



November 30, 2007

To: Western Climate Initiative Partners

Regarding: BCSE Comments on the Western Climate Initiative Program Questions for Designing a Greenhouse Gas Cap-and-Trade System

Submitted Via: WCI Website

On behalf of the members of the Business Council for Sustainable Energy (the Council), we appreciate the opportunity to provide comments on the Western Climate Initiative (WCI) program questions for designing a greenhouse gas cap-and-trade system as outlined in the WCI work plan. The Council looks forward to working with WCI and its various subcommittees as you consider design options for the western region.

Introduction

The Business Council for Sustainable Energy is a broad-based industry coalition of energy efficiency, natural gas and renewable energy interests that advocates energy and environmental policies that promote markets for clean, efficient and sustainable energy products and services. The Council's coalition includes power developers, equipment manufacturers, independent generators, green power marketers, retailers, and gas and electric utilities, as well as several of the primary trade associations in these sectors. We have several members who are based in the WCI region as well as others that are very active in the region's markets and clean energy activities including Sempra Energy, PG&E, PPM Energy, SMUD, First Environment, GE Wind, Calpine, 3 Degrees, Enel North America, and Solar Turbines.

The Council and its members have been working for many years with state, federal and international policymakers on market-based measures to reduce greenhouse gas emissions. The Council was the first industry coalition to support a binding multilateral regime to address climate change. The coalition supports the establishment of market-based programs for clean energy technology innovation, economic efficiency and enhanced energy security. We view the WCI cap-and-trade program as an important vehicle to reduce greenhouse gas emissions in the western region.

BCSE Comments on WCI Cap-and-Trade Design Questions

The Business Council for Sustainable Energy supports market-based design elements for implementation of a WCI greenhouse gas cap-and-trade program that provide consistent and long-term market signals for clean energy deployment and energy efficiency. From an industry perspective, it is essential to have regulatory certainty and consistency to effectively tackle the challenge presented by global climate change.

To be most effective, WCI's implementation measures should integrate energy and environmental policy to maximize energy sector and emission reduction investments. Further, the Council believes that use of market-based design elements for implementation of the WCI cap-and-trade program should place existing clean energy technologies at the center of compliance strategies. This will reduce compliance costs, mitigate fuel price increases and achieve the complementary objective of enhanced energy security. Further, design of specific elements and economic relief mechanisms will have a significant impact on market signals and need to

be evaluated in a holistic rather than an isolated manner. The Council generally does not support hard caps on the value of allowances that can dilute the market and deployment signals.

More specifically, the Council supports the use of market-based design elements for the WCI greenhouse gas program that:

- 1) **Expand alternative energy resources from clean energy technologies** including wind, solar, hydropower, biomass, geothermal, fuel cells, advanced battery systems, and natural gas.
- 2) **Expand the development and use of energy efficiency and natural gas technologies**, including the direct use of natural gas, on-site generation from combined heat and power, and energy efficiency for demand reduction.
- 3) **Recognize improvements in energy efficiency**. The WCI cap-and-trade program should reward energy efficiency in existing and replacement energy infrastructure to fully maximize market-driven incentives for energy and environmental improvements.
- 4) **Incorporate compliance flexibility**. Design measures should include a cap-and-trade as well as a project-based approach that efficiently achieve both energy and climate objectives. These types of approaches provide long-term signals to the economy and also offer compliance flexibility.
- 5) **Establish near-term and long-term targets** that are consistent with investment cycles to signal the marketplace and drive technology investment and innovation.
- 6) **Promote compatibility with voluntary renewable energy, energy efficiency, and greenhouse gas markets** so non-capped businesses and households can continue to support markets that result in actions that are above and beyond mandatory obligations.
- 7) **Establish linkages with state and international programs**. WCI should establish linkages with other state and international greenhouse gas initiatives at the outset of the program. These linkages should demonstrate comparability, and should be verifiable and transparent. The program should be designed to permit trading with compatible cap-and-trade programs and project-based initiatives elsewhere in the U.S. at the state, regional or federal level, as well as in other parts of the world.

These recommendations are consistent with the Council's work with the California Market Advisory Committee (MAC) for implementation of CA Assembly Bill 32 (AB 32) and the Council's work with Northeast and Mid-Atlantic states under the Regional Greenhouse Gas Initiative (RGGI).

The following comments address recommendations on specific program design questions contained in the WCI work plan.

Program Scope and Timing

Cover all sectors: In designing the scope of WCI's cap-and-trade program, the Council recommends that the Partners consider the need for a successful market that is broad and comprehensive enough to be effective at finding the least cost reductions. In general, the Council recommends that the WCI cap-and-trade program should be implemented economy-wide to ensure the most comprehensive approach to reducing greenhouse gas emissions from all sectors; however, the timing and method of the coverage need not be uniform across sectors. Consideration must be given to the sector's contribution to greenhouse gas inventory and its contribution in helping the region reduce such emissions.

