BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emission Standards Into Procurement Policies.	Rulemaking 06-04-009 (Filed April 13, 2006)

RESPONSE OF THE CLIMATE TRUST TO THE ADMINISTRATIVE LAW JUDGE'S RULING REQUESTING COMMENTS ON FLEXIBLE COMPLIANCE POLICIES

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I. Introduction and Summary

The Climate Trust respectfully submits these comments, in accordance with Rules 14.3, 1.9, and 1.10 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure, on the Administrative Law Judges' Ruling Requesting Comments on Flexible Compliance Policies. We also concurrently submit these comments to the California Energy Commission (CEC) in Docket 07-OIIP-01, the CEC's sister proceeding to this CPUC proceeding.

Thank you for providing The Climate Trust with the opportunity to submit comments to the California Public Utilities Commission (CPUC). We commend California for its pioneering lead in the establishment of greenhouse gas emission reduction goals and policies.

The Climate Trust is a non-profit organization whose mission is to promote climate change solutions by providing high-quality greenhouse gas offset projects and advancing sound offset policy. The Climate Trust was established in response to the United States' first regulation of greenhouse gases under 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 nearly 2.6 million metric tons of carbon dioxide over their lifetimes.

These comments include the following key points:

- **The Climate Trust supports the use of offsets for compliance under AB 32.** The Climate Trust supports the use of a robust and rigorous GHG offset program for AB 32 compliance purposes. Greenhouse gas offsets can be an efficient way to achieve large scale greenhouse gas emission reductions and transition toward a low-carbon economy.

- **California should harmonize its state offset program with that developed through the Western Climate Initiative as much as possible.** It is The Climate Trust's firm belief that a regional GHG offset program will be far more effective and efficient than a patchwork of individual state-run programs. Because California is a member of the Western Climate Initiative (WCI), The Climate Trust strongly encourages the California Public Utilities Commission (CPUC) and the California Air Resources Board (ARB) to harmonize California's offset program (if one is established) under AB 32 with that established through the regional consensus stakeholder process of the WCI.

- **The Climate Trust strongly discourages limiting the eligibility of offset projects by geographic source.** Greenhouse gases are global pollutants, thus, the location of an emissions reduction is immaterial to its impact on atmospheric concentrations of greenhouse gases. While we recognize that there are important positive environmental and economic externalities associated with the implementation of offset projects within California, we believe that there are compelling geo-political and economic reasons for allowing offsets from a broad geographic scope.

- **The Climate Trust supports the use of GHG offset credits generated under the auspices of credible and rigorous voluntary market approval and certification regimes.** Examples include: The Climate Trust, the Voluntary Carbon Standard, The California Climate Action Registry, Environmental Resources Trust and the Gold Standard.

- **The Climate Trust believes that if quantitative limits are introduced they should be based on comprehensive economic data that will provide information regarding the correct mix of reductions that must be achieved through allowance retirement and offset purchase and retirement.** Arbitrary numerical limits should not be imposed in the absence of further analysis, and have the potential to drive up compliance costs.

- **The Climate Trust believes that it will be particularly important to have an independent, centralized body to administer an ongoing offset program.** The Climate Trust supports the establishment of a regional offset program administrator as part of the WCI process to assist in administering California's compliance offset program under AB 32.

- **The Climate Trust supports the development of cost-effective, robust, and flexible offset project assessment tools that provide a rigorous and transparent framework for the evaluation of GHG offset projects**. The Climate Trust recommends a hybrid approach to developing regulations for the assessment of GHG offset project additionality, baseline establishment and quantification.

- **The Climate Trust supports the use of offsets (and other tradable units, such as allowances) from other government regulated greenhouse gas emissions trading schemes.** However, it is important to ensure that linked emission reduction systems reduction goals and emissions caps are coordinated to ensure that trading between systems does not weaken the environmental integrity of the system nor compromise the achievement of emission reduction targets.

