



August 13, 2008

The Climate Trust Comments to the Western Climate Initiative on the Draft Design of the Cap-and-Trade Program

Introduction

Thank you for providing The Climate Trust with the opportunity to submit comments to the Western Climate Initiative (WCI) regarding the Draft Design of the Cap-and-Trade Program.

The Climate Trust is a non-profit organization with the mission of promoting climate change solutions by providing high-quality greenhouse gas offset projects and advancing sound offset policy. The Climate Trust was established under the United States' first regulation of greenhouse gases, the Oregon Carbon Dioxide Standard. The Climate Trust solicits, negotiates, and contracts to purchase offsets on behalf of its funders, including regulated power plants, businesses and individuals. Since its founding in 1997, The Climate Trust has directed \$8.8 million in funding into 16 greenhouse gas offset projects that are expected to offset close to 2.6 million metric tons of carbon dioxide.

We commend the member states and provinces for their pioneering lead in the establishment of regional greenhouse gas emission reduction goals and a cap-and-trade program. Cap-and-Trade is an important policy tool for mitigating climate change, but it is only one of many policy mechanisms that will be needed to meet the scientifically-derived emission reductions that must be achieved. Examples of these additional policy mechanisms include building and appliance standards, renewable portfolio standards and feed-in tariffs, system benefit charges and decoupling. These multiple policies must be individually well-designed and integrated so that they complement one another and work in concert to achieve emission reduction targets in the most equitable and efficient manner.

Overview and Summary

These comments address the role of greenhouse gas offsets in the WCI cap-and-trade system as set forth in the Draft Design of the Cap-and-Trade Program. Specifically they address:

1. Quantitative limits (Section 9.2)

The Climate Trust is supportive of the ten percent limit of a regulated entity's compliance obligation to be met through the purchase and retirement of high quality offsets.

2. Eligible project types (Section 9.3)

The Climate Trust suggests significantly expanding the list of eligible project types, and highly recommends the development of a separate emission reduction project type eligibility list for emission reduction projects located in Mexico.

3. Geographic restrictions on offset eligibility (Sections 9.5, 9.9, 9.9.1, 9.9.2)

The Climate Trust strongly discourages the imposition of limits based on the geographic location of an offset project.

4. The role of CDM, JI, and other international offsets (Section 9.7)

The Climate Trust strongly encourages the inclusion of offsets sourced from international programs, particularly those from the CDM and JI programs, as well as international credits sourced outside of the CDM and JI that meet the quality criteria and standards established by the WCI system. The Climate Trust also discourages the imposition of additional regulatory requirements for projects sourced from these programs that have been approved to issue Certified Emission Reductions (CERs) or Emission Reduction Units (ERUs) by CDM and JI's governing bodies.

5. Treatment of existing state-established GHG regulatory programs

The WCI should provide guidance and flexibility to allow individual states to accommodate the reductions from previously existing GHG reduction regulatory programs, such as the Oregon and Washington Carbon Dioxide Standards for new power plants within the WCI cap-and-trade system.

6. The establishment of an Offset Advisory Committee for the WCI system

The Climate Trust strongly encourages the WCI to establish an offset advisory committee that would serve as a resource for the WCI as it develops the design of the regional offset system, and would provide a set of recommendations addressing a number of key outstanding issues. The Climate Trust has submitted under separate cover a complete proposal regarding the establishment of such a group.

1. Quantitative Limits (Section 9.2)

There are a number of considerations that must be weighed when establishing quantitative limits on the use of offsets to meet emission reduction compliance obligation requirements under the WCI system. Imposition of a quantitative limit that is too stringent could unnecessarily increase the costs of achieving emission reduction targets, potentially weakening support for emission reduction requirements and resulting in unintended political consequences. For example, if the costs of compliance with the emission reduction targets are too great, the entire program could lose support and face widespread public opposition. On the other hand, if the limit on the use of offsets is set too high, few emission reductions could be achieved in the capped sectors, resulting in lost faith in the efficacy of a cap-and-trade system to drive emission reductions in sectors covered by the program, despite global emissions being reduced.

Emission reduction regimes should be designed to ensure that technology transformation and adaptation is occurring in the capped sectors, as these are often the largest sources of emissions in a given system. Ideally, cap-and-trade policy will be designed to ensure that emission reduction opportunities at reasonable costs in the capped sectors are incentivized, while also ensuring access to lower-cost emission reduction opportunities in uncapped sectors through a robust offset program.

