

May 22, 2006

Dear RGGI Staff Working Group:

As part of the open commenting process on the Draft Model Rule, I would like to submit the following comments for your consideration.

As an independent, interested observer of RGGI's development, I have very much appreciated the open access to meetings and the open commenting opportunities that have been provided to date.

I have not been retained by any party with any financial or political interest in the outcome of this regulation to provide these comments. I am employed by Lexecon, an FTI company, as a Managing Director. Lexecon provides economic consulting services to a variety of public and private clients involved in matters directly related to the operation of the electric industry, including matters such as rate determination, industry restructuring, antitrust, electrical generation, transmission, and distribution. The opinions provided in these comments are my own and not those of my colleagues or my employer.

Please feel free to contact me at pwang@lexecon.com with any questions.

Sincerely,

A handwritten signature in black ink, appearing to be 'Patrick Wang', written in a cursive style.

Patrick Wang

Summary of Draft Model Rule Comments

On March 23, 2006, the Staff Working Group (SWG) for the Regional Greenhouse Gas Initiative (RGGI) states released a Draft Model Rule setting out program details derived from the principles outlined in the Memorandum of Understanding (MOU) among the RGGI states. While certain elements of the MOU remain controversial and may see future legal challenges, these comments assume that the basic elements of the MOU are given and limit the discussion to areas where the Draft Model Rule may more effectively execute the goals of the MOU.

While “cap and trade” is simple to commit to in name, for a regulatory framework to establish an interpretable cap and create conditions conducive to effective trade is a challenging matter. In its current form, the Draft Model Rule allows for the emission cap number to drift in meaning over time such that the reduction profile proposed for the cap may likewise lose its meaning and not accomplish its intended purpose. Clearer rules regarding accounting for exempt sources, offsets exchange rates, banking, and early adoption will help to achieve an interpretable cap.

To foster a more effective trading environment, the SWG should consider removing certain barriers that are written into the current Draft Model Rule. Applying offset allowance limits (initially set at 3.3 percent) at the system-wide level rather than at an individual source level can improve liquidity and increase source participation in the offset allowances market without sacrificing the regulatory goal of the

original limitation. The cap and trade system seeks to establish a specific value for greenhouse gas emissions and not values for renewable energy sources or energy independence. While in the electricity generation sector these elements can sometimes be found in the same project, the values of such elements are not inseparable, and so the Draft Model Rule may be overly restrictive regarding multiple funding sources for projects. Also, RGGI should seek to encourage the innovation of ancillary products in the emissions markets, and one clear opportunity to do so is to allow for third party insurers to provide products that protect the system against unexpected carbon release events from sequestration projects.

Finally, to allow RGGI to become a more sustainable regime, the Draft Model Rule should more explicitly address the issues of growth, emissions allowance availability, and interactions with other carbon regulation regimes. To this end, the lessons of the early run-up in EUA prices for the European Union Emissions Trading Scheme (EU ETS), the recent collapse in European Union Allowance (EUA) prices, and the remaining uncertainty over Phase I emissions allowance availability in the EU ETS can be instructive as RGGI develops its rules. These rules should recognize that by being allocated at least 25 percent of the emissions allowances, the state agencies have an obligation to establish clear policies regarding how they will deal with new generation as well as how and when their allocated emissions allowances will be made available to market. These rules should also recognize the ability of other carbon regulatory regimes to function as a safety valve for RGGI prices when their prices are below RGGI prices. However, these same regimes may also be able to exert upward pressure on RGGI prices if their allowance prices exceed RGGI allowance prices.

Many governments are now looking beyond the Kyoto time period with the goal of creating an international regulatory scheme that is broader than what exists today. If the goal of RGGI is to participate in such a regime, its responsibilities must include identifying and addressing issues regarding future policy harmonization with other regimes.

An Interpretable Cap

Accounting for exempt sources

Central to the regulatory scheme envisioned by the MOU are the state emissions caps, described in sections 2.C and 2.D, for the years 2009 through 2018. The MOU clearly states that its environmental goal is that the program “will regulate CO₂ emissions from fossil fuel-fired electricity generating units having a rated capacity equal to or greater than 25 megawatts.” However, it is unclear whether the proposed state caps are derived from that same universe of fossil fired generation of at least 25 MW capacity or from a broader universe of generating units. The Draft Model Rule, at section XX-1.4(b), also proposes an additional class of generation exempt from CO₂ emissions regulation based on permit conditions. It is likewise unclear whether this category of exemption agrees with the methodology for calculating the state caps.

