



May 19, 2006

BOARD OF DIRECTORS

Alan Zelenka, Chair
Susan Anderson
Diana Bodtker
Rick Colgan
Martha Dibblee
Bob Therkelsen
Bettina von Hagen

NON-VOTING DIRECTORS

Tim Carlberg
Peter Hansen
Michael Hayward
Wayne Lei
Roby Roberts

Mike Burnett,
Executive Director

The Climate Trust's Comments on
The Regional Greenhouse Gas Initiative
Draft Model Rule

Thank you for giving The Climate Trust the opportunity to comment on the RGGI Draft Model Rule.

We would like to commend the RGGI Commissioners, agency heads, state staff and other stakeholders for their hard work in addressing climate change. You are showing great leadership and bipartisanship in taking on one of the most crucial issues of our time.

The Climate Trust is a non-profit organization whose mission is to implement high quality project-based emissions reductions and to advance sound offset policy. Our formative function was to play a central role in implementing the Oregon Carbon Dioxide Standard, which requires new power plants built in the state to offset part of their CO₂ emissions. The Climate Trust acquires project-based offsets with funding provided by the new power plants. We are a non-profit organization independent of the state, not a regulatory body or state agency responsible for the enforcement of the Oregon Standard. We are based in Portland, Oregon, and have a broad national charter. Our role in providing offsets outside of the Oregon Standard has been growing. We have put into place a diverse and high quality offset project portfolio that has made us one of the largest and most experienced offset buyers in the US offset market. Our work is focused on ensuring high environmental integrity, both in the offsets we purchase and in the advice we give policy-makers.

In this memo, The Climate Trust will comment on the following:

1. **Price Triggers and Discounting.** The use of price triggers may distort the market and only add to the complexity to the administrative and accounting process.
2. **Regulatory Surplus and Future Regulations.** If an offset project subsequently becomes required by law, the project should continue to generate offset credit, but no new projects should be eligible.

3. **Offset Additionality Issues**

- a. *Systems Benefit Charge Funds*. Offset funding and systems benefit charge funds can coexist and lead to the implementation of projects that are additional and reduce GHG emissions.
 - b. *Renewable Portfolio Standard Credit*. Renewable energy project developers should be eligible for offset funding, but required to “pick a market” – either RPS credits or offset funding.
4. **Process for Selecting Additional Offset Projects**. The Climate Trust recommends that RGGI establish a process for identifying other project types, soliciting, evaluating, and selecting projects, and to eventually develop new offset project types and standards.
5. **Offset Pilot Program**. We recommend that RGGI include an Offset Pilot Program as part of the final rules.

Price Triggers and Discounting

Based on our experience buying offset credits domestically and internationally, The Climate Trust recommends that RGGI adopt an offset system whose primary focus is on quality and environmental integrity. We believe a system that leans heavily on price triggers and discounting of out-of-region offsets may create two significant problems: (1) compromise the quality of emissions reductions; and, (2) create undue administrative and accounting complexity.

First, an offset system that relies on price triggers distorts the market and shifts the focus from quality reductions to non-market criteria such as geography. For example, the RGGI region may have a relatively small pool of lower quality afforestation offset projects when compared to other regions in the US or abroad. However, price triggers and discounting tons from out-of-region will favor afforestation offsets from inside the RGGI region because out-of-region projects will be discounted on a 2-to-1 basis regardless of their quality. It is our experience that a global or US-wide system will generate cost-effective, high-quality offset projects.

Second, price triggers will likely result in an overly burdensome administrative and accounting process. In our experience, offset projects acquisition and management costs can be managed effectively; for example, our investment in a project in Ecuador is backed up by a strong US partner with whom we have contracted. As a result, management of a project in Ecuador becomes comparable to management of a project in the Pacific Northwest. Regardless of location, our projects must meet the same standards for additionality, environmental integrity, monitoring and verification, etc. In effect, price triggers create new complexity in the administrative and accounting process where it did not exist before. For example, suppose that RGGI eligible offset credits are available for \$3.24/ton outside the RGGI region. Due to discounting, the buyer would then presumably purchase one ton for \$6.48. However, the question is how this would count towards the price trigger of \$6.50/ton? Furthermore, is it counted at the 2-for-1 price or on the true price/ton basis? This creates confusion for the complying entity, project developers and RGGI administrators.