The Regional Greenhouse Gas Initiative (RGGI) set its quantitative limit on offsets to allow approximately 50% of a regulated entity's reductions to come from offset purchase and retirement, and 50% to come from allowance purchase and retirement. Functionally this resulted in RGGI placing a 3.3% limit overall on the use of offsets to meet emission reduction obligations. Preliminary analysis shows that a 10% limit will result in an average of approximately 40% of emission reductions resulting from offset purchase and retirement over the three compliance periods, with coverage being greater in the early years of the program and declining over time as reduction targets grow larger. This assumes that companies fully maximize their offset compliance option, and sufficient supply exists to meet demand (neither of which is a foregone conclusion at this point).

The Climate Trust is supportive of the ten percent limit of a regulated entity's compliance obligation to be met through the purchase and retirement of high quality offsets and does not recommend the establishment of a lower percentage, unless it is shown that an average of greater than 50% of the emission reductions will be allowed from offset purchase and retirement over all three compliance periods.¹

2. Eligible Project Types (Section 9.3)

The Climate Trust commends the WCI partners on the establishment of an initial priority list for possible offset project types for inclusion in the WCI offset system. However, the inclusion of a significantly expanded list of eligible project types is strongly recommended for a number of reasons. Most importantly, the supply and cost of available offsets at the start of the program will be largely dictated by the types and location of eligible offset project types available for use in the WCI system. If strict geographic and project type eligibility restrictions are imposed, there is a high likelihood that an insufficient supply of offset credits will be available for use in the WCI system, and that that supply will be significantly more expensive than it would be if there were broader offset project type eligibility standards.

One of the primary advantages of including offsets in a greenhouse gas reduction regime is the ability to capitalize on lower cost emission reductions in a broad array of sectors outside of the cap. If there is a very limited number of eligible offset project types (such as those identified in the draft design), that benefit will not be fully realized.

In general, The Climate Trust recommends direct emission reduction projects as ideal for inclusion in regulatory offset programs. Direct emission reduction projects are defined as projects where the emission reductions occur at the site of the offset project. This includes projects from the transportation sector, such as truck stop electrification projects, among others. Allowing offset projects from sectors that will be subject to a cap in later years of the program could help spur early downstream reductions and make the transition to a cap less costly over the long run, or allow for the establishment of greater

¹ If the limit is set at 10% it is likely that close to, or even over, 100% of a regulated entity's compliance obligation in the first compliance period could be met through the use of offsets because the cap is intended to be set at the projected emissions for that period. The Climate Trust believes that this is an acceptable outcome because regulated entities should be eligible to bank the lower cost offset credits for use in future compliance periods, and therefore reduce the overall cost of the program in later years when emission reduction requirements are greater and companies have fewer low cost reduction opportunities available to them as the cap is gradually decreased over time.

emission reduction targets and more stringent caps when those sectors come under the cap.

Additionally, the diverse geo-political contexts of a member jurisdiction should be taken into account when establishing the list of eligible project types for use in the WCI system. The establishment of a more limited list of eligible project types for jurisdictions located in the U.S. and Canada, where most sectors will be covered by some form of an emission cap or regulation, is probably appropriate. However, The Climate Trust strongly encourages a separate program for projects located in Mexico, and other developing countries, where binding emissions caps are unlikely to be implemented during the life of the WCI program.

An expanded list of emission reduction project types sourced from projects located in Mexico should be eligible to generate and sell offset credits into the WCI system. Because offsets are intended to cause emission reductions in uncapped sectors and because it is highly unlikely that there will be caps on emissions in any sector of the Mexican economy, limiting projects types in Mexico unfairly limits the additional emission reduction opportunities that exist there. This will result in significant missed opportunity to access the large number of lower-cost emission reduction opportunities available in its quickly developing economy, and provide important technology, knowledge and sustainable development practices transfer between the U.S, Canada and Mexico.

3. Geographic Limits (Sections 9.5, 9.9, 9.9.1, 9.9.2)

The Climate Trust supports allowing offset project types from throughout North America as recommended in section 9.5. However, The Climate Trust strongly discourages the use of any geographic limits on offset project eligibility. While there are compelling arguments to be made for imposing quantitative limits on offset use, limiting offset eligibility by geographic source runs contrary to the fundamental ideal of developing global solutions to a global problem. Imposing quantitative limits can severely impact the cost and supply of offset credits available for use. If WCI imposes very strict geographic limits coupled with a very limited number of eligible offset project types and stringent quantitative restrictions, there is a high likelihood that there will be insufficient supply to meet demand in the program, thereby driving up the overall cost of the program and potentially weakening its political support and viability in both the short and long terms.

