
From: Kristin Grenfell, NRDC (kgrenfell@nrdc.org; 415-875-6100)
To: California Air Resources Board Staff (ccplan@arb.ca.gov)
Re: NRDC Comments on Cost-Containment
Date: May 9, 2008

NRDC thanks CARB for holding the technical stakeholder workshop on cost-containment on April 25, 2008 and submits these comments in response to the presentations and discussion at that workshop, and in response to the questions presented by CARB staff. These comments do not pre-suppose whether CARB will ultimately decide to implement a cap-and-trade system, but rather they discuss how such a system could be designed to best manage costs if it is in fact implemented. A cap-and-trade system, if adopted, would be just one part of an integrated package of policies necessary to meet the AB 32 emissions limit, and to achieve the other economic and environmental goals set by AB 32.

1. What type of cost containment mechanisms should California consider for a potential cap-and-trade program?

We are pleased that CARB staff recognize that the design of a potential cap-and-trade program must be viewed holistically and that the advisability of each elements is dependent on the other elements included in the design. We urge CARB to continue considering many aspects of a well-designed cap-and-trade program as ways to manage costs, rather than focusing solely on a narrower group of mechanisms commonly described as “cost-containment” mechanisms.

a. Multi-Year Compliance Period

We believe that CARB should implement a three year compliance period in order to allow capped entities time to make the investment decisions necessary to meet their obligations. We would support rolling compliance periods designed to stagger compliance periods for different covered entities and thus mitigate market volatility.

Based on parties’ comments at the April 25 workshop, we understand a “floating” compliance period to mean that each covered entity would be allowed to choose to end its compliance period and surrender the appropriate allowances at any time. We believe this could result in greater market volatility, because multiple covered entities could each react to market conditions by trying to end their compliance periods at the same time, thus resulting in a price spike. A three year compliance period and banking should allow

covered entities sufficient flexibility. CARB should maintain control over compliance periods, but could stagger them in order to ensure smooth market functioning.

b. Frequent Allowance Auctions

We have advocated for frequent allowance auctions, preferably on a quarterly basis, in order to ensure liquidity in the market. This will allow capped entities many opportunities to adjust course and fine tune their carbon portfolios prior to compliance deadlines. If allowances are auctioned quarterly and compliance periods are three years long, capped entities will have 12 opportunities to match their allowances to their emissions without ever having to trade with other capped entities or purchase offsets. CARB should pre-determine the length of the compliance periods, the level of the cap at the end of each compliance period, and the number of allowances to be auctioned during each auction in order to give covered entities as much certainty as possible in planning their carbon portfolios through 2020.

c. Banking, with Appropriate Limits

Allowing covered entities to bank extra allowances, i.e. hold them for use in a future compliance period, can encourage earlier action to reduce GHG emissions. Allowing banking would provide an important means to encourage significant capital-intensive investments, because such investments may result in significant reductions that the capped entity will want to use for compliance during more than one compliance period. Some constraints on banking, such as limits on the number of allowances an entity may bank and limits on the number of compliance periods an entity may wait to surrender allowances, may be appropriate to prevent hoarding and market distortions from allowances being kept out of circulation for too long.

d. No Borrowing from Future Compliance Periods

Allowing covered entities to borrow allowances from future compliance periods would likely discourage early action.¹ Some sectors will need flexibility to respond to the variations in emissions that occur due to factors out of their control. In particular, the electricity sector's year-to-year emissions can vary significantly due to weather conditions and the availability of hydroelectric power. As discussed at the workshop, a multi-year compliance period can provide this flexibility. *If* borrowing is allowed, it should be limited. Limitations should include the percentage of an entity's allowances,

¹ The entity would still have to surrender the same number of allowances that it emits, but it would be allowed to put off reductions until later. For example, an entity could surrender 10 allowances in compliance period one, but emit 15 tons of CO₂e. It would then achieve reductions in period two so that it only emits 10 tons but it must surrender 15 allowances.

how often a single entity may borrow over the life of the program, and how many compliance periods ahead the may borrow from. Borrowed allowances should also be paid back with interest, just like borrowed money must be paid back with interest.

e. Limited Offsets, if Any

As described in our April 25, 2008 comments on offsets, AB 32 requires that if offsets are allowed, they must be real, additional, verifiable, permanent, and enforceable. We believe there are many practical difficulties with meeting these requirements, and so *if* offsets are allowed, they should be limited to no more than a small percent, perhaps 1%, of total allowances.

f. No Safety Valve or Price Cap

As discussed at the workshop, AB 32 already has an emergency mechanism built into Health and Safety Code section 38599(a). Creating a safety valve or price cap in the design of the cap-and-trade system *in addition to* the emergency mechanism in the statute is unnecessary and would lead to unacceptable consequences; it would allow the cap to be broken and emissions to increase, undermining the purpose of the law. Other design elements discussed above should be used to constrain costs and limit market volatility.

2. *Is there a need to establish an independent market oversight body?*

NRDC supports the creation of an independent market oversight body, such as the California Carbon Trust proposed in the Final Report from the Economic and Technological Advancement Advisory Committee (ETAAC).² The California Carbon Trust could act as a market maker and market stabilizer, and could also direct auction funds to ensure that they are used in a way that furthers the public good for all Californians and achieves AB 32's goals. Basic market rules and specific rules for intervention would have to be developed in advance.

3. *What systems should be considered for linkage with a potential California cap-and-trade system?*

Any system that has a comparable cap, comparable verification and reporting requirements, comparable limits on offsets, and comparable enforceability should be considered for linkage with a potential California cap-and-trade system.

² *Recommendations of the Economic Advancement Advisory Committee, FINAL REPORT: Technologies and Policies to Consider for Reducing Greenhouse Gas Emissions in California* (February 11, 2008), pp. 2-3 – 2-9, available at <http://www.arb.ca.gov/cc/etaac/ETAACFinalReport2-11-08.pdf>.