Regulatory Surplus and Future Regulation

Under the RGGI model rule, subsequent regulation will discontinue the generation of offset credits from a project. This creates uncertainty and undo risk for the offset buyer and project developer. As a result, the offset purchaser will only consider projects with a short-term payback impeding the development of a robust, high-quality offset market.

The Climate Trust recommends that RGGI rule enable projects that come under a future regulation to continue to generate credits. For instance, the Kyoto Protocol's Clean Development Mechanism (CDM) allows offset credits to remain despite subsequent regulatory changes. Neither the purchaser nor the developer should bear the risk of future regulatory changes. Instead, if RGGI wishes to maintain this position, the regulator should bear the risk of the loss of offset credits.

Offset Additionality Issues

The Climate Trust does not consider the inclusion of other public funds in a project – e.g. in the form of incentives to the project activity based on other (non-GHG) investment goals – to mean a *priori* failure of an additionality test. We distinguish here between regulatory mandates that require certain performance in the form of permits or other compliance-type regulations. For example, an RPS requires a minimum renewable content within delivered power. Whether or not that goal is met is a simple, binary “compliance event.” As a result, RPS-dedicated energy should not be eligible to generate “credits” toward GHG reduction goals. In fact, the lower carbon-content of the RPS energy already reduces the burden for carbon accounting on the part of the utility, going into the GHG baseline captured by the utility as another benefit of the RPS policy. Selling a GHG credit from RPS-required generation does not result in a further reduction in GHG emissions.

In contrast, direct incentives for project activity based on non-GHG benefits, e.g. kwh savings or reduction in other pollutants, can be augmented or “combined” with GHG offset purchase funds to achieve greater environmental benefit than in isolation.

Systems Benefit Charge Funds

Based on the distinction above, The Climate Trust has sought to work in concert with the Energy Trust of Oregon regarding co-funding on the basis of kWh savings and the Oregon Department of Energy regarding incentive programs for renewable energy project development and other projects demonstrating reductions in other, non-GHG emissions.

The Energy Trust of Oregon is a non-profit, public-purpose organization dedicated to energy efficiency and renewable energy generation. The Energy Trust of Oregon began operation in March 2002, charged by the Oregon Public Utility Commission (OPUC) with: (1) investing in cost-effective energy conservation; (2) helping to pay the above-market costs of renewable energy resources; and (3) encouraging energy market transformation in Oregon.

The Energy Trust offers state residents cash incentives for energy-efficient improvements to their homes and businesses. The Energy Trust's renewable energy programs also offer financial assistance for the generation of electricity using wind, biomass and solar energy.

Prior to jointly selecting the Blue Heron Project, The Climate Trust and the Energy Trust of Oregon had been in discussions for several months about potential cooperation on projects and/or programs. A main consideration in this process was each organization's funding thresholds. For the Energy Trust, it is above-market-costs. For The Climate Trust, it is additonality. The challenge was identifying projects that could meet both of these criteria.

The first step was to identify an appropriate project sector. The Industrial Energy Efficiency Sector program of the Energy Trust was singled out because it typically requires significant subsidies (greater than \$1 million). The Energy Trust already had an existing Industrial Energy Efficiency program with several projects in the pipeline. However, the Energy Trust's funding level was limited, and a number of potentially strong candidates remained beyond the reach of Energy Trust programs. One of the potential projects was the Blue Heron Project.

The Blue Heron Paper Company (established 2000) is an integrated producer of newsprint and specialty papers utilizing over 50% recovered fiber. The facility, located in Oregon City, OR, uses two types of feedstock to make their paper: wood waste chips from timber operations and recycled paper. Paper manufacturing using the recycled paper feedstock is much less energy intensive. The project proposed to increase the facility's capacity to use the recycled paper feedstock through the removal of production bottlenecks, retrofit of equipment, and other measures. Overall capacity of the facility would remain the same, resulting in a decrease of energy intensity and fossil fuel consumption. In addition of the GHG benefits, Blue Heron proposed to increase its paper-recycling capacity by over 100 tons per day and save millions of dollars in energy costs annually. The investment would increase the company's global competitiveness, providing more job security and job growth opportunities for its employees.

