IETA
INTERNATIONAL EMISSIONS TRADING ASSOCIATION

September 10, 2007

The Honorable Joe Lieberman, Chairman
The Honorable John Warner, Ranking Member
Subcommittee on Private Sector and Consumer
Solutions to Global Warming and Wildlife Protection
Environment and Public Works Committee
The United States Senate
Washington, DC 20510

Dear Senator,

We are writing to provide the comments of the International Emissions Trading Association (IETA) on the Lieberman-Warner proposal for climate change legislation released on August 2. We hope you will consider our perspective as the Committee considers climate change legislation this fall.

IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our 165 member companies include some of America's and the world's largest industrial and financial corporations, including global leaders in oil, electricity, cement, aluminum, chemical, paper, and banking; as well as leading firms in the data verification and certification, brokering and trading, legal, and consulting industries. IETA member companies represent emissions greater than the carbon emissions from Germany and the UK combined.

IETA is dedicated to the establishment of effective market-based trading systems for greenhouse gas emissions by businesses that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. We are pleased that the Lieberman-Warner proposal takes a number of positive steps in that direction.

I. Overall Approach

We applaud the authors for taking a market-based approach to addressing climate change. The proposed establishment of a single national cap and trade based system with unlimited domestic trading would provide incentives for both consumers and industry to reduce emissions and take actions that minimize costs. This proposal would create a market that will allow effective discovery of a price for carbon, act as a powerful incentive to minimize overall social costs, and enable the private sector to invest resources in the most efficient and effective manner in order to protect the climate.

II. Emissions Cap

While IETA supports the objective of climate protection consistent with the goals of the United Nations Framework Convention on Climate Change, of which the United States is a party, IETA does not engage in the scientific discussion of climate change and therefore does not take a direct position on the appropriate level of a cap. However, IETA recommends that any cap adhere to the following market principles:

First, any cap should create a functioning market that will lead to the stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. To achieve this objective, the cap must be set at a sufficiently stringent level in order to provide strong incentives for both businesses and consumers to reduce their emissions.

Second, any cap should provide long-term predictability. The development and adoption of new technologies will depend to a high degree on the predictability of there being a future price of carbon high enough to sustain them economically. These prices should be such that firms consider the carbon price when evaluating their next generation of investments in long-lived assets. Legislation should therefore incorporate targets in the mid- to long- terms.

Finally, IETA recommends that any cap be structured so as to ensure an orderly turnover of long-lived capital assets as the markets stimulate new technologies for reducing emissions. If the cap is set at a level that causes premature retirement of capital stock, the cost of legislation will be unnecessarily high.

III. Sectoral and Greenhouse Gas Coverage

IETA is pleased that the authors have made efforts to ensure broad sectoral coverage of the US economy in the proposed emissions trading system. IETA supports a cap and trade system that covers as high a percentage of national emissions as is practicable. Increasing abatement options through the inclusion of more sectors will increase market liquidity and effectiveness. Provided this is implemented carefully, it will generate savings and create a win-win situation for industries with both higher-than-average and lower-than-average costs of compliance.

IETA is further pleased that the authors have covered other greenhouse gases beyond carbon dioxide. IETA believes that legislation should cover as many gases as possible in order to take advantage of reduction opportunities throughout the economy. However, Congress must be certain that data exists to incorporate gases other than carbon dioxide in a trading program. The European experience has established that accurate, verifiable baseline data and monitoring capacity is essential to the success of emissions trading.

IV. Tracking Emissions

As presented, the outline of the bill calls for auditing and verification to be a responsibility of the Administrator. IETA would strongly urge the Senators to consider the use of a third-party verification model, analogous to corporate financial reporting and

taxation. The Administrator should retain the right to conduct its own audits of emissions reports at its own discretion, but in the normal course, reporting and verification should be left in the hands of the private sector.