At a minimum, The Climate Trust believes that there should be no geographic limit imposed on offsets sourced from North America for use in the WCI system. Based on The Climate Trust's experience with the Regional Greenhouse Gas Initiative program, it is unlikely that sufficient projects will be located in WCI member jurisdictions to meet demand for offset credits, particularly because much of the economy in the member jurisdictions will fall under an emissions cap as the program is currently proposed. We believe that by only allowing offset projects from within the member states, or even within North America, WCI will miss out on the true advantage of a cap-and-trade system: the ability to achieve quality emissions reductions from the lowest-cost options from around the globe.

4. Clean Development Mechanism and Joint Implementation Credits (Section 9.7)

The Climate Trust strongly encourages the inclusion of offsets sourced from international programs, particularly those from the CDM and JI programs, as well as international credits sourced outside of the CDM and JI that meet the quality criteria and standards established by the WCI system. The Climate Trust also discourages the imposition of additional regulatory requirements for projects sourced from these programs that have been approved to issue Certified Emission Reductions (CERs) or Emission Reduction Units (ERUs) by the CDM and JI governing bodies.

Adding additional layers of bureaucracy, cost and time to an already bureaucratic, costly and time-intensive program will not contribute to a strong and fungible global offset market. Moreover, requiring that credits sourced from CDM or JI meet additional criteria does not facilitate market linkage nor cost effectiveness in these systems. Tremendous time, resources and funding have been invested in the existing approval mechanisms under the CDM program, and these processes continue to be refined and improved over time. Emerging regulatory programs should build on and strengthen the extensive resources and experience offered by the CDM program, not undermine it through the addition of unnecessary and costly layers of bureaucracy.

5. Treatment of existing state-established GHG regulatory programs

At least two member jurisdictions of the WCI, the States of Oregon and Washington, have greenhouse gas control legislation in effect that predates the WCI by a number of years, enacted in 1997 and 2004, respectively. Both the Oregon Carbon Dioxide Standard (OAR Chapter 345, Division 24) and the Washington Carbon Dioxide Mitigation Program for Fossil Fueled Thermal Electric Generating Facilities (WAC Chapter 173-407 and RCW Chapter 80.70) require that new power plants built in each respective state mitigate a portion of their carbon dioxide emissions.²

The Oregon Carbon Dioxide rules are administered by the Oregon Energy Facility Siting Council (EFSC) and set carbon dioxide (“CO₂”) emissions standards for new energy facilities. The Washington Carbon Dioxide Standard is administered and implemented by the Washington Energy Facility Site Evaluation Council (EFSEC), and imposes similar requirements on new generating facilities built in the state to those of the Oregon law.

The Climate Trust has been an independent, qualified non-profit organization recognized under both laws, and to date has been the sole recipient of offset funds under the Oregon program. Since its founding in 1997, The Climate Trust has directed \$8.8 million in funding into 16 greenhouse gas offset projects that are expected to offset close to 2.6 million metric tons of carbon dioxide over their lifetimes.

The WCI should allow individual states to accommodate reductions achieved or expected within the WCI cap-and-trade system. This has important economic implications for entities currently regulated under both of these laws, who have invested significant funding towards offset projects over the past several years. Any guidance and recommendations WCI can provide to member jurisdictions regarding how best to

² The standards apply to base-load gas plants, non-base load power plants, and non-generating energy facilities that emit CO₂. EFSC originally adopted these rules pursuant to HB 3283, which the Oregon Legislature passed in 1997. EFSC has subsequently updated the rules, most recently in May 2007. The rules can be found in Oregon Administrative Rules, Chapter 345, Division 24. Definitions are in Division One.

integrate these reductions would be welcome. The Climate Trust will be working with our funders and state representatives over the coming months to address the issue of existing state GHG regulatory requirements and develop a set of recommendations regarding these programs' treatment under the WCI regional framework.

6. Establishment of a WCI Offset Advisory Committee

In order to develop a coordinated regional greenhouse gas offset system, The Climate Trust recommends that the WCI establish an Offset Advisory Committee. This Committee could be comprised of a diverse cross sector of participants in the greenhouse gas reduction field and could provide recommendations regarding a range of technical issues necessary for the establishment of a robust, rigorous and efficient WCI offset system. The Climate Trust has submitted a formal proposal under separate cover that provides a more detailed explanation of the role the Offset Advisory Committee could play.

Capitalizing on the extensive experience and knowledge of the existing GHG offset field will assist the WCI in developing a robust, comprehensive and adaptable compliance offset system. The Climate Trust stands ready to contribute our experience and assistance to the formation and coordination of an expert advisory committee should WCI choose to implement one.

For more information please contact:

Alexia Kelly, Policy Program Manager, The Climate Trust, at akelly@climatetrust.org