The Energy Trust of Oregon did not have enough funding for the project and the Blue Heron Paper Company's ability to borrow was maxed out. The Energy Trust then approached The Climate Trust regarding our participation as co-funders of the Blue Heron Project. In consultation with our Offset Committee and Board, The Climate Trust had previously adopted a minimum additio nality test for industrial energy efficiency projects of demonstrating simple payback of 18-months or more because projects above this threshold most often do not get done. Blue Heron met this threshold and the Energy Trust was able to engage in co-funding on the basis of measured and certified GHG emission reductions from the project.

The Climate Trust receives the rights to all the emission reductions generated by the project. The Energy Trust will record the kWh savings and report them to their stakeholder groups. The Energy Trust will not receive any rights to any GHG emission reductions.

The benefit of essentially sharing pipeline development costs is one important driver behind the attempt to find co-funding opportunities. In this case, The Climate Trust benefited from the project development and due diligence of the Energy Trust. In the future, the reverse may also be true and The Climate Trust may seek the co-funding role of the Energy Trust for one of its projects. In either case, the projects must meet the respective eligibility criteria of each organization. In addition, the organizations must share, to the extent possible, in the risk of delivery for their targeted goals (in this case kwh savings and persistent GHG emission reductions, respectively). Overall, more projects achieving both organizations' goals move forward than would be the case in the absence of collaboration.

Renewable Portfolio Standard Credit

The Climate Trust agrees with the draft model rule provisions that require projects to “pick a market,” such as the RGGI carbon market or the RPS market. For instance, if a project received RPS credit, it will not be eligible as an offset project in any carbon constraining regime. The concern has been raised that the inclusion of an offset market could create difficulty in meeting an RPS by allowing renewable energy projects to count as GHG offset projects. We do not believe this is the case. Instead, more renewables may be built because if a project picks the offset market, the RPS requirements still stand and more renewable energy projects will need to be built to meet the standard.

It should also be noted that the RGGI carbon market and the RPS market are two separate markets with different standards and requirements. For instance, not all renewable energy projects that are eligible for RPS credit are eligible for the RGGI offset market due to criteria such as additionality. As a result, renewable energy offset projects under RGGI will be *in addition to* projects qualifying under an RPS. In effect, additionality acts as a “gatekeeper” that a project must pass through before it can be considered for offset funding and must then “pick a market.” This ensures that the focus remains on quality and the integrity of the GHG reductions, rather than on which market can provide the greatest incentive.

Finally, with regards to additionality, measurement and administration of renewable energy offset projects, we reiterate several of the recommendations made regarding offsets (with some amendments) in the *Approaches to Integrating Renewable Energy into Greenhouse Gas Trading Programs Recommendations from the Renewable Energy Working Group*.

“Additionality: For offsets, the determination of additionality is essential to exclude carbon reductions from projects that probably would have occurred anyway. Under the September, 2003 Road Test Draft of The Greenhouse Gas Protocol Project Quantification Standard, offset projects are not additional if they are being undertaken to come into compliance with regulations, or as a result of “voluntary agreements” between business and government in lieu of regulations. Thus, at a minimum, the following are not eligible as offset projects. Projects: 1) For which the renewable energy (or energy certificates) have been used to meet an RPS requirement in another state, or 2) That have been awarded credit for GHG emissions reductions that have been applied to meet a state regulatory or GHG requirement [e.g., the Oregon and Washington carbon dioxide standards for new power plants], or 3) That

have been developed as part of a broader settlement (e.g. Minnesota wind projects developed to compensate in part for extending on-site storage of nuclear waste), or 4) That have been developed as part of an enforcement action, or 5) That are being paid for in a regulated utility's rates, or 6) For which the renewable energy certificates have been sold into some other renewable energy market.

Measurement and Administration of the Offsets Program:

Measurement and conversion of the generation into carbon offsets can be accomplished by (1) The verification of electricity generation through a generation tracking system or similar independently verified data source; and (2) the conversion of this generation information into tons of avoided CO₂ through a widely accepted emissions calculation methodology (GHG Protocol). The amount of avoided emissions caused by a particular renewable power facility should be calculated by applying the same predetermined methodology that is used to calculate renewable energy allowances for RGGI region offsets.

