



AB 32 Implementation Group



Working Toward Greenhouse Gas Emission Reductions
And Enhancing California's Competitiveness

April 24, 2007

Mr. Winston Hickox, Chair
Market Advisory Committee
Cal/EPA
Sacramento, CA 95414

Dear Winston,

Our coalition, which represents companies employing millions of working men and women in California, continues to constructively engage in the process of achieving Greenhouse Gas (GHG) emission reductions in a cost effective way under the terms of AB 32 (The Global Warming Solutions Act).

In general we believe that for California's GHG program to be effective the following general principles must guide the overall program:

- 1) The program must be simple, easy to implement, fair, equitable and cost-effective
- 2) The program must stimulate and encourage innovation and investment
- 3) The program must protect the California economy and its population and maximize the transparency of costs to consumers
- 4) The program must identify and track "early warning" indicators to prevent significant harm to California's economy and population
- 5) The program must target real, actual GHG emission reductions
- 6) The program must cover all GHG emissions and sources as is practical
- 7) Carbon sequestration is essential for a long-term GHG program -- appropriate regulatory standards are needed to ensure that carbon sequestration is embraced and encouraged.
- 8) The program must maximize the use of markets

Furthermore, we believe that a well designed Market mechanism -- one with high transparency, depth of trade and low transaction costs -- will speed new technologies to the market and minimize the cost of compliance to achieve the Greenhouse Gas emission reductions envisioned by AB 32. Based on our understanding that the MAC is currently evaluating "cap and trade" mechanisms, the following are basic principles that we would like your committee to consider as you proceed to a recommendation for a California GHG Cap and Trade Market program.

- 1) **California's GHG reduction program must include the entire economy.** To be successful it must consider all GHG emissions and all GHG emission sources in California.

- 2) **California's Cap and Trade program should not have geographic restrictions.** To truly minimize costs, the Cap and Trade Market program must be global in reach and structure.
- 3) **The program must include a broad based process to create offsets**
- 4) **It is essential the program include methodologies to allow cost-effective reductions outside of California, such as a Clean Development Mechanism.**
- 5) **California's market program should align with other existing or planned markets such as the European Union's ETS program.** Establishing one world standard for fungible carbon credits is an important element in establishing an effective program. A broad based program for creating offsets begins the process of building a world system.
- 6) **The program must provide certainty to encourage expansions and/or early actions to reduce emissions.** Early adoption of the rules will provide the kind of investor certainty that is needed to encourage investment. Without early rules it is difficult to justify significant investment in California.
- 7) **It is critical that the market program be harmonized with command and control programs to ensure that the programs work efficiently and effectively and do not subject facilities to overlapping, competing requirements.**
- 8) **Finally, we believe a Market Mechanism must minimize the use of "auctions" to allocate GHG emission allowances among the facilities within a sector.**

Broad use of auctions will disadvantage California

An auction penalizes companies that chose to invest, operate and create jobs in the state by devaluing those investments.

An auction would impose a new substantive cost on California facilities -- pay up front for the right to continue to operate. The need to pay up front as well as the uncertainty of the prices in a potential auction will drive investments and jobs out of state. The implementation of AB 32 should try to honor as much as possible the expected "rules of the game" to those who have chosen to invest in California.

A GHG emissions auction on California facilities rewards those who have chosen to invest in other states and countries. An auction would give those facilities outside California that compete against California companies an immediate cost advantage. .

Auctions divert capital away from investment in GHG reductions

An auction will divert capital away from facilities that must make reductions. Facilities need financial liquidity in order to operate and achieve reductions. The cost of an auction is capital that cannot be used by the facility for market opportunities and/or projects that reduce GHG emissions at the facility.

Revenue from the auction could potentially be diverted to economically inefficient uses --- which are a drain on the economy. Any auction in California would potentially divert money to inefficient purposes. The economic argument

for auctions is rooted in the concept that all of the money would be recycled in an economically efficient way – such as lowering debt or across the board decreases in the income tax rate. This is politically unrealistic given the current state of California politics. Without efficient recycling of the money, an auction will hurt the economy.

A GHG allocation auction is a potential \$10 Billion carbon tax on California facilities.

Imposing a cost for the right to emit GHG emissions is essentially a new tax on California businesses. In 2002, California generated about 500 million metric tons of CO2 equivalent GHG emissions. If all sources and emissions were to be included, at the \$20/ton EU cost it would cost the California economy about \$10 billion. If an auction was instituted “only” for the industrial and electric utility sectors, the cost of CO2 equivalent allocations would cost California utilities and industries about \$4 billion. There are good reasons to believe the costs of reductions could be even more in California than the EU, leading to even larger taxes.

A major tax of this magnitude would require major government oversight. It would require specific legislative authorization and oversight in order to be constitutionally valid. Such legislative authorization and oversight may likely make the auction process even more unwieldy and complicated than it is likely to be otherwise.

Grandfathering mechanisms can be effective in reducing GHG emissions

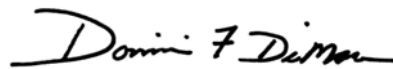
A properly designed grandfathering mechanism can help California businesses by avoiding the potential perverse consequences caused by an auction. Such a mechanism would lessen the financial impact on those companies that have committed to California and would encourage new investments as well as early actions to reduce emissions.

We thank you for considering our comments.

Sincerely,



Dorothy Rothrock
Vice-President
California Manufacturers &
Technology Association



Dominic DiMare
Vice-President
California Chamber of Commerce

cc: Committee members