The legitimacy of a cap and trade system is challenged if an exemption mechanism can contribute, either through the addition of exempt classes or through growth in the number of sources eligible as an exempt class, to declining system emissions. One method for dealing with this issue is to internalize the exempt class into the system accounting, even though it is not regulated. That is, the exempt classes of emission sources are included in the cap. However, emission allowances for the volume of emissions estimated to be produced by these exempt sources are then retired and not made available to the market. Such a treatment—including all fossil fired

generation under the cap but then making unavailable allowances in the amount of emissions from exempt sources—will mean that exempt classes do not function as an unintended safety valve for the system. A periodic calculation of estimated emissions from exempt sources, such as occurring with the allocation process, will account for any growth or shrinkage in emissions from exempt sources. RGGI should apply such a methodology to account for both of the exempt sources in the current Draft Model Rule as well as any other exempt class that may be recognized in the future.

Offsets exchange rates

The Draft Model Rule creates an initial carbon exchange rate for offsets projects of two tons of CO₂ outside of the RGGI states to one ton of CO₂ within the RGGI states (section XX-10.7(1)(i)(b)). This will change to an exchange rate of one ton of CO₂ outside of the RGGI states to one ton of CO₂ within the RGGI states upon a Stage One Trigger Event. Such a policy is confusing, particularly if the exchange rate resets again to 2:1 for the next compliance period.

There is no inherent difference in the environmental carbon impact of offsets projects within the RGGI states and those outside the RGGI states. Introducing such a distortion again affects the interpretability of the cap for the program and can complicate offsets project planning. Additionally, under this set of rules, a Stage One Trigger Event can suddenly produce additional offsets allowances without any carbon emissions changes. While this may seem like expedient accounting to help the system meet compliance, the fact

that carbon accounting is changing without an accompanying change in the real world is troubling.

If one assumes the goal of such rules was to give preference to projects conducted within RGGI states, this can be accomplished in different ways. For example, states can simply create different queues for projects within the RGGI states and for other projects, giving priority to the within-RGGI states queue. Other than the different queues, no other differences—such as multiple exchange rates—are necessary, and a project that meets the offsets criteria will be assigned a one ton emissions allowance for a proven one ton emissions reduction.

Banking

The bankability of allowances between compliance periods, as permitted in sections XX-6.5 and XX-6.6, is a useful flexibility mechanism that has been a feature of other cap and trade programs. However, it should be recognized that if RGGI joins a post-Kyoto international agreement, these banked allowances may potentially be a burden in negotiating the future agreement. This is because unrestricted banked allowances from prior periods will in effect increase the level of any negotiated post-Kyoto cap.

Currently, the EU ETS allows for banking of allowances between the Kyoto period and the post-Kyoto period, so other countries may have banked credits as well going into their post-Kyoto negotiations. (Phase I EUAs are generally not bankable into the Phase II Kyoto period, although CERs from CDM projects are bankable and countries such as Poland and France may allow for Phase I to Phase II banking),

While RGGI appears to have reserved the right to disappear allowances at any time, to avoid the shock of such an action—which may be tempting for banked allowances at the time of post-Kyoto negotiations—it is recommended that instead RGGI monitor the level of banked allowances that could potentially be used in a post-Kyoto period. If the level of banking is a concern such that any policy change is necessary, participants should be given enough time to adjust their operations accordingly.

The current Draft Model Rule does not seem to describe a procedure for officially retiring allowances, and so it may be difficult to distinguish entities that are banking credits from those who intend to retire credits. RGGI may want to spell out such a retirement procedure in the Draft Model Rule so that the market better understands the level of available credits and so that RGGI can determine the level of banked allowances. This banking and retirement data, as well as other RGGI data publications, should be made available to the market at regular intervals. The recent EU ETS experience regarding 2005 verified emissions reporting has demonstrated some of the hazards of concentrated (or uncontrolled) data releases.

As a general matter, anticipating harmonization issues with other greenhouse gas (GHG) regulatory schemes should be added to the list of responsibilities for the Regional Organization (RO). While the MOU provides more details about the RO than the Draft Model Rule, neither acknowledges the importance of anticipating harmonization issues. If a broad international regime is seen as necessary for the success of carbon regulation, RGGI should prepare itself for such.