Further, some sectors might pose difficulties in terms of administration and expenses associated with governing them. In this situation, in lieu of coverage, WCI Partners should consider allowing for a robust offset system that would provide coverage where sectoral coverage is either infeasible or impractical.

The natural gas sector should be handled in several different ways, depending on the nature of the usage. Greenhouse gas associated with natural gas fired electric generation will be subject to the cap-and-trade program and rules relating to electric generation, as discussed elsewhere in these comments. Greenhouse gas generated by large industrial users burning natural gas would also participate in the same cap-and-trade program. However, it is not practical to subject small natural gas users, including residential customers, to a cap-and-trade program. The better way, and an approach that has already been very successful in California, is to achieve greenhouse gas reductions through programmatic approaches such as energy efficiency and mandated building and appliance standards.

First-seller approach: The Council is exploring the concept of the “first-seller approach” under consideration by WCI Partners and recommended by the MAC for AB 32 implementation, and is interested in receiving further analysis on this approach. In particular, we believe stakeholders would benefit from additional discussion to further define the first-seller category (e.g., would this approach cover utilities, power marketers, ISOs, others?), as well as what WCI would consider to be the objectives of a first-seller approach applied at the regional level. The Council recommends that in selecting an approach, that WCI Partners pursue a model that will put it in the strongest position to serve as a regional/national model for other cap-and-trade programs and to link easily with an international system.

Cover all six greenhouse gases: The Council recommends that all six greenhouse gases – carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride – should be covered under the WCI greenhouse gas program. However, the program should recognize that all six gases are different and do not need to be covered in the same manner. As noted by the 2005 Energy Information Administration report, CO₂ from combustion accounts for almost 81 percent of total U.S. greenhouse gas emissions.¹

Setting Cap Level(s), Scheduling Reductions & Distributing Allowances

Consider market-based design elements holistically: The Council’s primary recommendation to lower the costs of the WCI cap-and-trade program (as well as other state programs or a future federal program) is to design implementation measures in a manner that deploy clean energy technologies. As previously stated, the Council believes that looking at individual features of the WCI cap-and-trade program in isolation does not effectively demonstrate overall program impacts on a broader scale. Design of market-based elements – such as specific caps, timetables, safety valves and other economic relief mechanisms – will have a significant impact on market signals and must be developed and evaluated in a holistic manner, as well as in terms of their relation to, and interactions with, other existing state, regional and federal energy programs.

Allocation: The WCI cap-and-trade program should base allocation methods on performance to provide value to energy efficiency, renewables and cleaner generation. The Council strongly supports an output-based methodology that would distribute allowances based on the amount of electricity generated, not on the amount of fuel used or historic emissions. With this focus on output over emissions, energy efficiency, carbon efficiency and cleaner generation sources – including renewable energy – are directly encouraged. The Council recommends a fuel-neutral, updating, output-based allocation. Output-based policies send a clear signal to the marketplace – lower-carbon emitting energy options receive direct, clear, consistent and bankable value.

¹ See EIA’s *Emissions of Greenhouse Gases in the United States 2005* - Executive Summary at: http://www.eia.doe.gov/oiaf/1605/ggrpt/executive_summary.html

The Council further recommends set-aside allowance pools for: 1) small and clean generators; 2) energy efficiency projects; and 3) new entrants, as a means to allocate allowances directly to clean generation and energy efficiency that would otherwise not be included under the primary source allocation. In the RGGI context, the Council has encouraged set-aside pools for small, clean generation (under 25MW). Further, the Council supports the use of set-aside programs to allow for competition and ensure a level playing field for new entrants. New entrants in the marketplace should be eligible to receive allowances so they are not put in a position of competitive disadvantage.²

Auction: The Council supports a direct allocation of allowances on an output basis; however, should WCI Partners consider an auction, we recommend the use of a mixed allowance/auction approach with a phase-in period for the auction to minimize possible dramatic economic impacts that a large-scale auction might have on affected sources in the initial phases of the program. Further, should an auction be pursued, the Council strongly recommends the targeted use of auction revenue to reduce program costs by driving clean energy technology investment and deployment. For example, New York has decided to dedicate 100 percent of auction revenue under its RGGI program to investment in energy efficiency and renewable energy, and the Council strongly supports New York's action as a model for WCI and other states that are considering auctions. Further, this approach is consistent with the MAC's recommendation that California use a portion of the allowance value created under a cap-and-trade program to promote investment in low-greenhouse gas technologies and fuels, including energy efficiency.³

Proposed auction revenue guidelines: Should WCI pursue an auction, Council members believe that any auction revenue should be directed toward expanding renewable energy generation and energy efficiency. This is why criteria for the use of auction revenue under the WCI cap-and-trade program are of great importance. The Council believes that auction revenue should:

1. Reduce the carbon intensity of electric generation
2. Reduce energy demand
3. Provide benefit to the western region's economy
4. Promote private investment through partial funding of investments
5. Enhance complementary energy program benefits
6. Help establish new energy programs
7. Increase the market potential of new technologies

