

**Comments of the Western Power Trading Forum on  
Implementation of the Quantitative Limit on the Use of Offsets  
Under the Cap and Trade System**  
4/30/09

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The Western Power Trading Forum<sup>1</sup> (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (ARB) on implementing the quantitative limit on offsets under the cap and trade system. WPTF has considered the three options proposed by ARB staff and considers that only the “usage” limit option will comply with the goal of reducing costs to capped entities. We therefore urge ARB to adopt the usage limit approach. Our comments on this and other questions posed by ARB staff are provided below.

### **Only the usage limit option will reduce costs for capped sectors**

The Scoping Plan adopted in December 2008 limits the use of offsets in California's cap and trade system to 49% of the total emission reductions achieved under the program. The fact that this limit is set relative to emission reductions rather than to the emissions cap means that ARB must determine both the total number of offset credits that may be used in a given time period and the mechanism for implementing the limit. ARB staff have proposed 3 options for implementing the offset limits:

- *A supply limit* would limit the quantity of offsets created or certified for use within the cap and trade system, presumably on a first-come, first-served basis. Because any offsets certified for use in California under this option would by definition be within the quantitative limit, capped entities would be assured that they could use any offsets purchased for compliance purposes. Since demand for offsets would likely exceed the supply, the price of offsets should approach the price of allowances.
- *A hybrid limit* that would be a variant of the supply approach. As WPTF understands this option, the limit would also be applied to the supply of offsets allowed into the system, but rather than issuing offsets on a first-come, first-served basis, as under the supply limit option, ARB would auction 'offset quota instruments' to offset project developers. Again, because of the excess of demand for offsets, offset prices would be expected to converge with allowance prices.
- *A usage limit* would apply the limit to the retirement/surrender of offsets by individual capped entities, rather than to the creation or certification of offsets. Under this scenario, the supply of offsets is likely to exceed demand, because the supply is potentially unlimited (or rather, conditioned on factors other than the offset limit) while demand is capped. For this reason, the usage limit approach would create a price spread between allowances and offsets.

WPTF considers that the primary purpose of allowing offsets to be used within California's greenhouse gas cap and trade system is to reduce compliance costs. This purpose was clearly established in the Scoping Plan adopted by the Board in December, which recognized “the need to provide sources within capped sectors the opportunity for low-cost reduction opportunities

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<sup>1</sup> WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

that offsets can provide.”<sup>2</sup> It is therefore imperative that each of the proposed options for implementing the offset limit be evaluated in terms of its impact on compliance costs for capped sectors and entities.

Both the supply limit and the hybrid variant<sup>3</sup> would result in higher offset prices vis-à-vis the usage limit approach. This is because an unlimited offset demand will be chasing a limited supply of offsets, driving up prices. The increased offsets prices will not affect the level of emission reductions achieved within the cap and trade system, nor the quality of offset reductions, but rather will only drive up compliance costs for capped sectors, which will in turn drive up costs to consumers. Furthermore, this approach will not lead to the development of the least-cost offset projects, only those that are fastest to get in line. This outcome is completely contrary to the purpose of the cap-and-trade program generally to reduce the societal costs of GHG emission reductions, as well as being contrary to an offset program specifically in reducing costs to compliance entities, and for this reason the supply limit and the hybrid variant options should be rejected.

On the other hand, the usage limit approach creates a situation where a potentially unlimited offset supply is chasing a limited amount of offset demand, resulting in the development of the least cost offset projects and lower consumer impacts. Thus, only the usage limit approach will result in lower compliance costs for capped sectors. For this reason, WPTF urges the Air Resources Board to adopt the usage limit approach and to advocate for its use across the WCI.

## **Input on other Issues**

WPTF offers the following comments on other issues raised by ARB staff related to the implementation of a quantitative offset limit.

- ***Should the offset limit be set for the entire period up to 2020 or for individual compliance periods? Should the limit be constant across compliance periods, or increasing or decreasing?***

WPTF recommends that the offset limit be applied for the entire period up to 2020. This approach will maximize the flexibility of capped entities to manage their compliance in light of variations in emission levels and to respond to market conditions. In addition, long term quantitative certainty will facilitate the financing and implementation of emission reduction offsets.

- ***How should the limit be applied across the WCI - WCI wide or by individual jurisdictions?***

WPTF considers that, to the extent possible, rules for the cap and trade system, including implementation of the offset limit, should be harmonized across the WCI. While

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<sup>2</sup> Scoping Plan Document at page 37

<sup>3</sup> Hypothetically, the hybrid variant could be implemented so that economic rents are returned to capped sectors. However, WPTF does not consider this to be a politically plausible outcome.

individual WCI jurisdictions may apply different quantitative limits on the use of offsets within their jurisdictions, each of these limits should be implemented in the same way – as a usage limit on the quantity of offsets that may be surrendered by individual entities.