The program Administrator will need to establish a process for reviewing and approving offset projects. It is important that projects are treated consistently, and that input from a broad spectrum of stakeholders is considered when developing the approval criteria. In order to ensure consistent treatment, one set of offset approval criteria based upon stakeholder input should be developed for all RGGI participating states, and RGGI should establish or designate an entity to review and approve offset projects for use anywhere in the region using these criteria."

Process for Selecting Additional Offset Projects

While The Climate Trust agrees with the project types and standards set forth in the draft model rule, we believe that this is only the first step towards a robust RGGI offset market with the ability to stimulate economic and technological development and produce real GHG reductions. Issues in the RGGI Comments document, such as additionality, should not prevent RGGI from recognizing other project types and technologies. The Climate Trust recommends that RGGI adopt a standardized process whereby offset projects, outside of the pre-approved project categories, are identified, evaluated and selected for contracting to produce real GHG emissions reductions for the RGGI offset market. Such a process would enable RGGI to become an originator of offsets by providing funding from complying entities at a key stage in project development, as shown in Figure 1. This would also serve to address many questions related to how RGGI plans to incorporate additional project categories in the future.

Figure 1. Carbon Funding and the Project Development Cycle

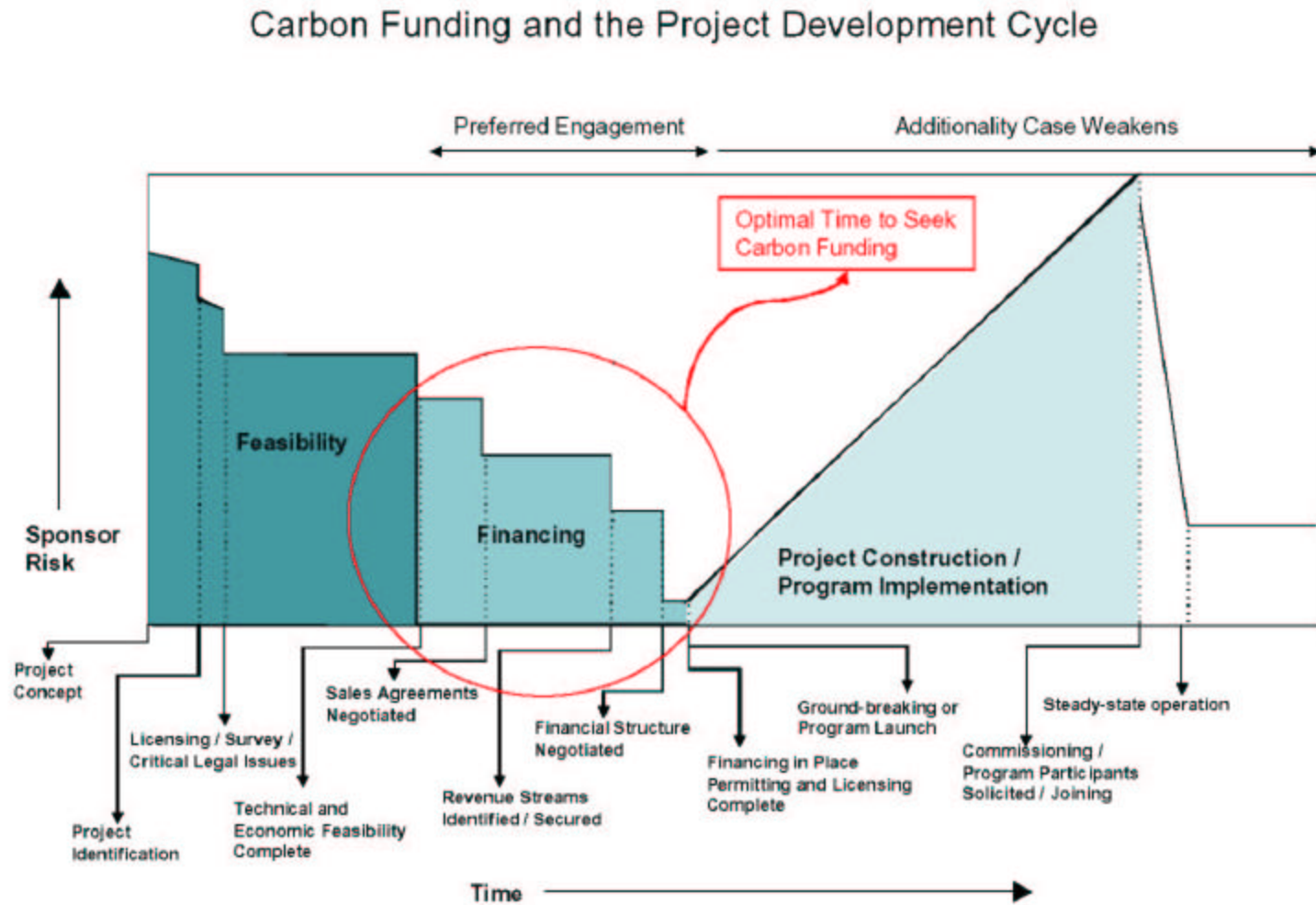
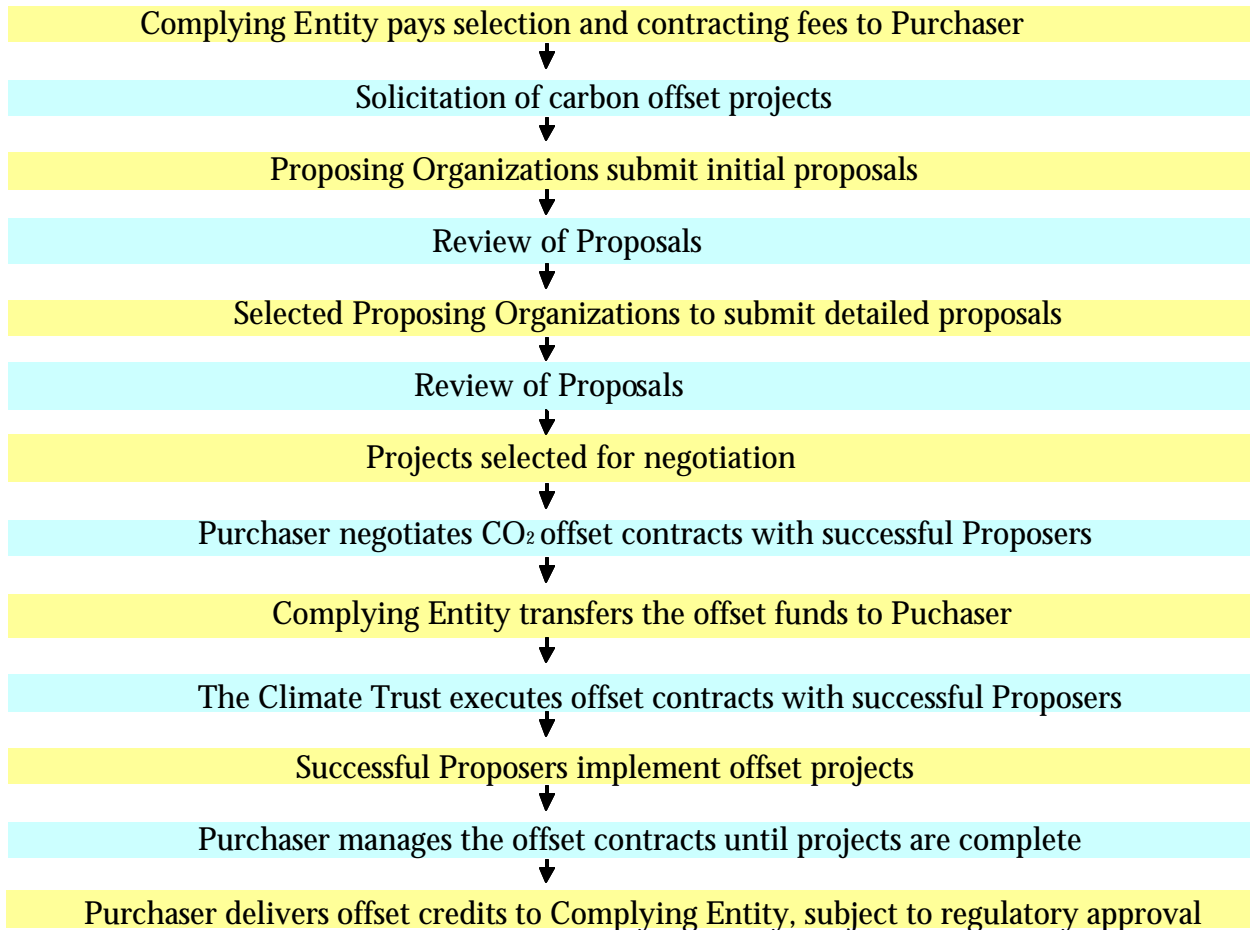