Recognition for Early Action: The Council strongly recommends that the WCI cap-and-trade program should be designed to promote early action, recognizing early investments in greenhouse gas reductions (consistent with the recommendations of the MAC for AB 32 implementation measures). Rewarding emission reductions that occur in advance of the enactment of the program has the potential to generate economic and environmental benefits, as well as hasten clean energy technology deployment. The Council encourages WCI to adopt simple and transparent early action program credits to ensure robust participation by interested companies. Further, the Council urges the WCI Partners to consider an early action program that may include offsets from other regulatory offset schemes and/or high-quality voluntary schemes.⁴

² For example, the federal set-aside program under the Clean Air Planning Act introduced by Senator Thomas Carper (D-Delaware) was included to avoid the situation where a generator of new, clean and efficient energy would have to purchase allowances from an existing competitor.

³ *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California*, Recommendations of the Market Advisory Committee to the California Air Resources Board, June 30, 2007, p. 60.

⁴ Early action programs such as those supported by state public utility commissions and other regulatory agencies (i.e., The Climate Trust in Oregon).

Offsets: The Council supports the use of offsets in the WCI cap-and-trade program to provide compliance flexibility, lower compliance costs and encourage technology innovation and deployment.⁵ The creation of an offset program will have a secondary benefit by creating a standardized currency for voluntary greenhouse gas credit trading. Non-capped sectors will have the opportunity to participate in creating additional reductions beyond levels set by the WCI Partners.

The Council offers the following recommendations for consideration with respect to the design of the WCI offset program:

- Emissions offsets must be real, additional, permanent, independently verifiable, enforceable, measurable, and transparent
- Promote broad sector and activity eligibility for offsets
- Permit broad use of emissions offsets
- Reward early action to reduce greenhouse gas emissions
- Promote linkages with other domestic and international offset programs, and permit fungible use of eligible offsets generated from within such programs
- Utilize a standards-based approach for offset projects while allowing for case-by-case review of projects without pre-approved methodologies
- Employ multiple tests for demonstration of offset “additionality”
- Utilize standardized emission factors

The offset program will need to be carefully designed to maintain integrity and ensure that offsets are real, additional, permanent, independently verifiable, enforceable, measurable and transparent. However, in developing standards for additionality, the Council wishes to caution against the use of pure financial additionality tests in determining offset project eligibility. Financial additionality can be part of a range of factors, but it should not be the only way of proving additionality, nor should it be weighted more than other additionality tests. In our experience, financial additionality tests alone deter good projects and weaken the credibility and market power of offset programs. Further, financial additionality tests are subject to gaming and cannot reasonably account for market behavior. Instead, we recommend practical application of a number of “barriers tests,” as is recommended by the World Resource Institute’s Greenhouse Gas Protocol for Project Accounting.⁶

The Council supports using a standards-based offsets program in lieu of a case-by-case review of individual offsets projects, which has caused issues with efficiency and consistency in the case law approach used by the Clean Development Mechanism.

Further, the Council recommends that offset program categories should be able to evolve over time, consistent with other cap-and-trade offset programs.

Lastly, the Council recommends that geographic or quantitative restraints should not be placed on offset projects as part of the WCI cap-and-trade program.

⁵ Please see the attached paper for a more thorough discussion of the Council’s position on offsets: *Recommendations for a Federal Greenhouse Gas Offset Program*, BCSE, September 2007, also available at:

http://www.bcse.org/publications/press_releases/BCSE_Offset_Principles_final_9_5_07.pdf.

⁶ See the WRI Greenhouse Gas Protocol for Project Accounting at:

http://www.ghgprotocol.org/DocRoot/m1Tv5lnUuFTjYZx3x1ev/GHG_Project_Protocol.pdf

Miscellaneous Issues

Linkages: The Council recommends designing the WCI cap-and-trade program to link with other compatible regional, national and international cap-and-trade programs to ensure lowest-cost compliance and increase global market liquidity. The Council supports strong linkages between the WCI program and the European Union Emissions Trading System and the Regional Greenhouse Gas Initiative, provided such linkages are based on comparable environmental commodities, and based on allowance transactions that are transparent and verifiable.

Treatment of Voluntary Markets: Depending on how the WCI cap-and-trade program is designed, it will have a significant impact on the vibrancy of voluntary markets for renewable energy. The Council strongly encourages WCI Partners to design a cap-and-trade system that allows consumers and businesses to continue to support these markets, resulting in emissions reductions that are above and beyond mandatory obligations.⁷

Conclusion

Thank you for the opportunity to provide comment on the Western Climate Initiative cap-and-trade design questions posed in the WCI work plan.

If you have any questions or comments please feel free to contact me at (202) 785-0507 or via email at ljacobson@bcse.org.

Sincerely,



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CC: Patrick Cummins, WCI

⁷ For a thorough discussion of implications of the design of the WCI cap-and-trade program on voluntary markets, please see comments provided to WCI Partners by the Renewable Energy Marketing Association.