Early adoption

As described in section XX-5.3(c) of the Draft Model Rule, early reduction allowances (ERAs) may be awarded for activity during the 2006-2008 period. This is another form of intertemporal banking, but ERAs are unique in that they will be rewarded for the 2006-2008 time period, and that is it. This is different than offsets and annual emissions allowances, both of which will continue into the future. It is again important to monitor how large a role ERAs are playing in achieving compliance in the first control period. This is because once used, they are unavailable for future control periods. The interpretability of the cap once again becomes an issue because it may be the case that, all else equal, the same cap in two different control periods may be much more difficult to achieve in the second period than in the first if ERAs are available for the first period but not for the second period. ERAs should therefore be part of the banking activity that the RO monitors.

A Functioning Market

Granularity of offsets limit regulation

The MOU at section 2.F(2)(b) states that initially, “In each compliance period, a source may cover up to 3.3% of its reported emissions with offset allowances.” Trigger events may later increase this limit to 5 percent and then 20 percent. The Draft Model Rule states the same limits in its description of compliance at XX-6.5(a)(3).

Regardless of the particular percentage that is applicable, the general principle behind establishing a maximum value for the use of offsets is to limit the extent to which reductions in emissions external to the activities covered by regulation can contribute to compliance for regulated entities. However, from the perspective of the regulator, this goal can be accomplished whether the maximum value is imposed at a system level or at a source level. That is, the regulator can either regulate the supply of offset allowances for the entire system or regulate the use of offset allowances in compliance source by source. In the following, I describe how regulating the supply of offset allowances at a system level and removing the source level restrictions produces benefits for the system.

First, consider some of the market features for offset allowances that may develop under a system of source level restrictions: (1) a lower spot price for offset allowances than for emissions allowances; and (2) severe oversupply of offset allowances.

A lower spot price for offset allowances than for emissions allowances is not difficult to imagine. An unrestricted allowance (emissions allowances) will be worth more than an allowance subject to restrictions (offsets allowances). Specifically, the offsets limitation can take buyers out of the market, either because they have already reached their offsets limit or because it is not economic for them to transact for the small volumes dictated by the offsets limit. This restriction can lead to a deadweight loss as price and supply deviate from their optimal levels that would otherwise occur without this market distortion. This loss is due to system design rather than due to any intrinsic characteristic of offsets.

The current offsets system envisioned by the MOU and the Draft Model Rule can also lead to an oversupply of offset allowances relative to the demand. This is due to the fact that offsets projects are approved based on consistency determinations and not limited in any way by the number of existing offsets projects or the number of offsets allowances that have already been issued for the compliance period. However, demand is limited by the offsets limit percentage. If there are fewer offsets allowances available than the total number of potential offsets demanded by the system (the offsets limit multiplied by the total level of emissions for covered activities), for the reasons discussed above, the offsets allowance price will not be expected to rise above the emissions allowance price. However, if there are many more offsets allowances available than the total number of potential offsets demanded by the system, the price for offsets allowances could collapse. The possibility of such a market environment may strongly discourage offsets projects.

Regulation at a more aggregated level can address both of these issues. A limit on total offsets allowances awarded accomplishes the goal of limiting the use of projects with emissions reductions external to regulated activities to achieve compliance for the regulated activities. However, if there are no restrictions on the use of an offsets allowance relative to an emissions allowance, the prices will tend to converge. This is desirable as both allowances represent the same volume of emissions. Regulation at the aggregate level also prevents the scenario described above where there is a severe oversupply of offsets allowances leading to a price collapse in that particular market. This is because only a limited amount of offsets allowances can be supplied to the emissions market, and when they are supplied, they can be traded as freely as emissions allowances.

There may be some other benefits that come from the actual practice of implementing an aggregate offsets limit. If offsets allowances are limited by the level of capped emissions, it would make sense that each state would be able to issue offsets allowances according to its own state cap. This may be seen as desirable both for reasons of equity and to prevent states from competing for offsets projects on the basis of policy differences that may emerge when the final regulations are adopted in each of the states.

Using the value of carbon

If the RGGI system is successful, trading activity will reveal a general value for an allowance to emit CO₂. This value for carbon is a

useful signal to businesses for investment and operation decisions, but it can also be of use to regulators.

Regulators often face many goals simultaneously. For example, a regulator may be concerned about CO₂ emissions, SO₂ emissions, energy sustainability, and energy independence. Different programs may be created to address different goals or sets of goals, and complications may arise when determining how the various programs should interact with each other. To sort through the interaction of RGGI with other programs, it is useful to recognize the limits of the RGGI system. A successful RGGI program will reveal a value for carbon emissions; the market should not and will not reveal the value of any other environmental goal. Fuel switching does not contribute to sustainability and independence. The development of a carbon capture system will not contribute to sustainability and independence.