II. The Climate Trust response to questions 21-25

21. Should California allow offsets for AB 32 compliance purposes?

The Climate Trust supports the use of a robust and rigorous GHG offset program for AB 32 compliance purposes. Greenhouse gas offsets can be an efficient way to achieve large scale greenhouse gas emission reductions and transition toward a low-carbon economy. Including offsets as a compliance option for the electricity and natural gas sectors bring several important advantages:

- Regulated entities in the electricity and natural gas sectors in California have relatively limited and costly options for reducing their GHG emissions significantly in the near term. California's stringent air pollution control and efficiency measures have already instigated many of the lowest cost reduction and efficiency options available. Moreover, many power generators in California have made significant capital investments in infrastructure and technology that is not near the end of its productive life. Incorporating high quality GHG offsets into AB 32 compliance strategies can allow regulated entities to meet their emission reduction targets at a lower cost in the near term, without necessitating the retirement of high cost infrastructure prematurely.
- For sectors that have even fewer GHG mitigation options available, such as the natural gas sector, GHG offsets can allow these sectors to contribute to meeting overall emission reduction goals, while still providing crucial and cleaner burning energy.
- Offsets can also stimulate emission reduction opportunities in sectors that either are not covered by or are not appropriate for an emission's cap. Significant emission reduction opportunities exist in these un-capped sectors. Robust and well-designed offset policies can capture some of these reduction opportunities at

a lower cost than through either cap and trade without offsets or traditional command and control regulation.

- Offsets can stimulate emission reduction activities and early action in the beginning years of a greenhouse gas reduction regime, driving critical infrastructure and behavioral changes in sectors not covered by a cap and trade system or direct regulation.
- Offsets are a market-based mechanism that enable capped entities to take advantage of the lowest cost reduction opportunities first by incorporating uncapped sectors into a broader mitigation scheme; this results in a more economically efficient distribution of reduction efforts and mitigation funding.
- Offset funding can provide a significant driver of new, innovative technologies that will help the transition to a low carbon economy, reduce reliance on fossil fuels, increase energy security, and assist in meeting emission reduction targets.
- Offsets can promote technology and knowledge transfer between the developed and developing worlds. These technologies not only provide emission reductions, but also provide other important environmental, social, and economic co-benefits.

22. (A) If offsets are permitted, what types of offsets should be allowed?
(B) Should California establish geographic limits or preferences on the location of offsets? If so, what should be the nature of those limits or preferences?

(a) If offsets are permitted, what types of offsets should be allowed?

It is The Climate Trust's firm belief that a regional GHG offset program will be far more effective and efficient than a patchwork of individual state-run offset programs. Because California is a member of the Western Climate Initiative (WCI), The Climate Trust strongly encourages the California Public Utilities Commission (CPUC) and the California Air Resources Board (ARB) to harmonize California's offset program (if one is established) under AB 32 with that established through the regional consensus stakeholder process of the WCI.

Offset programs can be costly to establish and administer over time; a regional approach will employ important economies of scale and will provide necessary certainty for regulated entities and other market participants, such as offset originators. However, we recognize the accelerated timeline set by AB 32 and propose a two step process for establishing a GHG offset program in California in advance of the final design and implementation of the WCI offset system.

In the short term, California could develop a positive list of project types that have existing qualification and quantification criteria and methodologies. There are a number of existing methodologies, such as those from the Clean Development Mechanism, the California Climate Action Registry (CCAR), The Regional Greenhouse Gas Initiative (RGGI), The Climate Trust, Environmental Resources Trust (ERT), EPA Climate leaders, and the Voluntary Carbon Standard (VCS) that California could draw from. The selected project types and methodologies could be valid for a certain period of time and have a limited crediting period for offset credits (e.g. five or ten years) for compliance use under AB 32. As the WCI system takes shape, the offset program could be adapted and integrated into the regional system. By establishing a clear list of eligible project types and determining acceptable quantification methodologies for those project types, and by providing clear and predictable time periods for the initial offset program, California will provide vital information to market participants and investors and stimulate near term emission reductions.

