



## Union of Concerned Scientists

Citizens and Scientists for Environmental Solutions

April 30, 2009

VIA E-MAIL: [ccworkshops@arb.ca.gov](mailto:ccworkshops@arb.ca.gov)

Brianne Aguila

California Air Resources Board

1001 "I" Street

Sacramento, CA 95812

### **Re: Design Recommendations to Implement a Quantitative Offset Limit**

Dear Ms Aguila,

The Union of Concerned Scientists appreciates the opportunity to comment on issues relating to the implementation of a quantitative limit on the use of offsets in a California cap-and-trade program.

AB 32 directs the Air Resources Board to establish emission reduction measures that minimize administrative burdens while maximizing benefits for the California economy, improving and modernizing California's energy infrastructure, maximizing environmental and economic co-benefits to the state, and improving air quality. The manner in which an offset limit is applied can help achieve these important AB 32 requirements. Below, UCS provides feedback on the specific questions raised by CARB in the March 23 workshop on implementing a quantitative limit on offsets.

#### **1) Should the offset limit be based on the use of offsets, the supply, or a hybrid of both?**

The offsets supply should be based on the use of offsets (ie: the "usage limit").

The EU ETS and RGGI programs are both designed to limit offsets at the compliance source. Program designers in the EU and RGGI began by determining the percent of emission reductions that should come directly from the capped sectors. The resulting offset limit, relative to total reductions, was then translated into a percentage of each regulated source's compliance obligation, to be enforced at the source level. In RGGI, for instance, each source may cover 3.3% of its reported emissions in a compliance period with offsets (as long as certain allowance price triggers are not met).

CARB should adopt a similar method for enforcing an offsets limit at the source level. This method of enforcement will ensure that any offset that meets the standards and protocols established by CARB will be available to any capped entity that would like to purchase an offset. This creates a competitive offsets market by not limiting the pool of available offsets.



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Usage limits enforced at the source level may also be a valuable tool in helping to avoid the creation of criteria or toxic pollutant hot-spots, by providing a barrier against one source buying large amounts of offsets and actually increasing emissions. (Similar precautions may need to be put in place to avoid hot-spot creation through trading.)

A supply limit should not be used because it will dampen competition amongst offset producers and may lead to unintended or perverse impacts depending on how the supply of offsets is chosen. A supply limit will practically guarantee that offsets are sold for the same price as allowances, providing rents to offset producers at the expense of capped entities and the public.

Applying a usage limit with a quota certificate acts like an offset supply limit and ensures that offsets will trade at the same price as allowances. Rather than artificially inflate the price of offsets with a quota certificate it may be better for the state to charge offset purchasers a fee to cover the state's costs for running the offset program. Quota certificates create additional transaction costs for the market system and an additional administrative burden for CARB.

### **2) How should the 49% offset limit be applied across jurisdictions in the WCI?**

California and the other WCI states have not yet decided on specific quantitative offset limits.

The limits, once they are determined, should be applied at the jurisdiction level within the WCI. So, each state and province may determine its own offset level, as long as it is no more than 49% of reductions. We encourage CARB to advocate that the WCI should define "reductions" as relative to the level of the cap from the previous compliance period.

### **3) How should the limit be divided among compliance periods?**

The limit should be established as a percent of reductions expected per compliance period, relative to the previous compliance period (as was demonstrated in slide 17). This is the simplest methodology to implement. If reductions are instead defined relative to a 2012 baseline, the percentage of offsets relative to reductions becomes very large and carry-over issues across compliance periods could arise and complicate estimation especially in the latter years of the program.

The periodic offset limit should remain fixed throughout each compliance period. A pre-announced and certain offset limit will help regulated sources make effective investment decisions, and will help offset developers by keeping the offset market relatively stable throughout the program.

It has been argued that more offsets may be needed during certain phases of the program in order to contain costs or increase price stability. However, given the many difficulties involved



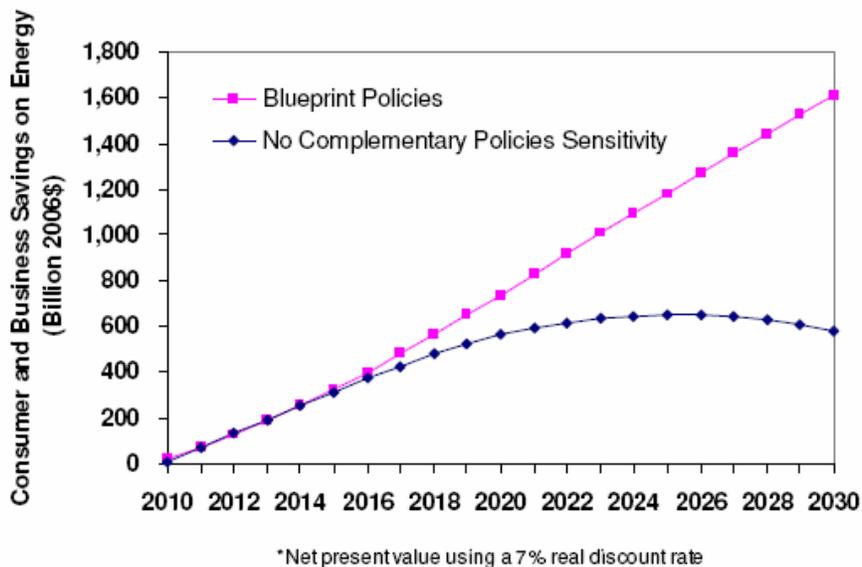
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in ensuring the additionality and environmental integrity of offsets, UCS recommends that other mechanisms be considered to contain costs. For example, banking, the use of an allowance reserve, and strategic spending of auction revenues, can all be used to decrease price volatility and moderate allowance price. As you know, complimentary policies also act as cost-containment mechanisms.

UCS will soon be releasing a comprehensive national economic report<sup>1</sup> on how to cut global warming pollution 56 percent below 2005 levels by 2030 with net economic benefits. The report shows how great a role complimentary policies can play as cost-containment mechanisms. The report explores several scenarios, including a scenario in which an economy-wide cap-and-trade program plus a suite of complementary policies are implemented, and a scenario that strips out the complimentary policies and relies solely on cap and trade to achieve the emission reductions.

The “no-complementary policies” case shows that if these policies are removed, consumers and businesses will save much less money. Excluding the complementary policies in the energy and transportation sectors would double the price of allowances reduce cumulative net consumer and business savings through 2030 from a total of \$1.6 trillion to \$0.6 trillion. (See graph below).



<sup>1</sup> The executive summary of the report is online at: [http://www.ucsusa.org/global\\_warming/solutions/big\\_picture\\_solutions/knoblochtestimony.html](http://www.ucsusa.org/global_warming/solutions/big_picture_solutions/knoblochtestimony.html)  
The final report will be available in May.



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In summary, we urge you to adopt a usage limit on offsets, and define the offset limit relative to the cap from the previous compliance period.

We also urge you to explore the full range of cost-containment tools in order to select the policy instruments that best achieve the goals of AB 32.

Thank you for consideration of our comments. We look forward to continuing to work with CARB staff on this and other design issues relating to implementation of the AB 32 cap-and-trade program.

Sincerely,

Erin Rogers