Given these limits to what the carbon markets can value, it is not necessary to preclude all projects with carbon value from receiving any other allowances or any other funding as the Draft Model Rule currently proposes at section XX-10.3(d)(2). If the carbon value and the other funding address separate goals, simultaneous funding can be reasonable. If the carbon value and the other funding overlap goals—for example, a program lists limiting carbon emissions as one of multiple goals—simultaneous funding is still possible without a complicated financial filing. This is accomplished by using the value of carbon.

For example, a project applies for offsets allowances and receives funding from another program that has multiple goals, one of which is to reduce carbon emissions. The regulator can award offset

allowances in the amount of: offsets that would have been awarded for a project with no other funding, less the value of the other funding converted into offset allowances using the value of carbon. While this methodology is very conservative in its awarding of allowances, it is simple and will be useful in addressing situations where entities receive funding in trace amounts or from programs that are not easily terminated. There may be other ways of using the value of carbon to determine how simultaneous awards from different programs can be consistent. The goal is to avoid double counting, but that does not necessitate restricting policy to only allow funding from one program.

It is worth noting that in the previous example, even if the regulator had awarded all of the offsets allowances to a project that received carbon funding from another source, from an emissions accounting perspective, the system is accurately accounting for net emissions tonnage. What this means is that if the regulator does in fact carve out a piece of the offsets allowance award, it may choose to make that piece available to the market. To not do so hides some of the reduction in emissions recognized by the regulation.

Development of ancillary products

At section XX-10.5(c)(4)(iii) of the Draft Model Rule, it is proposed that for afforestation sequestration projects, the net carbon stock change be calculated using a formula which deducts “twenty percent (20%) to account for potential losses of sequestered carbon.” While this has the appearance of putting in place an insurance policy to protect against unexpected events that release sequestered carbon that has already been credited in the program, it is actually creating a

liability. RGGI is putting itself in the position of insurer. This means there are scenarios where it could experience carbon gains, and there are scenarios where it could sustain carbon losses. At a minimum, it should be specified what RGGI will do to deal with such gains and losses. Doing nothing implicitly changes the cap. However, it is preferable that RGGI remove itself from the role of insurer such that it will not see such gains and losses.

Without RGGI as insurer, there are still other possible options for ensuring that unexpected carbon release events from offsets projects do not affect net system emissions. The liability for such events can simply be assigned to the project sponsor subject to particular credit or reserve conditions. Or the project sponsor, again assigned the liability, can seek an insurance product from a third party. Or the RGGI system itself can seek an insurance policy to protect against such events for all its sequestration projects. All of these alternatives shift the insurance risk away from RGGI such that it does not sustain unexpected gains or losses and such that it does not have to directly address insurance issues such as moral hazard. Of these alternatives, a project by project insurance requirement is particularly attractive. Risks will likely differ by project, and diverse products offered by multiple firms can be a positive outcome. The RGGI program is an opportunity for innovation, not only for technology, but also for insurance and financial products for the carbon markets. By removing itself as insurer and accepting an insurance product, RGGI can help to develop these ancillary markets.

In the event that there is no third-party that can provide a suitable insurance product (market failure), then the regulator should consider putting in place a reinsurance program to boost the private

insurance markets. Such a reinsurance program will necessarily model actuarial risks more carefully than the current 20 percent deduction policy for all projects. It may be that some types of sequestration projects, such as afforestation, will more easily find willing third-party insurers without government reinsurance programs in place than other sequestration projects, such as oil recovery. This may lead to different mixes of private insurance and government reinsurance products to cover GHG release events over the range of offsets projects.

Generally, government reinsurance products are more likely to be needed for cutting edge, less familiar sequestration projects than what currently appears in the Draft Model Rule. Just as RGGI has set out rules that allow for addition of future offsets project classes, it could likewise indicate that government reinsurance programs may be added in the future. The RO should investigate the need for these programs, the development of which may require coordination with the federal government.

A Sustainable Regime

Growth

While the MOU recognizes the importance of leakage and a working group has been formed to study the issue, little appears in the MOU or the Draft Model Rule to address the other key challenge for the proposed regulation: growth. A strategy for dealing with growth is key to the sustainability of a cap and trade regulatory regime. The three G8 countries with the highest growth rates in GDP at the time Kyoto was open for signature (relative to the 1990 benchmark for emissions) were the US (27%), Canada (19%), and the UK (17%). The growth has continued since then such that today, relative to 1990, the US has seen 57% growth, Canada 49%, and the UK 43%. While Canada and the UK have ratified Kyoto, they each have shown recent struggles with meeting their goals. Canada's 2005 GHG emissions were 35% over 1990 levels, and the country is debating how realistic it is that it can reach its Kyoto target. Recent calculations of verified 2005 emissions showed the UK to be in a 27 MtCO₂ short position. Facing growth and a recovering coal industry, the UK has admitted some Phase I challenges, although it expects to be in compliance for Phase II.