Diagram Provided Courtesy of Eoenergy International Corporation

Since our inception in 1997, we have demonstrated that, with a standardized evaluation and selection process, rigorous monitoring and third-party verification, it is possible to fund a wide-variety of project types while providing high quality reductions to both the regulatory (under the Oregon CO₂ Standard) and voluntary markets. We recommend that RGGI adopt a similar process, illustrated in Figure 2.

Figure 2. Standardized Offset Selection Process



Based on our experience, adopting such a process would have several necessary benefits. First, it would contribute to the development of new project categories. For example, there may be several project categories, inside and outside of the RGGI region, not included in the draft model rules that could offer significant benefits as offsets, including:

- Coal mine methane;
- Truck-stop electrification;
- Blended cement;
- Transportation (vehicle miles traveled reductions);

- Biofuels; and,
- Agricultural sector energy efficiency (e.g. farm equipment).

Adopting a standardized process like that above would enable the addition of such categories.

Second, this process could provide valuable administrative and regulatory learning experience, leading to the eventual inclusion of new project categories and standardized criteria in RGGI. For example, suppose a number of blended cement projects are proposed and approved. The purchaser, RGGI regulators and stakeholders could then learn from past projects and develop standardized criteria like those in the model rule for other, pre-identified sectors (e.g. methane recovery). This would then create a larger and more diverse pool of high quality offsets for the RGGI market. Finally, the inclusion of such a process would stimulate the market for offset projects and new technologies, resulting in more emissions reductions and other economic and environmental co-benefits.

Offset Pilot Program

An Offset Pilot Program is a valuable tool with a tested process and structure for administrative and regulatory learning, whether for an on-going case-by-case approach to project selection or for development of further pre-qualified offset project sectors.

We recommend that RGGI include an Offset Pilot Program as part of the final rules. A RGGI Offset Pilot Program would be a public-private partnership managed by a third-party, public benefits corporation. Oversight of the Pilot could consist of representation from controlled entities, RGGI regulators, a third-party administrator and stakeholders. The purpose of the Pilot would be to solicit, evaluate and contract offset projects for future delivery. In doing so, the Pilot would secure reductions outside of entities' control area; provide ongoing market information (e.g. price, transaction costs, etc.); identify other eligible project sectors; continue reducing in "non-capped" sectors; and, disseminate information on offset project quality.

An important step in developing a Pilot is to establish the potential roles of controlled entities, the RGGI regulators, the third-party administrator, and the stakeholders. Controlled entities would be expected to provide carbon funding in return for credit for emissions reductions and mitigation of regulatory risk and uncertainty. RGGI regulators would provide this risk mitigation for participating companies and provide compliance oversight. In turn, the regulators would expect collaboration and cooperation from all parties and the third-party administration to provide real emissions reductions. The third-party administrator, or offset purchaser, would provide solicitation, evaluation, contracting, and contract management services and expect to recover the costs of their services. Finally, stakeholders would provide oversight and support as well as technical expertise while expecting accountability and transparency in the Pilot Program. The potential Pilot structure is illustrated in Figure 3.

The Climate Trust also recommends that any pilot program strongly emphasize the concept of “quality” as a core component. It is essential that the regulators and other stakeholders have confidence in the offsets generated by projects. A crucial step in standardizing this *process* and in creating a structure for administrative and regulatory learning is an Offset Pilot Program.

Thank you for this opportunity to provide comments to the RGGI draft model rule. The Climate Trust looks forward to working with RGGI stakeholders in any way valuable.

Sincerely,

A handwritten signature in dark ink, appearing to read "Mike Burnett". The signature is fluid and cursive, with the first name "Mike" and last name "Burnett" clearly distinguishable.

Mike Burnett
Executive Director
The Climate Trust
Phone: 503-238-1915
Fax: 503-238-1953
65 SW Yamhill St., Suite 400
Portland, OR 97204

Figure 3. Potential Offset Pilot Program Structure

