DRA

Division of Ratepayer Advocates
California Public Utilities Commission

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July 13, 2010

Mr. Kevin Kennedy
Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA, 95814 -2828

Re: Division of Ratepayer Advocates' Comments on the ARB Workshop on Cost Containment and Offsets in a Cap-and-Trade Program

Dear Mr. Kennedy:

The Division of Ratepayer Advocates (DRA) appreciates this opportunity to submit comments to the Air Resources Board (ARB) regarding the June 22nd ARB workshop on cost containment in a greenhouse gas (GHG) cap-and-trade program. DRA is an independent division of the California Public Utilities Commission (CPUC) created by Section 309.5 of the Public Utilities Code. DRA's mission is to obtain the lowest possible consumer rates for utility services consistent with safe and reliable service.

The following is a summary of DRA's recommendations on cost containment mechanisms and offsets in an ARB cap-and-trade program:

1. **Strategic Reserve:** DRA supports cost containment as a key policy objective within green house gas (GHG) cap-and-trade compliance programs. DRA supports a Strategic Reserve that makes allowances available to the market if and when allowances reach a "trigger" price, which is pegged to a predetermined level above the regional Marginal Abatement Cost (MAC) curve. DRA's preference is to utilize a window sales approach to access the Strategic Reserve. DRA believes that the Strategic Reserve should be filled by allowances drawn from within the years of the program. The allowances for the Strategic Reserve should be allocated from the current and future annual budgets, and should be replenished annually with the same number of allowances that was released from the reserve in the previous year.

2. **Offsets:** DRA believes that the Strategic Reserve and offsets should work together as cost containment mechanisms. DRA recommends that CARB replace any allowances allocated to the Strategic Reserve with additional offsets above the quantitative usage limit of four percent. This as an important backfill methodology to fill the Strategic

Reserve by increasing the supply of instruments from outside of the program in the event that cascading borrowing results in a shortage of allowances. In order to quell the concerns about offset supply, DRA recommends that ARB prioritize the evaluation of additional protocols and external programs to link to, in accordance with ARB's criteria for offset quality requirements: real, additional, quantifiable, permanent, verifiable, and enforceable. Further, DRA believes that a cap-and-trade compliance program must include a mechanism to protect the market if cost containment measures and the Strategic Reserve fail to prevent excessive increases in the price of allowances. Therefore, DRA recommends that regulators be delegated the authority to suspend the program if allowance prices remain unacceptably high.

3. **Effective Market Oversight:** DRA supports effective market oversight as a necessary component of cap-and-trade. Market oversight is essential for successful enforcement of the cap-and-trade auction rules, monitoring the emissions market, and monitoring market prices to determine if the trigger price is reached and if the Strategic Reserve is working. DRA recommends that ARB work to establish a market oversight advisory board to perform ongoing review of the cap and trade program. DRA further recommends that the board be given the authority to suspend the program or recommend that the Governor suspend the program if allowance prices remain unacceptably high.

4. **Consumer Protection Measures:** DRA supports the use of program revenues to protect consumers. DRA is encouraged by the consumer protection measures in Kerry-Lieberman's proposal at the federal level, the American Power Act (APA), and urges ARB to consider similar mechanisms to return revenues to consumers.

The following provides a more in-depth discussion of DRA's recommendations:

Strategic Reserve

DRA supports a Strategic Reserve as an important cost containment mechanism within a GHG cap-and-trade program. The Strategic Reserve should make allowances available to the market if and when allowances reach a predetermined "trigger" price. DRA has not analyzed the correct trigger price, but recognizes that it is very important to set the trigger price pegged to a predetermined level above the expected cost of abatement. This would diminish the effect of short-term fluctuations in allowance prices, but would not impact the long-term price signal. DRA recommends that ARB consider the regional MAC curve provided in the most recent Western Climate Initiative (WCI) report, "Updated Economic Analysis of the WCI Regional Cap-and-Trade Program," as well as the ARB economic modeling and any additional California-specific MAC analyses available. Complementary policies, such as energy efficiency and clean car standards, have the potential to reduce emissions significantly and to contain costs within a cap-and-trade program, and are a necessary inclusion in the modeling and analysis. DRA also recommends that ARB have the authority to change the trigger price at the end of each compliance program, based on the most current information and analysis.

DRA's preference is to utilize a window sales approach to access the Strategic Reserve, because the price is guaranteed using this methodology. DRA also believes that as a cost containment mechanism, the Strategic Reserve should only be available to compliance entities, and allowances purchased through the Strategic Reserve should not be able to be resold.