Without dramatic revisions to the Draft Model Rule, small steps can be taken to acknowledge and begin to address the challenge that growth presents. One such step would be to clearly establish set-aside allowances for new generation. This is hinted to in section XX-6.4(a), but it should not be left as an issue states have the option to address. Without establishing a set-aside, new generation does not fit well into

the timeline of the current Draft Model Rule. Per section XX-5.2(a), allowance allocations for years 2009 through 2012 are to be completed by January 1, 2009. It is not difficult to imagine a new generating unit commencing operation after January 1, 2009 and before the end of 2012 that would not be allocated any allowances. However, the standard requirements for compliance, section XX-1.5(c), obligate the unit to surrender allowances for CO₂ emissions beginning from the start of unit operation. To have to sustain a significant period of time without an emissions allowance allocation is an unnecessary handicap for new generation to face. Depending on the price for emissions allowances, this handicap could affect operation decisions for new generation. A set-aside specifically for new generation, as is found in other cap and trade regimes, such as the new entrant reserve (NER) in the EU ETS, would address this problem.

Availability

While basic economic theory generally predicts that the level of the cap is the important policy instrument in a cap and trade regime and that initial allocations will not affect the price of allowances, that prediction does not recognize that generators within the RGGI states face different regulatory situations which may value the risk of market exposure differently. Also, such a prediction assumes that all allowances under the cap will be made available. If there is any uncertainty regarding availability of allowances, prices could be elevated for a period of time while the uncertainty persists.

Since the state regulatory agencies will each be allocated at least 25% of the state cap, when and if the state agencies make such

allowances available to the market will be of great consequence. It should be clarified in the Draft Model Rule how many of the allowances the regulatory agencies will make available to the market and when this will occur.

Such information is as vital as establishing when allowances will appear in tracking accounts since the regulatory agencies will control such large shares of the market for allowances and since generators will generally be in a short position and need to acquire these allowances. If states decide not to make some allowances available to the market and either directly allocate them to particular parties or retire the allowances, these actions will have consequences. If the rules are not changed to clearly establish when, how, and how many allowances will be made available to the market, they should be changed to at least obligate the state regulatory agencies to publicly provide this information at the time of the allocation plan for each year, if not sooner.

Other carbon markets

It is generally recognized that if cap and trade carbon regulation is to be an effective tool in controlling GHG emissions, it must extend beyond the set of countries that have ratified Kyoto. Therefore, as described previously, the RO should seek to harmonize the RGGI system with other international systems. However, the Draft Model Rule appears to already include a linkage to international systems. It is important to understand some of the implications of this particular linkage.

Section XX-10.3(b) of the Draft Model Rule states that the regulatory agency *may* award CO₂ offset allowances for permanent retirement of certain GHG allowances issued by other regulatory systems. Section XX-10.4(c)(2) adds that a demonstration must be made that the “CO₂ emissions credit is equivalent to the allowance under the CO₂ Budget Trading Program and has been permanently and irrevocable retired.” Finally, in Section XX-10.7(a)(2), a cite is made to a non-existent paragraph XX-10.3(c)(2), and the statement is made that one offset allowance will be awarded for each ton of CO₂ emissions credit retirement after a Stage Two Trigger Event.

The Draft Model Rule should clarify how extensive a showing an entity, say who wants to retire (in effect exchange) an EUA credit, must make to comply with section XX-10.4(c)(2). The citation in XX-10.7(a)(2) should be corrected, and it should be clarified what discretion the states have for awarding offsets allowances for retirements. Are states obligated to make such awards if a compliant application is made and such offsets allowances are available?

This linkage to international trading systems has the potential to be the most effective part of the safety valve design. It is unclear whether offsets projects can emerge and be executed quickly enough to provide price relief within the compliance period. It is also unclear how the implied price decrease, that presumably would result from the policy changes set in motion by a trigger event, would affect the number of offsets projects that are economic. However, the linkage to international trading systems will provide, assuming no state-level barriers, a supply of international allowances from markets where their prices per ton are less than the RGGI price.