An interim compliance offset program could be a valuable learning period for California and all affected parties, and would spur important early investment in emission reduction technologies and practices in uncapped sectors. Much like the learning phase employed in the Kyoto Protocol, the experience of California could be utilized to inform the development of the regional offset system established under the WCI.

One important point to remember is that the fewer projects types allowed for compliance use under AB 32, the more expensive the resultant offset credits are likely to be. Ensuring the environmental integrity and rigor of an offset program is of paramount importance, but the program must also be designed so that the true benefit of GHG offsets, achieving emission reductions at the lowest cost from across the uncapped economy, can also be realized.

This proposed two phase approach would allow the California to retain a high level of control over the types and sectors that are included in the offset program under AB 32, while allowing the program to scale up quickly and in a transparent fashion. Moreover, it will provide a framework for integrating GHG offsets under AB 32 that will allow California to transition to the regional GHG offset program under WCI when that system is established.

(B) Should California establish geographic limits or preferences on the location of offsets? If so, what should be the nature of those limits or preferences?

The Climate Trust strongly discourages limiting the eligibility of offset projects by geographic source. Greenhouse gases are global pollutants, thus, the location of an emission reduction is immaterial to its impact on atmospheric concentrations of greenhouse gases. While we recognize that there are important positive environmental and economic externalities associated with the implementation of offset projects within California, we believe that there are compelling geo-political and economic reasons for allowing offsets from a broad geographic scope.

The Climate Trust believes that by limiting the geographic scope of offsets, regulators could significantly decrease the available supply of offsets, thereby driving up their cost; particularly in the early years of AB 32 implementation. Moreover, there are currently limited numbers of offsets available from existing offset quantification programs active in the U.S. such as CCAR, The Gold Standard and VCS. While this should change over time as greater certainty emerges regarding the shape and structure of the regulatory landscape in the United States, there is the potential for a serious supply deficit in the early years of the program. Additionally, utilizing the more mature and robust frameworks already established at the international level through the Kyoto Protocol will greatly facilitate the integration of offsets into the California system when they are very important, in the early years of the program.

Second, as more sectors of the economy are capped in the U.S., there will be fewer and fewer eligible sources of offsets over time from within the uncapped economy. If offsets are only allowed from within California, or within the United States, and the pool of available credits shrinks over time, the economic benefits of integrating offsets into the California GHG mitigation framework will be limited.

Due to this, The Climate Trust believes that in the long term, most eligible offset project types will be located in uncapped economies, predominantly in the developing world. We believe that by only allowing offset projects from within California, or within the U.S., California will miss out on the true advantage of a cap-and-trade system: the ability to achieve emissions reductions from the lowest-cost options available from around the globe.

23. Should voluntary GHG emission reduction projects, i.e., projects that are not developed to comply with governmental mandates, be permitted as offsets if they are within sectors in California that are not within the cap-and-trade program? In particular, should voluntary GHG emission reduction projects within the natural gas sector in California be permitted as offsets, if the natural gas sector is not yet in the cap-and-trade program?

The Climate Trust supports the use of GHG offset credits generated under the auspices of credible and rigorous voluntary market approval and certification regimes such as The Climate Trust, the Voluntary Carbon Standard, The California Climate Action Registry, Environmental Resources Trust and the Gold Standard. In addition to voluntary offset projects implemented with California, the CPUC and ARB should consider allowing voluntary offset credits from projects located outside of the state. By allowing voluntary offset credits to be used as regulatory compliance tools, California could significantly increase the type and quantity of credits available at the beginning of AB 32's implementation, thereby reducing the economic impact of achieving GHG emission reductions in both the near and longer terms.