The third-party verification model has been demonstrated to combine environmental and market integrity in various jurisdictions, including several US state programs. It is critical that as the Federal Government develops a US GHG market, the various existing initiatives be unified into a single national level registry allowing American business clarity and simplicity in their reporting process.

V. Allocation of Allowances

A. Overview

The approach to allocation presented in the outline is a careful attempt to design a portfolio of mechanisms to address the complexities of the allocation process. Many interests have argued for a simple approach that will select a single allocation mechanism, but this does not reflect real-world complications. IETA agrees with the fundamental approach taken in the Lieberman-Warner proposal, as experience in other jurisdictions has clearly demonstrated that no single mechanism, auctioning, benchmarking, or grandfathering, can produce universally satisfactory results. Allocation for a Federal GHG cap and trade program will need to carefully balance the various policy considerations by using the range of available mechanisms to design the best possible portfolio approach. However, as stated the initial level of auctioning is a cause for concern, as the allocation to non-emitters will de facto mean that from the outset 42% of allowances under the program are auctioned. There is no precedent for running such high levels of initial auctioning and the outcomes are uncertain. Furthermore, given the lack of a global system, this level of auctioning could have negative impacts on the competitiveness of American industry. We would suggest that a more gradual approach be utilized, with a careful consideration both of means of minimizing consumer costs and of the capacity of covered entities to recover allowance costs.

IETA is further concerned about the use of the allocation process to reward non-emitting sources. The allocation of allowances to non-emitting energy sources will simply be a transfer of marketable assets unaccompanied by any obligation to surrender these allowances as a compliance instrument. While IETA recognizes the need to develop new technologies for reducing emissions, a robust carbon market would be a more efficient way of directing resources towards these technologies.

IETA would suggest that the use of revenues from auctions and the allocation process be rigorously separated, with the sole objective of the allocation process being to initiate a Federal emissions trading program on a fair and efficient basis.

B. Early Action

IETA is pleased that a percentage of the allowances are dedicated to giving firms credit for early actions taken to reduce greenhouse gas emissions. IETA believes that companies should be provided credit for actions that reduce emissions prior to there being a legally binding requirement to do so. The actions need to be accurately measured and verified. The process for providing credit for early action must be rigorous in recognition of the fact that such credit would be provided from a fixed cap.

C. Allowances Allocated to the Climate Change Credit Corporation

IETA believes that any revenues derived from the allocation of allowances should be dedicated to the reduction of greenhouse gas emissions, and should be placed in a dedicated fund that is not accessible as a general revenue source. The Climate Change Credit Corporation (CCCC) would help meet this objective by laying out clear policy objectives and ensuring that revenues are not appropriated for other purposes. However, IETA believes that resources are best left in the private sector, while government should concern itself with sending the correct policy signals and incentives to drive investment toward change.

VI. Cost Containment

Cost control is a key principle of climate legislation. The most robust possible cost control mechanism is a broad, effective, market, through the establishment of effective timelines and caps, and which includes the greatest possible supply of offsets.

Since environmental markets are purely regulatory in nature, it is important that a balance be maintained between supply and demand and sufficient liquidity be available in the market. Fundamentally, IETA believes this objective is best achieved with a robust supply of offsets. Price management is the option least favorable to IETA since it is the most interventionist and would essentially eliminate most benefits arising from a market system. In this context the establishment of a federal agency to manage or intervene in the market raises potential concerns and must be closely examined.

Emissions trading delivers economic efficiency by discovering and exploiting differential costs. This efficiency helps consumers and businesses and provides greater environmental benefits for a given expenditure of societal resources.

Costs are reduced through the use of larger markets, including linking between different markets, since larger markets are inherently more efficient, liquid, and competitive. In addition, larger markets provide a broader pool and greater variety of abatement costs, providing greater opportunities for low-cost emission reductions. In order to take advantage of these savings, it is important that the broadest array of offsets be included, including offsets across borders and markets.

