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Kevin Kennedy
California Air Resources Board
1001 I Street
Sacramento, CA

Re: **NORTHERN CALIFORNIA POWER AGENCY Comments on April 28
Workshop “Criteria for Compliance Offsets in a Cap-and-Trade Program”**

Dear Kevin:

In accordance with the direction provided during the April 28 Workshop, *Criteria for Compliance Offsets in a Cap-and-Trade Program* (April 28 Workshop), the Northern California Power Agency¹ (NCPA) hereby submits these comments. NCPA cannot overstate the positive role that an offset program will have to mitigate the economic impacts of the greenhouse gas (GHG) reduction program ultimately implemented by the California Air Resources Board (CARB). Without question, a robust offset program provides alternative compliance options and cost control mechanisms for entities subject to CARB’s program. As it pertains to entities such as NCPA’s member utilities, any cost savings go directly to businesses and residents served by these members.

CARB’s Scoping Plan discusses the use of offsets in several contexts, including as: (1) a means of providing low-cost reduction options for regulated entities, (2) an incentive for carbon reduction projects outside of the state and the country, in areas where reductions would otherwise not occur, and (3) a way to reduce the cost of GHG reductions for the entire State.² The April 28 Workshop focused on discussions regarding specific criteria for offset projects that can be recognized by CARB for use in a California cap-and-trade program.

While Assembly Bill 32 (AB 32) requires CARB to look at the cost-effectiveness of emissions reduction measures, few cost containment opportunities are readily available to entities with a compliance obligation. A viable offset program provides one such opportunity, while concurrently offering a tool that will facilitate and encourage the development of new emission reduction technologies.

¹ NCPA members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

² Scoping Plan, p. 36.

It is imperative that CARB establish well-defined criteria that meet the minimum standards set forth in AB 32.³ Those criteria must also provide the necessary flexibility to ensure that offsets can be utilized by entities with a GHG reduction obligation as a means to help control AB 32 compliance costs and encourage innovation in alternate GHG reduction mechanisms. The regulations developed by CARB must ensure the viability of a robust offsets program.

Furthermore, offset compliance criteria must be closely aligned with discussions regarding review and approval of offset projects, which was the topic of a CARB workshop held on May 21. The verification process for offset credits, for example, must be closely aligned with the initial project review and approval process, as should criteria regarding additionality. These issues must be considered in concert when developing final regulations and guidelines on compliance criteria.

I. COMMENTS ON SPECIFIC CRITERIA

A. Approaches to Defining Offsets

At its most basic level, CARB defines an offset as a GHG emission reduction that: (1) is beyond any reduction otherwise required by regulation or that otherwise would occur, (2) generates a credit that can be used to meet a regulatory compliance obligation or a voluntary commitment, and (3) addresses emissions not included in a cap-and-trade program. (Staff Presentation, Slide 7) This broad definition assumes that such a reduction will meet all the technical requirements mandated by AB 32.

In order to ensure that stakeholders have a usable working definition of an offset, Staff presented various alternatives for how the compliance criteria of an offset should be defined. The most useful (and usable) approach for defining offset criteria is to include certain minimum definitions in the regulation ultimately adopted by CARB. NCPA urges consideration of the following minimum criteria for defining an offset:

- Offsets meet all of the criteria set forth in AB 32.
- Offsets must be characterized as a tradable unit within the cap-and-trade program, equal to one metric ton of carbon dioxide equivalent (one metric ton CO₂e).
- Emissions reductions attributed to an offset must come from a source outside of the capped sectors.
- Any emission reduction from an offset project must be certified as eligible by CARB.
- To be eligible for consideration, the emission reduction from the eligible offset project must meet all of the specific project requirements set forth in the Guidelines.
- The entity surrendering the offset credit to meet a compliance obligation must own the offset credit.
- The location of the offset project is not subject to any geographic limitations.

³ Offsets must be “real, permanent, quantifiable, verifiable, and enforceable by the state board,” (Health & Safety (H&S) Code § 38562(d)(1)) and “in addition to any greenhouse gas emission reduction otherwise required by law or regulation, and any other greenhouse gas emission reduction that otherwise would occur.” (H&S Code § 38562(d)(2))

Remaining information specific to eligible offsets should be left to more detailed design documents or CARB guidelines. This includes particulars regarding the types of eligible projects and project eligibility dates and specific provisions relative to ownership rights in an eligible project, as well as the timing and requirements associated with project verification. Discussion regarding the duration of accreditation for an eligible project or offsets credits from such a project, including implications of new or revised regulations or legislation, should also be included in guidelines and design documents. Because the California offset program is not only a nascent program, but one that the State will want to compliment any regional or federal program, the program must be designed to provide interested stakeholders with minimum assurances, without being so restrictive that it would be impossible to adapt and adjust to changes in the marketplace.

