved in reporting and

enforcement, and we urge the MAC to provide a summary of its key recommendations on these issues in Chapter 8.

Thank you for considering our views as you finalize your report to CARB.

Sincerely,

Bonnie Holmes-Gen, American Lung Association of California
Danielle Fugere, Bluewater Network/Friends of the Earth
Lenny Goldberg, California Tax Reform Association (CTRA)
Scott Smithline, Californians Against Waste
Rachel McMahon, Center for Energy Efficiency and Renewable Technologies
Mike Sandler and Ann Hancock, Climate Protection Campaign
Tam Hunt, Community Environmental Council
Dan Jacobson, Environment California
Mary Luevano, Global Green USA
Devra Wang, Natural Resources Defense Council
Michelle Passero, Pacific Forest Trust
Andrew Hoerner, Redefining Progress
Bill Magavern, Sierra Club California
Lenny Goldberg, The Utility Reform Network (TURN)
Peter Barnes, Tomales Bay Institute
Chris Busch, Union of Concerned Scientists

CC: Linda Adams, Secretary for Environmental Protection
Dan Skopec, Undersecretary, Cal EPA
Eileen Tutt, Deputy Secretary, Cal EPA
Dr. Robert Sawyer, Chairman, ARB
Catherine Witherspoon, Executive Officer, ARB
Chuck Shulock, Climate Change Program Manager, ARB