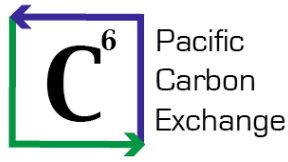




Key Carbon Policy Issues for CA & the Western Climate Initiative

In the wake of a disappointing outcome of the Copenhagen climate talks, and a sense that US Federal comprehensive climate legislation has entered a state of stagnation, California's AB32 legislation and the Western Climate Initiative become more important than ever. California and the western region will continue to be a leader in the United States on the fight to mitigate global climate change through the reduction of greenhouse gas (GHG) emissions. We believe the following policy initiatives will be crucial to our success going forward:

- *Cap-and-Trade* – This is, of course, the principle reason for instituting any policy response in lieu of regulating CO₂ and other GHG emissions. Whether through cap-and-trade, carbon tariffs, or straight industry regulation, the goal is the reduction of GHG emissions in the United States. Cap-and-trade is the only market-based solution that is directly tied to emissions reductions through the progressively lower cap on allowed emissions that is a critical function of a cap-and-trade system. Only through a market-based system, like cap-and-trade, can you create adequate market incentive, in the form of a clear emissions price signal, to shift investment away from artificially cheap fossil-fuel consumption and toward energy-efficiency, clean energy research and development, and the building of renewable energy generation capacity. Business as usual will always favor cheap oil, gas and coal, especially when the price of GHG emissions is artificially left out of the cost equation.
- *Offsets* – Carbon offset projects and their resulting credits play a critical role in creating a balanced response to the needs of industry in California and the West, and the requirements of the regulatory framework to effectively reduce GHG emissions. For industry, the preeminent issue is cost. Offsets provide a lower cost alternative, especially in the earliest compliance periods, for effectively reducing GHG emissions. Lower cost alternatives will help build significant covered industry support for cap-and-trade and GHG emissions reductions efforts. Because GHG emissions are not a local pollution problem such as sulphur dioxide (acid rain) and nitrogen oxide (smog), but a global atmospheric problem (CO₂ emissions enter the atmosphere and remain, circulating globally for generations), local emissions reductions are not critical to the



overall goal emissions reductions in general. In fact, offset projects enable reductions in emissions faster, and at a lower cost than more expensive local responses. Offsets provisions both in the AB32 and WCI regulatory designs should be expanded to at least 15% of compliance obligations, and perhaps as much as the roughly 30% provision included in current US Senate legislation. We also believe a similar mix of local, US-wide, and internationally sourced offset projects should be allowed within the cap-and-trade system. The offset protocols and methodologies included within the AB32/WCI system should be help to the highest standards of additionality and scientific rigor possible. Finally, offsets projects are a significant creator of jobs and clean and greentech investment. Offset protocols offer new revenue generating opportunities for agriculture, timber, waste management, and other industries which will be part of the investment engine that will be created by carbon markets and cap-and-trade legislation.

- *Renewable Portfolio Standard (RPS)* – The nation-leading RPS in California should be expanded to promote the creation of a WCI-wide, and eventually nationwide market for tradable renewable energy credits (RECs) and energy efficiency credits (EECs). Electricity generators will need as many tools as can be created to help them successfully accomplish the creation of 33% of electricity consumed in California through renewable energy sources. We strongly support the creation of tradable RECs and EECs (see below) markets in CA and the WCI to compliment carbon cap-and-trade markets in the region.

- *Energy Efficiency Markets* – It has been widely acknowledged that hitting the CA RPS target of 33% by 2020 will be difficult to achieve through renewables generation alone. That is why the Pacific Carbon Exchange has been working toward the creation of an Energy Efficiency Credit (EEC) market, a sister credit to the REC, which would be applicable to the expanded California RPS. This EEC credits system would allow utilities to meet part of their RPS obligations by purchasing EECs earned by building owner/operators, developers and buildings service providers through their investment in building energy efficiency technologies. By lowering energy consumption in buildings below a given baseline determined by building energy consumption models for new construction and major retrofits, owner/operators can earn EECs (one EEC = 1 Mwh saved). Utilities will have the opportunity to purchase these credits, as they do



renewable energy credits (RECs), and apply them against the expanded RPS. Set-asides of allowance allocations are required to prevent double-counting of the related energy savings/emission reductions under capped sectors. This energy efficiency credit market system will create hundreds of thousands of green construction jobs in the moribund construction industry in California, as well as reduce GHG emissions by as much as 40% in some building sectors. It would be applicable nationwide and make California and the western region a clear leader and innovator in GHG emissions reductions policy.

- *Transparency, Oversight & Standardization* – Given events of the past three years, there is considerable suspicion of financial markets in general. It is, therefore, critical to the success of cap-and-trade in the western region that effective oversight and regulation of carbon markets be an integral part of the regulatory framework. We believe this includes, to the extent technically possible, tight integration of trading mechanisms and the credit/allowance registry systems. Emissions financial instruments traded within the cap-and-trade system should also be cleared by approved platforms trading standardized environmental commodity contracts. In this system, registries and exchanges will play crucial, integrated roles in the risk assessment, clearing and settlement process of these carbon trading instruments. An approved exchange mechanism also provides many other critical benefits including: trade history and forensic transparency to the regulatory framework, financial safety of cleared trading, efficiency of the market, and higher liquidity to lower costs for covered entities.

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