B. Geographic Eligibility

Offsets are an important cost containment tool for compliance entities, and as such their use should be defined in the broadest possible way that still meets the minimum criteria. As noted in both the Scoping Plan⁴ and the April 28 Workshop, the logic behind not imposing geographic limitations on the use of offsets stems from the desire to facilitate the utilization of high quality offset projects – even projects located outside of California – that can help lower compliance costs for regulated entities in the State, while reducing GHG emissions.

Offset credits from projects located in uncapped markets outside of the California or the Western Climate Initiative (WCI)⁵ programs should not be excluded from eligibility solely because had those projects been located within California/WCI they would be covered by the cap. Such an arbitrary limitation on offsets only chills the usefulness of an offset program as a cost containment tool, as well as the development of emissions reducing projects in other jurisdictions. Offsets generated from within the electricity sector, but outside of the California/WCI program, should be encouraged, unless the jurisdiction within which the project is located is subject to a cap.

Staff suggested that offset projects located in “developed” countries not be eligible as compliance offsets. No distinction should be made between programs in developed versus undeveloped countries where an emissions cap does not exist. The rationale for this limitation is ostensibly that if a “developed” country has the capability to develop a cap-and-trade system, they should do so. However, this argument runs afoul of a primary goal of an offset program: to encourage emissions reduction projects. It is likely that the development of offset projects in these regions could even facilitate the development of more aggressive emissions reduction measures globally.

4 Scoping Plan, pp. 30, 36.

5 Comments regarding the scope of the proposed offset program assume a California/WCI program. However, any limitations discussed in the context of this jurisdiction should be expanded to include a national program once one is developed, in order to further ensure the ongoing parity and fungibility of offset credits in a national program.

Especially at the nascent stages of the California cap-and-trade program, the offset program should not be designed to favor any one geographic region. However, if one goal is to encourage the development and utilization of domestic offsets, there are ways that CARB can encourage domestic offsets without placing undue restrictions on the geographic eligibility of offsets. For example, CARB could adopt accounting protocols that assign a different or scaled credit value for offsets located with the California/WCI program. CARB must carefully balance the desire to encourage development of emission reducing offset projects with the desire to encourage other market behaviors, and such balancing must be undertaken in the context of ensuring that the California offset program is a viable cost containment tool for compliance entities.

Staff's initial thinking is to exclude from eligibility offsets that are the result of indirect emissions reductions other than where the reduction activity is implemented (Staff Presentation, Slide 13). NCPA disagrees. Offsets derived from projects outside of the California/WCI jurisdiction should not be limited to direct emissions if substantial reductions can be achieved through indirect emissions programs, and such an exception should not be limited to a distinction between developed and developing countries.⁶

C. Project Eligibility Date

Staff has identified two key dates related to offset credit eligibility: *project eligibility date* and *eligible vintage date*. The project eligibility date refers to the date that construction or other significant steps were taken to develop the offset project. The eligible vintage date refers to the date when verified carbon reductions actually occur.

Staff presented a number of alternatives for determining when an offset project should be deemed eligible to have offsets utilized within the California cap-and-trade program. For purposes of both the project eligibility date and eligible vintage date, it is important that an arbitrary date not be imposed that would needlessly exclude valid and viable offset projects. It is not clear what purpose is served by restricting the project eligibility date if the underlying project meets all of the other mandatory criteria.

The date of project inception becomes more important as the time for implementing the cap draws near. Because some offset projects are likely to require considerable development time, it is important that emissions from projects deemed eligible when "approved" are not limited by the date that the emissions reductions are actually recognized. Indeed, the only crucial date may be the eligible vintage date, as it is conceivable that a project that meets the criteria at the commencement of project development may not meet all of the criteria when emissions reductions are actually realized. If a project meets all mandated criteria upon development approval, and is still able to generate verifiable reductions when it is actually operable, the offset

⁶ During the April 28 Workshop, staff noted that CARB may be willing to accept offsets resulting from indirect emissions reductions if they are derived from projects located in developing countries (Staff Presentation Notes, Slide 15). NCPA encourages CARB to carry this rationale over to all indirect emissions reductions located outside of the California/WCI jurisdiction.

credits from that project should be fully recognized for the duration of the crediting period.