24. Should there be limits to the quantity of offsets? If so, how should the limits be determined?

From a strictly environmental and economic perspective there is no rationale for limiting emission reduction credits eligible to meet emission reduction compliance obligations, as long as those credits are issued from qualified sources. The Climate Trust recognizes the concerns regarding the incentivization of innovation and technology transformation in capped sectors. However, the establishment of rigorous and conservative quality criteria for greenhouse gas reduction mechanisms under climate change mitigation policy should serve as a sufficient limiter of greenhouse gas offsets available to regulated entities. Stringent offset quality criteria, particularly robust additionality and quantification criteria, will serve to screen out projects that are not resulting in above business as usual reductions, and should serve as a natural limiter on the number and type of compliance eligible offsets credits available in the market.

If quantitative limits are introduced they should be based on comprehensive economic data and analysis that will provide information regarding the correct mix of reductions that must be achieved through allowance retirement and offset purchase and retirement. Arbitrary numerical limits should not be imposed, and have the potential to drive up compliance costs by a significant amount.

25. (A) How should an offsets program be administered? (B) What should be the project approval and quantification process? (C) What protocols should be used to determine eligibility of proposed offsets? (D) Are existing protocols that have been developed elsewhere acceptable for use in California, or is additional protocol development needed? (E) Should offsets that have been certified by other trading programs be accepted? (F) Should use of CDM or Joint Implementation credits be allowed?

(A) How should an offsets program be administered?

The Climate Trust believes that it will be particularly important to have an independent, centralized body to administer an ongoing offset program. The Climate Trust supports the establishment of a regional offset program administrator as part of the WCI process to assist in administering California's compliance offset program under AB 32.

Having an experienced, knowledgeable and proficient body to administer an offset program in California, through an integrated framework with the WCI system, will be very important in ensuring that the program is able to scale up quickly and functions as effectively as possible over the longer term. In the interim, we suggest designating a governmental agency or qualified non-profit organization to administer the offset program under AB 32 for California.

The Regional Greenhouse Gas Initiative (RGGI) member states have chosen to establish a multi-state, non-profit, central administrative body, RGGI, Inc., with one of its purview being offsets. The State of Oregon's pioneering efforts in carbon offsets have also developed such an entity specific to offsets: The Climate Trust. As the longest-standing implementer and administer of a greenhouse gas offset program in the United States, The Climate Trust would like to contribute our unique perspective.

We believe that California, and the WCI, would be well served by incorporating a non-profit greenhouse gas offset administrator into the offset program framework under AB 32 and the regional trading regime. Under a regional model, each member state could hold a seat on the board of the organization, which would ensure that all states had an equal voice. Advantages of the non-profit offset administrator model approach include:

- Administrative efficiency and greater cost effectiveness;
- Adaptability of the program over time;
- Centralization of resources, knowledge and expertise;
- Consistency across states in regulations and rules;
- Increased transparency and accountability;
- Greater coordinated oversight by member states; and
- Impartial and independent implementation of the regional offset program.

A centralized administrative entity could serve several vital functions in administering and executing a multi-sector greenhouse gas reduction program in California and under the WCI reduction frameworks. This entity could:

- Serve as the central California and WCI greenhouse gas offset system administrator, including overseeing modifications to offset regulations and criteria over time.
- Partner with an organization to serve as the registry for AB 32 and WCI regime compliant offsets.
- Enforce the offset program requirements and evaluate and monitor AB 32 and WCI offset projects used for compliance over their lifetimes.

The Oregon Model

The state of Oregon has long been a leader in the field of environmental innovation; one of the best examples of this leadership is the Oregon Carbon Dioxide Standard and the establishment of The Climate Trust. As the only state in the U.S. with a long standing greenhouse gas reduction requirement and offset program, Oregon has nearly a decade of experience in achieving real, additional, and verifiable greenhouse gas reductions through the purchase of high quality GHG offset credits.

