January 15, 2004

Mr. Mark Friedrichs
PI-40
Office of Policy and International Affairs
U.S. Department of Energy
Room 1E190
1000 Independence Ave., SW
Washington, DC 20585

Dear Mr. Friedrichs:

Many thanks to you and your colleagues for conducting an informative workshop on the Bush Administration's proposal to modify the Voluntary Reporting of Greenhouse Gases Program (VRGGP). In addition to the comment I submitted last Friday (Jan. 9) on behalf of the Competitive Enterprise Institute (CEI) and ten other pro-market organizations, I want to submit an additional comment addressing four issues discussed at Monday's meeting.

(1) No legal authority to award credits. One of your colleagues stated that the Department of Energy (DOE) removed early credits from its plans to revise the VRGGP because the Department's general counsel determined there was "no explicit authority" for credits in Section 1605(b) of the 1992 Energy Policy Act (EPAct). While this explanation is correct as far as it goes, it may inadvertently give the impression that 1605(b) provides *implicit* authority for credits. As CEI's previous comments demonstrate, current law provides no authority, expressed or implied, for an early credit program. Clarification of the Administration's views on the legal boundaries of 1605(b) is overdue. Please ensure that DOE's final document explains the Administration's legal opinion in reasonable detail.

(2) No legal authority to issue a rule. David Finnegan of Mayer, Brown, Rowe, and Maw questioned DOE's authority to propose a "rule" to modify the VRGGP. Section 1605(b)(1) of the EPAct requires the "issuance of guidelines." It provides no authority for rulemaking. Indeed, Congress specifically considered and rejected the option of issuing a rule when it rejected language that would have set up an early credit program.

As explained in previous CEI comments, an early credit program is *pre-regulatory*—it provides government-certified offsets applicable to future regulatory requirements. That is presumably why the House-passed version of 1605, which would have provided opportunities for participants to receive "credit against any future Federal requirements that may apply to greenhouse gas emissions," also directed DOE to "establish *by rule* a national accounting system for voluntary reductions of greenhouse gases" [emphasis added]. DOE's choice of the term "proposed rule" to describe its proposal may reflect the Administration's earlier plans to transform the VRGGP into a pre-regulatory credit program. DOE now acknowledges that it lacks authority to award credits. DOE should similarly acknowledge that it lacks authority to issue a rule, and publish a retraction of the misleading terminology in the *Federal Register*.

(3) Project versus entity-wide reductions. Several participants at the workshop questioned DOE's rationale for refusing to allow entities to "register" project-level reductions. Some noted that the President's goal is to reduce emissions intensity, not absolute emission levels, and that it is by means of projects that emissions intensity is reduced. They wondered why, if a firm's project reductions are not a product of shifting emissions to non-reporting parts of the entity, the firm is only allowed to "report" such reductions but not "register" them, relegating project reductions to a second-tier status.

The distinction between "registering" and "reporting" seems to be a holdover from DOE's now-abandoned plan to award credits for "registered" reductions. Since DOE no longer intends to award credits, the rationale for a two-tiered system is unclear.

However, stakeholders who raised this issue apparently want to "register" project reductions for the purpose of receiving "credit" applicable to a future emissions cap. That would be entirely inappropriate. A cap is a legal limit on absolute emissions measured against an historic baseline. To comply with a cap, a firm must reduce absolute emissions (not just emissions intensity) on an entity-wide basis (not just at one or more facilities or sources). Although all early credit schemes are mischievous, it would be illegitimate to award credits for actions other than "real" (i.e., tonnage) reductions, measured on an entity-wide basis.

Therefore, until and unless stakeholders renounce their support for a credit program, DOE should retain the two-tier system and not "register" project reductions. Allowing companies to "register" project reductions, which are generally easier to achieve than entity-wide reductions, would simply encourage stakeholders to lobby for credits.

(4) Risky insurance. William Pizer of Resources for the Future (RFF) argued that businesses need an early credit program to "hedge their bets" in case a future Congress decides to enact mandatory limits on carbon emissions. This is a variant of the well-worn refrain that credits are needed as an "insurance policy" or "baseline protection" system so that "early reducers" will not have to do double duty (reduce emissions from already lowered baselines) under a future climate policy.

However, an insurance policy that makes the insured-against event far more likely to happen is a prescription for disaster. That is exactly what "Kyoto insurance" in the form of early credits would do. As explained in previous comments, credits worth little or nothing under current law could be worth millions or billions of dollars under Sen. James Jeffords's (I-Vt.) Clean Power Act (S. 366), the McCain-Lieberman Climate Stewardship Act (S. 139), or the Kyoto Protocol. Consequently, if credit holders want to turn "voluntary" reductions into real money, they must lobby for mandatory programs. DOE cannot create a Kyoto "hedge fund" without growing the greenhouse lobby and, thus, increasing the risk that Congress will enact Kyoto-style policies.

Not all hedging strategies deserve approbation and support. A prizefighter caught placing large bets on his opponent might say—and perhaps even believe—that he was just hedging. However, most people would conclude the fix was in. That early credits are part and parcel of a "Kyoto fix" for U.S. energy markets may be inferred not only from the lobbying incentives that credits would unavoidably unleash, but also from the fact that Kyoto "insurance" salesmen work both sides of the street.

Consider that many leading proponents of early action credits—Sen. Joseph Lieberman (D-Conn.), Environmental Defense, the Pew Center on Global Climate Change, RFF, Dupont, Clean Energy Group, etc.—are also among the leading proponents of emissions cap-and-trade programs. They are in the odd position of advocating a hedge against, or demanding baseline protection from, the very policies they promote!

The U.S. Senate would never ratify Kyoto, nor would Congress ever enact McCain-Lieberman or the Clean Power Act, unless pushed to do so by many of the same policymakers, companies, and activist groups advocating credit for early reductions. If they really wanted to, Sen. Lieberman, RFF, Dupont, et al. could easily ensure that "good corporate citizens" are not "penalized" in the future for "voluntary" reductions today. All they would need to do is disavow their support for cap-and-trade! Instead, they try to sell "protection" from a threat they have in large measure created—all the while knowing that such "insurance" would make the threat more imminent and certain.

To wrap up, awarding early credits would increase, not reduce, the risk of an energy-constrained future for U.S. businesses and consumers. DOE's decision to drop early credits from its proposal is, therefore, not only good law, but also good policy.

Sincerely,

Marlo Lewis, Jr., Ph.D.
Senior Fellow
Competitive Enterprise Institute
202-331-1010; mlewis@cei.org