As it pertains to existing projects, the eligibility date is the least important criteria, and any project that meets all of the other mandated criteria at the time the “approval” is requested should be allowed to generate offset credits for use in the California cap-and-trade program as long as emissions reductions can be verified. For these projects, the project eligibility *date* is a moot point, since eligibility would be subsumed within the other eligibility criteria.

D. Ownership Rights

CARB must maintain a registry of all projects that are eligible to generate offset emission reduction credits and the total number of offsets available from each project. Rights in emission offset credits should be freely transferable and treated as any other emission allowance, and entities wishing to surrender offset credits in lieu of an emissions allowance must be able to verify the origin of the offset credit and its ownership interest in the offset credit.

During the April 28 Workshop, Staff invited responses to three specific questions regarding ownership rights to an offset credit (Staff Presentation Notes, Slide 17), which are answered below.

Would the entity with operational control of an emission reduction project be the owner of the offset?

Ownership of the offset credit is separate and distinct from the ownership interest in the underlying offset project. The interest in the offset credit is severable from the ownership or operational control of the project, even if the same entity owns the project and retains the rights to the offset credit.

To link ownership interests in an offset credit to ownership or control of the underlying project would severely limit the development of offset projects or the utilization of offsets as a cost control mechanism. Project developers without a compliance obligation should be able to maintain ownership and operational control of their projects while still marketing a usable offset (just as the owner of an electricity generation facility may sell the electricity generated without jeopardizing its ability to operate the facility). Likewise, a compliance entity without the capital to purchase and/or operate an offset project would still be able to contract for the offset credit.

Furthermore, as Staff noted, linking operational control of the emission reduction project to ownership of the offset would also be a challenge in the face of multi-party projects. However, contracts establishing parties’ ownership rights in the product of an underlying project is not a new concept, and is easily accomplished. Such a situation is seen often in ownership of electric generation powerplants, and similar contractual arrangements could be made to define the ownership interests in an offset credit.

Should ownership of compliance offsets be freely transferable?

Offset ownership should be 100% transferable at any time. Just as emissions allowances

can be bought and sold, so should offset credits be transferable.

Which instrument should be used for tracking transfers of ownership?

Offset ownership or title to the offset credit can be tracked through contracts. Compliance entities surrendering an offset credit in lieu of an emissions allowance will have to show not only their ownership interest in the offset, but the origin of the offset credit as well. Since CARB will need to maintain a database of eligible projects, it will be able to verify the ownership right.

E. AB 32 Mandate of “Real” Reductions

While there are clearly nuances that must be addressed with regard to the specific mandates set forth in AB 32, for the most part, the “real, quantifiable, permanent, verifiable, enforceable, and additional” requirements are generally non-controversial, and developing guidelines to address them should be relatively straightforward.

In defining “real” emission reductions, NCPA agrees that the principle of conservativeness is a good starting point. Doing so will ensure that uncertainty and accuracy are incorporated into the review process, minimizing the potential to double count emission reductions. However, it is also necessary to avoid unnecessarily cumbersome restrictions.

During the April 28 Workshop, Staff noted that the definition of “real” reductions must include a means by which to address emissions leakage. As it is used in this context, the definition of “leakage” must be more fully developed. To a certain extent, the use of an offset means “leakage” to another area. While Staff noted that such criteria would attempt to account for instances where an offset project results in an increase in emissions outside of the project boundary, such a determination must be made on a project by project basis (Staff Presentation Notes, Slide 20). In order to more fully understand the type of “leakage” contemplated herein by CARB Staff, specific examples would be helpful.

F. AB 32 Mandate of “Quantifiable” Reductions

NCPA agrees with the preliminary Staff positions defining the quantifiable element of the offset credit. (Staff Presentation and Staff Presentation Notes, Slides 20-21) The adopted quantification methodologies are going to be key to determining whether or not an offset project is even viable, and those methodologies should be well established at the time the underlying offset project is first submitted for approval. As noted above, elements associated with quantification of the reductions must be addressed concurrently with matters regarding review and approval of offset projects.

G. AB 32 Mandate of “Verifiable” Reductions

If emission reductions cannot be verified, offset credits cannot be utilized to meet a compliance obligation. Clearly, verification is a crucial criterion that must be met, as well as a crucial element in ensuring the integrity of the California offset program. However, the verification process itself must not impose substantial delays on project approvals or eligible

offset vintaging.

Offset verification programs should rely on accepted protocols adopted by regulatory entities. This is important in order to maintain the integrity of the offset program, and ensure that stakeholders are aware of the standards by which a program will be evaluated at the beginning of project development. As noted above, verification is also inexorably linked to the initial project review and approval process. Verification standards must also be project specific.