In the case when the RGGI price is less than prices in other carbon markets, the linkage obviously does not provide pricing relief for the RGGI system. However, this pricing relationship with other carbon markets may still impact the RGGI price. The reason for this is the necessary openness of the RGGI system; anyone who can properly register an account can transact to procure allowances. If RGGI is recognized as a legitimate regulatory regime, it is possible that other carbon markets may allow for the exchange of allowances the way the RGGI rule currently contemplates allowing for the exchange of offsets allowances for retirement of allowances from other carbon markets. In this way, if other carbon market participants retire RGGI allowances to receive allowances under a different regime, RGGI allowance supply would decrease, and there would be upward pressure on the RGGI price until it more closely resembles prices in other carbon markets.

Should such a scenario come to pass, it would not necessarily be undesirable if one believes that broad, international systems are necessary for effective GHG regulation in the long run. However, the RGGI states should prepare themselves for the possibility that allowance prices will remain high for a six year compliance period. For the 18 months EUAs have traded, the daily bid-offer close calculation for various markets that trade EUAs has never shown a price below the proposed Stage One Trigger Event price of \$7 per short ton of CO₂ for any of the Phase I vintage allowances.

Even the EU's recent announcement of an overall long position in Phase I allowances has not resulted in Phase I allowance prices falling below the Stage One Trigger Event price. This Phase I long position may lead to more stringent Phase II caps—a move that would support higher allowance prices in Phase II. It is during Phase II, the

Kyoto compliance period from 2008-2012, that RGGI will overlap with EU ETS. One might then expect even more pricing pressure in the future than what current markets indicate. European environment commissioner Dimas recently referenced a target price of 15 euros per metric ton. Such a price has been referenced by banks and other participants in EU ETS as a politically sustainable price. At current exchange rates, this price is approximately 75 percent higher than the Stage Two Trigger Price.

While members of the SWG have indicated that they do not expect a Stage One Trigger Event, the high price of allowances in the EU ETS also took some European regulators by surprise as their models predicted different results. Whether resulting from a combination of the chosen cap and economic growth in RGGI states or from export of allowances to other carbon markets, RGGI states should prepare themselves for the possibility that allowance prices may remain high while the complicated safety valve may provide only limited relief.

Conclusion

With the Draft Model Rule, the Staff Working Group has elaborated on key principles of the MOU. While still respecting these principles, the Draft Model Rule can be improved significantly to establish an interpretable cap, to form a more effective trading environment, and to set the foundation for a sustainable regime. The following recommendations will work to accomplish these ends, adding clarity and removing market impediments when they are unnecessary:

- (1) Include emissions from exempt generating sources in the calculation of the cap, and make allowances for emissions from such sources unavailable for compliance.
- (2) Remove the initial 2:1 exchange rate for offsets projects outside of RGGI states and replace with a 1:1 exchange rate that reflects the carbon impact of the offsets projects.
- (3) If there is a preference for within-RGGI states offsets projects, express this preference with different project queues rather than with exchange rates.
- (4) Establish procedures for officially retiring credits to allow the system to distinguish between banking and retirement activity.

- (5) Assign RO the responsibility of anticipating future harmonization issues with other carbon regulatory schemes (national and international).
- (6) Assign RO the responsibility of tracking and reporting banking (including ERAs) and retirement activity (possibly including conversion to allowances used in other carbon regulatory regimes).
- (7) Apply limits to the number of offsets allowances that can be used for compliance at the system level rather than at the source level.
- (8) Remove the restrictions on multiple program funding.
- (9) Use the price of carbon to avoid double counting of funds towards carbon goals.
- (10) When multiple program funding results in reduction of allowances awarded, make those withheld allowances available to the market.
- (11) Protect against unexpected carbon release events from sequestration projects by assigning liability to the project sponsor. Establish the options of reserve or credit requirements for meeting this liability or allow for the purchase of third party insurance.
- (12) In the case of market failure for the insurance of one or more types of sequestration projects, allow for the

possibility of government reinsurance initiatives to boost the private insurance markets.

- (13) Assign RO the responsibility of assessing the need for reinsurance initiatives and coordinating development of such programs with the federal government if necessary.
- (14) Establish a new entrant reserve and procedures to address growth issues.
- (15) Clearly establish when, how, and how many of the state set-aside allowances will be made available to the market.
- (16) Clarify offsets procedures for retiring allowances from other carbon regulatory schemes. Describe how extensive retirement showings need be, and describe any discretion states have in awarding these offsets.