In 1997, the State of Oregon established the nation's first regulation of carbon dioxide with the Oregon Carbon Dioxide Standard. This law requires that all new power plants with greater than 25 megawatts of generation capacity mitigate a portion of their carbon dioxide emissions. Since its passage, the State of Washington has also enacted similar regulations. The Oregon and Washington CO_2 Standards[1] allow regulated entities to meet their compliance obligations by paying a set price per ton to an independent qualified organization. This organization then purchases greenhouse gas offsets to meet the power plant's mandated emission reduction requirements. To date, all regulated entities under the law in Oregon have chosen this compliance path.

The Climate Trust was established to serve as the independent qualified organization under the Oregon Carbon Dioxide Standard in 1997, and has administered and executed the offset program since its establishment. The Climate Trust is a 501(c)3 organization, governed by a legislatively stipulated, appointed board of directors. This

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[1] A summary of the legislation can be viewed here: http://www.oregon.gov/ENERGY/SITING/docs/ccnewst.pdf

board of directors is comprised of representatives of the environmental community, the regulated power plants and the Oregon Energy Facility Siting Council. To date, The Climate Trust has placed $8.8 million dollars in 16 different offset projects that are anticipated to result in nearly 2.6 million metric tons of carbon dioxide reductions over their lifetimes.

The Climate Trust is eager to share Oregon's success and "lessons learned" from its groundbreaking regulation of carbon dioxide with California policymakers. We stand ready to contribute our practical experience in offset program implementation and success in assisting regulated entities procure and retire real, verifiable and additional greenhouse gas offsets.

(B) What should be the project approval and quantification process?

The Climate Trust supports the development of cost-effective, robust, and flexible offset project assessment tools that provide a rigorous and transparent framework for the evaluation of GHG offset projects. Regulation should strive to integrate the transparency and consistency of standardized assessment methodologies, while utilizing the flexibility and adaptability of project-specific assessments. For this reason, the Climate Trust recommends a hybrid approach to developing regulations for the assessment of GHG offset project additionality, baseline establishment and quantification.

Striking the appropriate balance between environmental rigor and administrative flexibility when developing qualification and quantification methodologies for offset project types is a challenging, though possible, task. Most methodologies in use today provide standardized guidance for determining the eligibility of a specific project for use under the system (additionality, start date, etc.). Additionally, some methodologies provide project-type specific, standardized guidance for quantifying the emissions reductions expected from a given project activity.

The Climate Trust believes that a hybrid approach to additionality and quantification assessments will strike the best balance between transparency and standardization, while taking into account the consideration of project specific circumstances. Emerging regulatory regimes should build off of the existing groundwork that has been laid at the regional and international levels, and seek to design policy that incorporates the lessons learned from current activities, while allowing for flexibility, innovation and adaptation over time.

The Climate Trust has a standardized, publicly accessible assessment protocol for determining the additionality of a potential offset project. To be considered additional by The Climate Trust, a project proponent must demonstrate that the project activity: 1) was not require by law, 2) faced at least one barrier to its implementation (these barriers can be financial, technological, or institutional), and 3) was not common practice in its sector or industry.[2] In addition, only new projects are allowed under the Oregon Carbon Dioxide Standard, which means that The Climate Trust does not fund any projects that have occurred in the past. The Climate Trust develops project-specific quantification methodologies for each project in its portfolio.

The Climate Trust strongly discourages California from "going it alone" with an offset program. As part of the WCI, allowing each member jurisdictions to retain regulatory authority for offset protocol and project approval and issuance of offsets and enforcement, will result in undesirable outcomes. A patchwork of offset quantification methodologies across the western region could result in inconsistent environmental impacts and uneven economic investment in offset projects as project developers "protocol shop" for the methodology that will result in the greatest number of reduction credits.

The Climate Trust does not recommend that California attempt to independently develop project or sector-specific additionality and quantification methodologies before the WCI system is designed and implemented. A comprehensive offset framework could be approached in a three step process:

1. California could identify a list of initial project types and sectors that have robust existing methodologies for inclusion in the offset program under AB 32. This

[2] The Climate Trust's additionality determination document can be accessed here: http://www.climatetrust.org/about_us_press.php

will send important market signals to project developers and other participants and will spur early action in the identified sectors. It will also provide assurance to stakeholders regarding the scope and scale of an offset program in California under AB 32, regardless of the outcome of the WCI process.]