H. AB 32 Mandate of “Enforceable” Reductions

CARB must have the authority to enforce the claims of emission reductions in an offset program. As noted by Staff, CARB must have appropriate mechanisms in place to register, track, and retire offset credits. Buyers of offset credits must be ensured that they are purchasing a valid product and valid offset project developers should not be forced to compete with fraudulent offset projects. Accordingly, CARB must establish enforcement penalties that can be imposed on project developers that attempt to sell a greater number of offset credits than authorized.

I. AB 32 Mandate of “Additional” Reductions

As technologies advance and lawmakers become more aggressive in mandating greater and greater emissions reductions, determining additionality will be somewhat of a moving target. What is deemed additional today may be deemed mandatory tomorrow. In order to facilitate the development of cutting-edge offset programs in such a dynamic environment, additionality criteria should look at both standardized assessments and project specific criteria.

Project crediting should not be based on arbitrary and predetermined timeframes, as expressed by Staff at the March 28 workshop (see Staff Presentation, Slide 33). While these parameters may be helpful as a base, actual crediting periods should be project- and technology-specific. NCPA also supports the option a “renewal option” for review of a specific project to determine if offset credits should be authorized for an additional period of time. Such renewal process, however, must have clearly defined review criteria and should not be used as a reason for limiting initial project crediting. It is conceivable that some high emissions reducing projects would not be developed if project proponents could not be ensured that the offset credits would be usable for more than a limited timeframe.

Offset credits from approved projects should be valid throughout the crediting period, even if subsequent changes nullify one or more of the original criteria. While AB 32 mandates that offsets be verified, projects that meet all of the other requirements at their inception should be deemed eligible projects. If a project met all of the other criteria when approved, the only remaining criterion to be met should be verification of the actual emission reduction. Offset projects with long lead times to develop, and which would likely not have been developed without the incentive provided by the existence of an offset program should not be penalized because those same project technologies become “mainstream” by the time the *initial* project is finally brought online. Hindsight should not be used to judge the other compliance criteria that

were already reviewed in light of the circumstances in existence at the time the project was first approved.

Funding sources should not be linked to additionality. Doing so could hamper the development of costly offset projects that have the potential to realize significant emissions reductions. To be sure, if there is a funding source that is willing to provide 100% of the capital necessary to develop a certain technology, then perhaps that should be scrutinized more closely. However, if that same source is doing so in the hopes of expanding the development of such technology into the mainstream, there is no reason why the initial development should not meet the additionality requirement for approval as an offset project (assuming that all other criteria have been met). The source of funding should not be determinative of whether or not a project qualifies as a valid offset project.

J. Offset Value

California's offset program should recognize offsets and allowances as having an equivalent value and both should be valued at one metric ton CO₂e. Compliance entities should be able to trade and surrender allowances and offsets in a like manner, and offsets should be recognized synonymously with an allowance.

If CARB is interested in encouraging domestic offsets, CARB could adopt measures, such as those set forth in the current discussion draft of the Waxman-Markey bill (H.R. 2454) that imposes a 5:4 exchange basis on international offsets after a date certain (2018 for the proposed federal legislation).

K. Point of Regulation

There are potentially two points of regulation within a California offset program. One point of regulation would be over the offset project itself, and the ability of CARB to review and certify a project as eligible to generate offset credits that can be used in a California cap-and-trade program. There are jurisdictional implications associated with this point of regulation, and if the project owner is located outside of CARB's jurisdiction there are limited actions the agency can take in the event of malfeasance. However, while CARB may not have specific enforcement jurisdiction over all offset projects, CARB does retain the right to certify the offset project and makes the sole determination of whether or not the agency will accept an offset credit from a specific project. In that case, it does have some ability to reach a fraudulent entity by precluding offset credits from such entity's project.

Another point of regulation centers on the surrender of the offset credit by a compliance entity. CARB will always have authority over the compliance entity and can impose penalties against this jurisdictional entity in the event that there is malfeasance in the surrender of invalid or forged offset credits. Given CARB's jurisdictional limitations, compliance entities that wish to utilize offset credits from extra-jurisdictional projects will need to do due diligence to ensure that they are contracting for offset credits from a valid source, and that the offset credit purchase agreement addresses these concerns.

II. CONCLUSION

NCPA appreciates the opportunity to offer these comments and looks forward to continued efforts towards the development of a viable offset program within the context of the State's cap-and-trade program. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or scott.tomashefsky@ncpa.com.

Sincerely,
MCCARTHY & BERLIN, LLP

A handwritten signature in blue ink that reads "C. Susie Berlin". The signature is written in a cursive style.

C. Susie Berlin
Attorneys for the Northern California Power Agency