BEFORE THE
AIR RESOURCES BOARD
OF THE
STATE OF CALIFORNIA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY COMMENT ON JULY 30, 2009 WORKSHOP TOPIC: INTERNATIONAL OFFSETS IN A CALIFORNIA CAP-AND-TRADE PROGRAM

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**SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMMENT ON
JULY 30, 2009 WORKSHOP TOPIC:
INTERNATIONAL OFFSETS IN A
CALIFORNIA CAP-AND-TRADE PROGRAM**

The Southern California Public Power Authority ("SCPPA")[1] respectfully submits this comment on the topic of the Air Resources Board ("ARB") staff's July 30, 2009 workshop, international offsets in a California cap-and-trade program.

Multiple benefits can be derived by recognizing high quality offsets, particularly, international offsets, within the California cap-and-trade program. A liberal inclusion of high quality offsets is entirely consistent with the objectives of the California cap-and-trade program. However, the Scoping Plan sharply restricts the use of high quality offsets. The ARB should reevaluate the restrictions to permit realization of the multiple benefits that could flow from a robust offsets program.

To the extent to which the ARB plans to use standards to evaluate offset projects, the ARB should expedite the development of those standards. Likewise, if the ARB intends to apply sectoral crediting baselines to limit the use of offsets from developing countries or provinces, any requisite agreements with developing countries or provinces should be undertaken expeditiously to avoid delaying the availability of offsets. If the development of standards or agreements is going to be delayed, offsets should be evaluated in the interim on an individual project basis to assure that offsets will be available for the first cap-and-trade compliance period which starts in 2012.

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[1] SCPPA is a joint powers authority. The members are Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Los Angeles Department of Water and Power, Imperial Irrigation District, Pasadena, Riverside, and Vernon. This comment is sponsored by Anaheim, Azusa, Banning, Burbank, Cerritos, Colton, Glendale, Imperial Irrigation District, Pasadena, and Riverside.

Additionally, if the ARB adopts a standards-based approach for evaluating offsets, there should be some flexibility to allow non-conforming offset projects to be evaluated on an individual basis. Lastly, if there are enforcement issues that could delay the availability of offsets, the ARB should consider alternative points of regulation for offsets, as discussed below.

I. MULTIPLE BENEFITS CAN BE DERIVED FROM RECOGNIZING HIGH QUALITY OFFSETS, INCLUDING INTERNATIONAL OFFSETS, IN A CALIFORNIA CAP-AND-TRADE PROGRAM.

Multiple benefits can be derived from recognizing high quality offsets, including international offsets. Benefits flow to entities that are not covered by cap-and-trade programs but which participate in offset projects. Benefits also flow to the cap-and-trade covered entities that fund the offset projects.

A. Benefits to Entities that Are Not Covered by Cap-and-Trade Programs but Which Participate in Offset Projects.

For entities that are not covered by a cap-and-trade program, offsets can facilitate the deployment of technologies and investments to obtain highly cost-effective greenhouse gas ("GHG") emission reductions that would not occur otherwise. While there is a general need for a cap-and-trade program to be designed to permit liberal recognition of high quality offsets, there is a special need for the program to be designed to permit liberal recognition of high-quality offsets from uncapped entities in developing countries.

Given the multiple demands on the limited resources of developing countries, the ability of those countries to undertake emission reduction projects may be constrained in spite of the availability of highly cost-effective emission reduction opportunities. A robust offsets program is a vehicle for utilizing the resources of advanced economies such as California's to realize the potential of those opportunities. The result would be both highly cost-effective emission reductions and associated social and health advancements that may not be realized in the developing countries in the absence of a robust offsets program.

B. Benefits to Entities that Are Covered by a Cap-and-Trade Program.

Allowing the liberal recognition of high quality offsets from projects that are undertaken by entities that are outside of a cap-and-trade program creates a win-win situation. While highly cost-effective emission reductions and associated social and health co-benefits can be obtained in, particularly, under-resourced developing countries, entities in advanced economies such as California's that are covered by a cap-and-trade program can benefit from the liberal recognition of high quality offsets by using the offsets to meet a portion of their cap-and-trade compliance obligation. Assuming that the offsets are obtained at a cost that is lower than the market price of cap-and-trade allowances, the overall cost of the cap-and-trade program can be reduced for the capped entities, benefitting both the capped entities and the economy as a whole. Thus, California and its capped entities can realize valuable cost-containment benefits from the liberal recognition of high quality offsets.

II. THE SCOPING PLAN'S LIMIT ON THE USE OF HIGH QUALITY OFFSETS UNREASONABLY LIMITS REALIZATION OF THE BENEFITS OF OFFSETS.

The Scoping Plan sharply limits the amount of offsets that could be used by cap-and-trade covered entities during the compliance period: "[The] use of offsets and allowances from other systems are limited to no more than 49 percent of the requirement reduction of emissions." Scoping Plan at 37. Thus, "the allowable offsets in each compliance period is less than half of the emission reductions expected in capped sectors in that compliance period." *Ibid*.

Limiting offsets to 49 percent of the required reduction of emissions during the compliance period may result in the ARB achieving its apparent objective of "meaningful emission reductions from capped sources" at sites in California. *Ibid.* However, there is a high likelihood that the Scoping Plan's severe limitation use of offsets would have unintended negative consequences.

The limitation would have a negative impact on entities in sectors that are not covered by cap-and-trade programs. The ARB's limitation on the use of offsets would crimp the spread of clean, low carbon technologies beyond California's covered entities to, particularly, developing countries that could benefit the most from additional resources to reduce GHG emissions. Highly cost effective opportunities for emissions reductions would not be funded, and the social, environmental, and health co-benefits that can accompany GHG emissions reductions in, especially, developing countries would be forfeited.