2. As the WCI develops its offset program, a centralized, regional offset administrator could be tasked with the development of qualification and quantification assessment methodologies for the identified project types and sectors for use in the program on a pre-determined timeline. These WCI project methodologies could be vetted through an independent panel of experts, and have a stakeholder comment and review period.

   There are several ways these methodologies and protocols could be developed:

   a. Through the adoption of existing methodologies, such as those from the Clean Development Mechanism, the California Climate Action Registry, The Regional Greenhouse Gas Initiative, The Climate Trust, Environmental Resources Trust, EPA Climate leaders, and the Voluntary Carbon Standard;
   b. Through the development of hybrid methodologies drawing on the groundwork that has already been laid in these systems and programs;
   c. or, developed from scratch for any project type that does not have an existing methodology or protocol that meets the requirements of the WCI system.

3. The establishment of an ongoing process for the addition of new project types and methodology development that would be administered by the centralized administration agency.

This approach would allow California and other WCI member states to retain a high level of control over the types and sectors that are included in the offset program, while allowing the program to scale up quickly and in a public and transparent fashion. Moreover, it will send early market signals to project developers eager to begin delivering emissions reductions from uncapped sectors and will provide a means for the offset program to grow and adapt over time.

(C) What protocols should be used to determine eligibility of proposed offsets? (D) Are existing protocols that have been developed elsewhere acceptable for use in California, or is additional protocol development needed?

The Climate Trust supports the use of existing protocols where practical and possible. However, care should be taken where multiple protocols exist for a particular project type. For example, there are several methodologies that exist for the quantification of emission reductions associated with the implementation of manure digester projects. Examples include the Clean Development Mechanism, the California Climate Action Registry, EPA Climate Leaders, the Regional Greenhouse Gas Initiative, and the Environmental Resources Trust. The Climate Trust recommends that the California convene an expert group to analyze and recommend the use of one methodology for projects interested in selling compliance offsets in California under AB 32 in the near term. Multiple offset quantification methodologies under AB 32 could result in inconsistent environmental impacts and uneven economic investment in offset projects as project developers "protocol shop" for the methodology that will result in the greatest number of reduction credits.

In the longer term The Climate Trust suggests that California work with other members of the WCI and a panel of independent experts to assess and develop quantification methodologies for use in the WCI offset system (and California) adapted from the existing methodologies in the market.

(E) Should offsets that have been certified by other trading programs be accepted? (F) Should use of CDM or Joint Implementation credits be allowed?

The Climate Trust supports the use of offsets (and other tradable units, such as allowances) from other government regulated greenhouse gas emissions trading schemes. Linking to other greenhouse gas trading systems is one of the most cost-effective means of achieving emissions reduction goals at a global level. However, it is important to ensure that linked emissions reduction systems reduction goals and emissions caps are coordinated to ensure that trading between systems does not weaken the environmental integrity of the system nor compromise the achievement of emission reduction targets.

The Climate Trust supports the allowance of CDM and JI credits for compliance under AB 32. CDM is the largest offset trading scheme in the world and is a source of cost-effective and high quality greenhouse gas reduction credits. While not without its problems, the CDM is evolving rapidly and is moving to address many of the concerns raised regarding the issue of business as usual projects earning offset credit. As California well knows, going first is not always easy, and the Clean Development Mechanism has developed critical infrastructure and precedent toward a robust and high quality global offset trading market.

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Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **"RESPONSE OF THE CLIMATE TRUST TO THE ADMINISTRATIVE LAW JUDGE'S RULING REQUESTING COMMENTS ON FLEXIBLE COMPLIANCE POLICIES AND REQUEST FOR PARTY STATUS" in the matter of R. 06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on June 2, 2008 at Portland, Oregon.

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