

California Air Resources Board Criteria for Compliance Offsets in a Cap-and-Trade Program

Comments submitted by
Adam Stern, Vice President for Policy and Strategy
TerraPass Inc., San Francisco, CA
May 21, 2009

TerraPass, a San Francisco based company with a large portfolio of carbon offset projects and more than 150,000 individual and business customers, is pleased to submit comments on the California Air Resources Board (CARB) criteria for compliance offsets in a cap-and-trade program. We commend CARB for continuing to recognize the important role offsets can play in helping the state reach the greenhouse gas emission reduction goals contained in AB 32. Offset projects can reduce compliance costs, while spurring innovation in areas of the economy not subject to GHG regulations. The key is to insure that emission reductions from offsets are real, additional, quantifiable, independently verified, and permanent – all criteria reflected in the AB 32 scoping plan approved last year.

To support the CARB staff's preliminary thinking, we offer these recommendations:

Offset Definition and Eligibility

- 1) **Project start dates and vintages:** Compliance offsets should be allowed from projects that began operations Jan. 1, 2006 or later.

Assembly Member Pavley first introduced AB 32 in December 2004. Amended versions of the bill emerged in March and August 2005 and April 2006 – each time gathering more legislative support and becoming more visible to the general public. The Legislature passed AB 32 in August 2006 and Governor Schwarzenegger signed it into law on Sep. 27, 2006. Throughout this time, offset project developers had increasingly good reasons to believe that greenhouse gas regulation was coming to California.

Across the country, the Regional Greenhouse Gas Initiative (RGGI) workgroups began work in 2003 to create a regulatory system for greenhouse gas emissions in the Northeast. Development of RGGI offset provisions began in 2004; after substantial public review, the offset provisions were codified in the final model

TerraPass Inc.

rule in December 2005. Under RGGI, offset projects that began operating after December 20, 2005 are eligible as compliance offsets.

Federal initiatives were also evident in this timeframe. For example, in October 2003 the proposed McCain-Lieberman Climate Security Act – which included a cap-and-trade system with offset provisions – was brought to a vote before the full U.S. Senate.

The policymaking environment in 2001-06 provided increasingly clear market signals that greenhouse gas emission reduction projects could provide a financial return. These signals mirror TerraPass' own experience with greenhouse gas emission reduction projects. We have reviewed well over 100 domestic greenhouse gas emission reduction projects against our own additionality criteria, and believe that a project online date of January 1, 2006 appropriately distinguishes between projects which were implemented for the purpose of generating saleable greenhouse gas emission reductions, and those which were implemented for other reasons and would have happened in any case. The harmony between this date and the RGGI eligibility date provides an additional benefit.

We also support the issuance of compliance offsets from these projects from their start date: January 1, 2006. We see no compelling argument to restrict compliance offset vintages separately from compliance offset project eligibility. If the project is eligible, then all of its offsets should be eligible as well.

- 2) **Sources Eligible for Offsets:** According to the AB 32 scoping plan, some sources covered by the cap-and-trade system will enter the system in 2012, while others will enter several years later. The scoping plan recognizes the value of providing incentives for early action by sources that will ultimately be covered by cap-and-trade, but CARB has not yet defined the nature of such incentives.

As noted in other meetings, the means of distributing carbon emission allowances will have a major impact on the incentives for early action. For example, if all allowances are auctioned, early actors benefit automatically because their early actions reduce the number of allowances they are required to purchase when they enter the cap-and-trade system. However, if allowances are allocated to emitters based on a baseline emission year, the incentives to reduce emissions early become less certain. And in both cases, the economic benefits available to these early actors cannot be realized prior to their entry into the cap-and-trade system. This delay in return on investment may discourage early action.

We urge CARB to consider an Early Action Offset program, whereby sources which will enter the cap-and-trade system in 2015 may choose to register emission offsets for any early actions so that these reductions can be immediately monetized. This way, the financial return on early actions is less speculative and can be achieved more quickly. Such a program would require an offset definition and offset protocols which allow cap-and-trade sources to issue offsets for a limited period of time (e.g., until their entry into the cap-and-trade system), and would also require special accounting provisions so that no emission reduction credit is provided via allowance allocation if the reductions have already been registered as offsets.

- 3) **Agreements with Other Jurisdictions:** We support CARB's thinking that projects could be issued compliance offsets if they are approved by another system, or if they are located in a jurisdiction which has implemented an agreement with California (among other requirements). We urge CARB to develop the criteria and the language of such agreements quickly as we envision possibly lengthy administrative processes in other jurisdictions to implement such agreements. Delays of this sort may reduce the early availability of offsets in the cap-and-trade system.

Offset Criteria

- 4) **Verifiable:** We agree with CARB that no credits should be issued prior to verification (no forward crediting). This is a vital principle for insuring offset integrity. Furthermore, we add that verification protocols must insure that offsets cannot be verified until the emission reduction or sequestration has actually occurred. Said differently, all verifications should be ex-post confirmations of actual reductions or sequestrations.
- 5) **Additional:** Compliance offsets should rely primarily on standardized "performance standard" additionality assessments.

The benefits of "performance standard" additionality tests are frequently cited in terms of efficiency and clarity. To these benefits, we would add that performance standards are a familiar regulatory tool, and that a well-executed performance standard test sacrifices very little in terms of its ability to distinguish between projects which would have occurred anyway from those which are being implemented due to the cap-and-trade system.

The most important and powerful performance standard tests for additionality are the regulatory test and the common practice test. A "common practice" test identifies the prevalence of an action within an industry segment or project type. If carefully constructed and reviewed with some frequency, this test is powerful

in its ability to exclude projects which are being implemented absent the cap-and-trade. Simply put, if the action is “common,” then it would likely be implemented in a business-as-usual scenario.

To ensure a common practice test does its job, we recommend that careful consideration be given to the following:

- At what point does a practice become “common”? What proportion of a population needs to have implemented an action in order for us to assume that *all* members of the population will implement it without further incentives? We suggest that a reasonably high figure is required here (approaching or even above 50%) before we can conclude that the opportunities for further emission reductions have been exhausted.
- Specifics matter. Though performance standard tests are often created for a project type as a whole, our experience is that there may be significant subsets within a project type with widely varying practices. Common subsets may be geographical or related to project size. For example, the installation of voluntary landfill gas control systems is more common in growing landfills adjacent to urban or suburban areas than they are in stable, shrinking or closed landfills in rural areas.

We offer two exceptions to the general rule of preferring performance standards over project-specific investigations:

First, we caution that performance standard tests often require project-specific investigations to determine whether the project meets the performance standard. For example, a regulatory performance standard test requires project-specific evidence of regulatory compliance. We do not believe that performance standards can or should be constructed with the principle that *any* project-specific investigation is necessarily a failure of the performance standard. Such a principle would likely lead to performance standards that exclude a great number of emission reduction opportunities.

Second, CARB suggests that compliance offsets be allowed from other offset systems, provided those offset systems meet various criteria. We see no reason that CARB should prefer “performance standard” over “project-specific” offset systems when reviewing those systems’ eligibility. While CARB may not wish to establish a new offset system based on a project-specific testing system, existing systems should be considered on their merits.

* * *

Thank you for the opportunity to comment on the compliance offset criteria. We would be happy to answer additional questions from CARB staff.