In order to achieve the greatest possible benefit from markets, the market design should avoid mechanisms seeking to directly manage the associated price for emissions. Similarly, market design should also generally avoid managing the associated supply and

demand of allowances with a view to indirectly managing the price for allowances. Such measures will run a great risk of undercutting the value of a market-based program.

A. Offsets.

IETA applauds the authors for both allowing facilities to use offsets to meet their submission requirements, and for proposing detailed, rigorous requirements to ensure that offsets represent real, additional, verifiable, and permanent emissions reductions. However, we are concerned about the limitations that the bill places on the use of offsets.

IETA does not believe that the use of offsets should be arbitrarily limited. Limiting offsets runs counter to the fundamental logic of emissions trading, and would increase costs and reduce benefits for investments in abatement activities outside the capped sectors. It is critical that offsets be subject to a rigorous approval process that will ensure environmental integrity; but we believe it is contrary to the purposes of the bill to arbitrarily deny high-quality offsets that benefit the environment and are demonstrably real, additional, verifiable, and permanent.

Fundamentally, IETA believes that a robust carbon market with ready access to offsets across broad geographic boundaries is the most effective method of cost containment which preserves environmental integrity.

B. Linking to markets outside of the United States.

We salute the authors for advancing the concept of a single global carbon market through the acceptance of allowances purchased on greenhouse gas emissions trading markets outside of the United States. Linking the US emissions market and other emissions markets around the world will provide a broader geographical scope and greater liquidity, and will encourage the most cost-effective reductions of greenhouse gases.

We are further pleased that the proposal requires the rigorous certification of monitoring, compliance, and enforcement methods before credits in other markets can be used to meet US requirements. Linking markets requires a careful assessment in order to insure that the policy objectives of both markets are met.

However, we are disappointed that the proposal would limit linking to 15%, and does not explicitly state that offsets would be available from international sources. Given the benefits that a broader carbon market would bring in terms of reducing social costs and delivering more efficient and effective environment of solutions, we see no reason to arbitrarily limit the connections between markets.

C. Carbon Market Efficiency Board

The proposed Carbon Market Efficiency Board is an innovative mechanism that requires careful consideration. While the level of government intervention in the market should be minimized, there is scope and precedent for a Federal body to act within a market to

monitor the balance between liquidity and scarcity. The operating principles for such an entity must be transparent and predictable, and provide strict guidance that in the normal course the market should be left to function on its own to develop an accurate and efficient price for carbon.

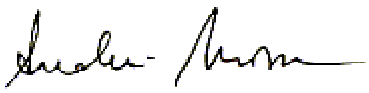
VII. Carbon Capture and Storage

The initiative proposed in the bill to develop carbon capture and storage is an important step. In the long term, this must be a part of the solution. However, we would urge that carbon capture and storage (CCS) projects not be treated in isolation from the design of an emissions trading system. Most carbon capture and storage projects are not currently economically viable at a near term price for carbon, but nonetheless the price signal provided by a robust carbon market has an important role to play in stimulating investment in CCS, either for reduction of compliance obligations or generation of offset credits. A structured mechanism to invest in long-term technology may be necessary to drive the necessary technological change in the required time frame. There is a need for increased public funding and other policies to accelerate adoption of transformational technologies to the point where they can compete based on the carbon price of the day.

VIII. Property Rights

IETA believes that the emissions allowances under a Federal GHG cap-and-trade program should be considered the property of the purchaser. While this implies significant complications for the Government, and is contrary to the precedent in the creation of the Clean Air Markets, it is important to understand the consequences of this choice. Firstly, major emitting companies will have a significant exposure and obligation to purchase compliance assets that will not be valued as property in their financial reporting, which may significantly complicate their ability to accurately report operating results and restrict their ability to raise capital. Secondly, this may preclude existing trading systems such as the European Union's Emissions Trading Scheme (EU ETS) from extending reciprocal linking to the US Federal program. Under the EU ETS, allowances are considered property and American firms purchasing these allowances for Federal compliance would have an absolute right of ownership.

Yours truly,



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