Harvard Square
206 W. Bonita Avenue
Claremont, CA 91711
USA

Tel +1 909 621 1358
Fax +1 909 621 7438
Email us@ecosecurities.com
www.ecosecurities.com

Kevin Kennedy
California Air Resources Board
1001 "I" Street
P.O. Box 2815
Sacramento, CA 95814

May 5, 2008

Re: Comments from EcoSecurities on Cost Containment in the AB 32 Scoping Plan

Dear Mr. Kennedy,

Thank you for the opportunity to provide comments on cost containment measures to be included in the AB 32 Scoping Plan. EcoSecurities believes that no single cost containment measure will be the silver bullet, but rather, that a suite of mechanisms will be necessary. For the purposes of this letter we will focus on two measures: 1) a market oversight body, and 2) linkages. However, we would also emphasize that offsets are an important mechanism for cost containment that was not explicitly referenced in either the staff presentation or white paper from April 25th. Acknowledging that offsets are being considered by ARB through their own separate public comment process, we have refrained from opining here at length on their ability to promote economic efficiency and cost containment. However, we urge ARB to remember the valuable cost containing opportunities offsets can provide which we have outlined in past comments, e.g. those submitted subsequent to the April 4th, 2008 meeting on offsets.

Linking With Other Systems

EcoSecurities supports linking with other systems whose programs meet California's standards for environmental integrity. The importance of such linkages is in line with California's participation in the Western Climate Initiative and the International Carbon Action Partnership. The importance of international linkages in California is also reflected by Governor Schwarzenegger's agreements to collaborate with China, the UK, Australia, British Columbia, Manitoba, and Mexico.

In addition to linking with other cap-and-trade systems, EcoSecurities encourages California to explicitly allow Certified Emission Reductions from the Clean Development Mechanism (CDM) for compliance. These credits are created though a process that is regulated and overseen by the UN, and is acknowledged as high quality.[1] While there have been a variety of criticisms of the CDM, the UN has noted that the capacity of the Executive Board and the scrutiny of individual projects is improving substantially. For example, requests for reviews of projects have increased, and many third-party verification issues have been addressed with the EB's release of the "Validation and Verification Manual," which provides clarity and guidance on key parts of the verification process. Methodologies have been consolidated for enhanced clarity and reduced administrative complexity, and the CDM Executive Board has begun to address project types which can create perverse incentives by announcing that new HFC 23 facilities will no longer be eligible for CDM credits.[2]

Cost-Containment
Explicitly allowing use of CERs in California would help contain exposure of consumers to possible carbon price spikes while also boosting the ability of developing countries to adopt domestic emissions management systems. Recent research at the federal level indicates that international offsets will be necessary to help manage the compliance costs associated with implementing a U.S. cap-and-trade program. A recent analysis by the EPA notes that, "If international credits are not allowed (or are more expensive than U.S. GHG allowances), and domestic offsets are still limited to 15%, then allowance prices increase by 34% compared to the bill as written."[3] In contrast, allowing CER use would decrease costs 34% while allowing their unlimited use would further decrease costs 26%. Another recent study by New Carbon Finance (NCF) indicates that under Lieberman-Warner, a carbon price of $40-$50 is likely by 2020. The NCF report concludes that allowing 15% international offsets could save the US economy up to $145 billion (or $480 per person) annually.

Research by CRA International found specifically for California that allowing CER use provided significant cost-containment, and under a conservative scenario, decreased the cost of GHG permits by more than 50% over a CA offsets only scenario. Allowing international credits also resulted in a loss in California's welfare of 0.11% less than under a scenario with only CA offsets. The report concludes, "offsets could significantly lower the economic costs of complying with AB 32. Therefore, it would be prudent to research *all possible sources of offsets* (emphasis added) to determine which ones are viable. Unlike a safety-valve where total emissions can increase, California emissions less offsets are the same for all scenarios; hence global emissions remain the same in all scenarios…The importance of offsets depends greatly on the availability of low emitting technologies… Since these technologies likely will not come on-line for the next ten to twenty years, the availability of offsets in the near-term is quite critical."[4]

---

[1] See the Environmental Data Services report, "The ENDS Guide to Carbon Offsets 2008."
[2] See: http://environment.newscientist.com/article/dn11155-kyoto-protocol-loophole-has-cost-6-billion.html.
[3] US ENVIRONMENTAL PROTECTION AGENCY, EPA Analysis of the Liebermann-Warner Climate Security Act of 2008, S. 2191 in 110th Congress, March 2008.
[4] "The Role of Offsets in Enhancing the Cost-Effectiveness of AB 32." CRA International for Chevron Corporation. April 23, 2008. Pg 18.

Allowing for use of international offsets also provides an effective way of making cost-containment opportunities available immediately at the onset of the cap. There is an existing pipeline of CERs available that have already been verified by an independent 3rd party and certified by the UN, and allowing their use in California would provide needed liquidity in the early years before capped entities can make the large infrastructural shifts necessary to achieve their caps, and before a California offset pipeline is significant enough to provide the cost containment that will be necessary to ease the transition to a low-carbon economy.

Other Benefits of Linking

Including internationally sourced offsets like those generated under the CDM into California acknowledges that climate change is a global issue, and positions the state to engage as a leader on the issue with the international community. It promotes goodwill with other countries that are already actively reducing emissions, and can help provide a bridge to a future international climate agreement. As noted by UNFCCC Secretary Yvo de Boer at the recent Bali Roadmap meeting in Bangkok: “a functioning carbon market will be critical to a successful [post-2012 climate change] agreement.”

International project-based credits, or CERs, can also provide export and relationship-building opportunities for California’s growing businesses in clean technologies, finance and management. A recent UN report[5] shows that 14% of technology and 10% of knowledge transferred through the CDM is currently U.S.-based; this could grow significantly with direct U.S. engagement in the market.

Some stakeholders have voiced concerns about the possibility of credits from certain project types that they feel are of questionable quality, e.g. HFC-23 destruction, entering the California market. As noted above, many of these concerns are already being addressed through a variety of reforms underway by the Executive Board to the CDM. If these reforms do not adequately address California’s concerns with respect to the CDM, the appropriate response would be selectively discounting or prohibiting credits from these kinds of projects from California, not prohibiting all credits from the CDM across the board. This would be easily achievable, since each CER has a unique serial number that identifies where it comes from geographically and with respect to project type.

Market Oversight Body

EcoSecurities supports the general concept of a market oversight body. However, such a body should be designed so that allowable market intervention is clearly defined, and the processes and steps for intervention are clearly stated. This will minimize regulatory risk and uncertainty for market players.

[5] Seres, Stephen. “Analysis of Technology Transfer in CDM Projects.” December 2007.

Furthermore, the membership of any carbon market oversight body should be comprised of individuals with experience in environmental and market regulation, and specifically, individuals with experience in the carbon markets. These individuals should be dedicated to providing market oversight and should be equipped with ample resources to do their job.

As a company with over 10 years experience in the international carbon market, we hope that you and your staff will feel free to contact us should you have any questions—in particular, those related to the issue of ensuring the quality of international offset credits like those from the CDM. Thank you for taking the time to consider our comments.

Sincerely,

Aimee Barnes
Manager, US Regulatory Affairs
EcoSecurities
aimee.barnes@ecosecurities.com
Direct line +1 909 621 1358

Cc: Samuel Wade, Stephen Shelby, Brieanne Douke