DRA believes that the Strategic Reserve should be filled by allowances drawn from within the years of the program. The allowances should be allocated from the current and future annual budgets, beginning with any allowances unsold when an auction resolves at the Reserve Price. Allowances should be replenished annually with the same number of allowances that were released from the reserve in the previous year. Borrowing from future compliance periods can address situations with short-term price fluctuations, while retaining the emissions cap. DRA recognizes the potential for cascading borrowing in the event of repeated situations that require borrowing, and therefore supports a backfill methodology to increase the supply of instruments from outside of the program. DRA recommends that additional offsets above the quantitative usage limit of four percent replace any allowances allocated to the reserve.

Offsets

DRA believes that the Strategic Reserve and offsets should work together as cost containment mechanisms. If the Strategic Reserve is depleted, this represents an undesirable situation where allowance prices are unacceptably high, and the allowances initially allocated to the Strategic Reserve are not able to contain costs within acceptable levels. The next step is to replenish the Strategic Reserve with allowances borrowed from future annual budgets until costs are contained or a predetermined borrowing limit based on robust analysis is reached. This presents the potential for a situation of cascading borrowing, in which allowances borrowed from future annual budgets will not be available to compliance entities in those future years, thereby creating a shortage of allowances and high market prices. DRA believes that the best way to address this issue is by relaxing the quantitative usage limit of offsets, which ARB currently has set to four percent of an entities' compliance obligation. The quantitative usage limit should be increased to allow compliance entities to use enough offsets to replace any allowances that have been allocated to the Strategic Reserve. DRA recognizes this as an important backfill methodology to increase the supply of instruments from outside of the program in the case of allowance shortages caused by cascading borrowing to fill the Strategic Reserve. Using this methodology, the annual cap is maintained based on allowances not in the reserve plus the additional offsets that are allowed.

The Kerry-Lieberman GHG compliance program proposal at the federal level, and the current program in the European Union (EU), allow for much higher limits on offsets (approximately 43 of capped emissions at the US federal level and an average of 14 percent in EU countries) as a mechanism to contain costs. DRA recommends that ARB consider relaxing their offset limit if needed as a cost containment mechanism.

DRA is aware of the market concern that there will not be enough offsets available to meet the demand of an increased quantitative limit. If this is the case, DRA recommends that ARB expand the list of eligible offset protocols. DRA supports ARB's criteria for offset quality requirements: real, additional, quantifiable, permanent, verifiable, and enforceable. DRA believes that this set of criteria will ensure that the use of offsets would not impair the integrity of the program. Hence, DRA recommends that ARB prioritize the evaluation of additional protocols and external programs to link to, such as the Climate Action Reserve (CAR) and specific Clean Development Mechanism (CDM) project types. This will assure that the necessary offset supply is available to compliance entities if it is needed. As long as the offsets meet all of ARB's criteria for quality, they will amount to emission reductions on the global level, which is the ultimate goal of all GHG cap-and-trade compliance programs.

Effective Market Oversight

DRA supports effective market oversight as a necessary component of cap-and-trade. Market oversight is essential for successful enforcement of the cap-and-trade auction rules, monitoring the emissions market, monitoring market prices to determine if the trigger price is reached and assessing if the Strategic Reserve is working as intended. DRA is encouraged by the market oversight rules in Kerry-Lieberman's proposed APA, and the role of the Commodity Futures Trading Commission (CFTC) in regulating that market.

California ratepayers suffered enormous losses during the energy crisis, and ARB should ensure that the creation of a brand new market for CO_2 does not produce similar unintended consequences. DRA recommends that ARB establish the proper mechanisms and authority to prevent and respond quickly to potential market failures. This should include a market oversight advisory board with the authority to suspend, or, in the alternative, recommend that the Governor suspend the program if allowance prices remain unacceptably high.

Consumer Protection Measures

DRA supports the use of cap-and-trade program revenues to protect consumers. DRA is encouraged by the consumer protection measures in Kerry-Lieberman's proposal at the federal level, the American Power Act (APA), and urges ARB to consider similar mechanisms to return revenues to consumers.

In the early years of the APA program, around 60 percent of carbon permit value is returned to consumers. This is done through free allocation to local utilities, which are required to pass along the financial benefits to their ratepayers on a per-capita basis. Starting in 2026, a Special Reserve Fund comes online, where a growing share of permits are auctioned with the revenue directed to the fund, and then returned directly to households. By 2035, nearly 78% of all permits will be auctioned with the money set aside for per capita dividends to households. DRA is encouraged by the inclusion of this consumer protection measure in the bill, and urges ARB to consider similar mechanisms to return revenues to consumers.

Thank you for this opportunity to comment on the cost containment workshop and we look forward to providing ARB staff with more comments on program aspects in the coming months. For any questions regarding these comments, please contact Jordan Parrillo at Jordan.Parrillo@cpuc.ca.gov or (415) 703-1562.

Best Regards,

/s/

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