Similarly, the limitation would have a negative impact on entities that are covered by the California cap-and-trade program. They would be denied opportunities to obtain concrete emission reductions through high quality offset projects that could be accomplished at a much lower cost than emission reductions at California sites. Those entities would be deprived of opportunities to contain the cost of the California cap-and-trade program.

The "49 percent" restriction should be reevaluated.

III. LIBERAL RECOGNITION OF HIGH QUALITY OFFSETS IN A CALIFORNIA CAP-AND-TRADE PROGRAM WOULD BE CONSISTENT WITH ATTAINING THE AB 32 EMISSIONS REDUCTION GOAL AND WITH ATTAINING THE ARB'S OBJECTIVE FOR THE CALIFORNIA CAP-AND-TRADE PROGRAM.

The liberal recognition of high quality offsets in a California cap-and-trade program would be entirely consistent with the Assembly Bill ("AB") 32 mandate to attain a "statewide greenhouse gas emissions limit" by 2020 that is equivalent to "what the statewide greenhouse gas emissions level was in 1990…." Cal. H&S Code §38550. The liberal recognition of offsets from outside of California should also be understood to be entirely consistent with using a cap-and-trade program "to provide a firm limit on emissions" in California as envisioned in the Scoping Plan. Scoping Plan, p. 30.

Under a cap-and-trade program, a limit is placed on the emissions of covered entities by restricting the number of emission allowances that are available to the covered entities and by

requiring the covered entities to surrender allowances at the end of each compliance period in proportion to their reported emissions for the compliance period. If a covered entity surrenders an offset certificate instead of an allowance at the end of a compliance period to cover a ton of emissions, the offset represents a ton of emissions reductions that occurred at the site of a non-covered entity somewhere in the world. The offset is the equivalent of a ton of emissions reductions that would have occurred at the site of a covered entity but for the availability of the offset. Thus, the use of a high quality offset of one metric ton by a covered entity is the precise equivalent of the covered entity emitting one less ton of GHG during a compliance period.

Consequently, the use of high quality offsets by covered entities is entirely consistent with AB 32 requirement that California attain the 1990 level of emissions by 2020, and it is entirely consistent with using a cap-and-trade program to achieve "a firm limit on emissions." While there may be one more ton of emissions at the site of a covered entity in California if an offset certificate is surrendered by the covered at the end of a compliance period, that ton of emissions would be precisely offset by a ton of emissions reductions elsewhere, canceling the ton of emissions in California so as to permit California to be within the AB 32 goal and to permit covered entities to be within the cap-and-trade program's "firm limit on emissions."

A. The ETAAC's Concerns.

The impact of offsets on attaining the AB 32 goal and on attaining cap-and-trade "firm limit on emissions" in California was implicitly raised as an issue at the August 24, 2009 Economic and Technology Advancement Advisory Committee ("ETAAC") meeting in Sacramento. The ETAAC worried about the consequences of H.R. 2454, the American Climate and Energy Security Act ("ACES") that was passed by the U.S. House of Representatives in June, 2009 and is now pending before the U.S. Senate.

The ETAAC was concerned that if ACES became law and entities that are covered by the California cap-and-trade program elected to purchase all of their allowances from out-of-state, none of the emissions reductions that were intended to be obtained in California through a cap-and-trade program under the Scoping Plan would be realized through emissions reductions in California. *See* SCPPA Comment on the July 27, 2009 Workshop on Linking California's Cap-and-Trade Program to Other Greenhouse Gas Trading Programs, p.6 and Attachment A. The ETAAC apparently takes the view that the AB 32 mandate to reduce California emissions to 1990 levels by 2020 means that all emissions reductions must occur in California, and if California entities were to obtain allowances from outside of California under ACES, ARB would no longer be able to rely on cap-and-trade to meet the AB 32 goal. Presumably, the ETAAC would have the same concern if offsets from outside of California were used in lieu of emissions reductions that occurred at the site of covered entities in California.

The ETAAC appears to have an overly crabbed view of the AB 32 requirement that California reduce emissions to the 1990 level by 2020. Given that greenhouse gases are distributed around the globe and that GHG reduction is a global problem, the objective of AB 32 is for California to play its appropriate role in reducing global greenhouse gases. Accordingly, if California's cap-and-trade program were linked to other cap-and-trade programs, and a California covered entity were to buy allowances from an entity that is located outside of California but which is covered by a linked cap-and-trade program, the availability of the allowances would represent the fact that the counter-party that is located outside of California would have been able to reduce its emissions so as to make the allowances available to the California entity. That reduction in emissions could be attributed to California just as though the emission reductions had occurred within the boundaries of California.

Likewise, if a California covered entity obtains an offset that represents a ton of GHG emissions reduction at a site outside of California, that ton of emissions reduction is equivalent to the California entity reducing its emissions in California by a ton during the compliance period, and the objectives of AB 32 and the Scoping Plan's cap-and-trade program would be completely satisfied.

B. The ARB Staff's Concerns.

At the August 24, 2009 ETAAC meeting, an ARB staff representative expressed the view that the ACES cap-and-trade emissions reduction target was weakened by the ACES's relatively liberal recognition of offsets, implying that the Scoping Plan's reduction target should be seen as being stronger than the ACES target due to the Scoping Plan's tight restriction on the use of offsets.[2] This view is inconsistent with the proper understanding of the role of offsets.

Permitting the use of high quality offsets to a greater or lesser degree does not affect the stringency of the cap in a cap-and-trade program. Insofar as a high quality offset represents a ton

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[2] The ACES provides both for "economy-wide reduction goals" and for "reduction targets for specified sources" that would be covered by the ACES cap-and-trade program. The "economy-wide reduction goal" under ACES for 2020 is "80 percent of the quantity of United States greenhouse gas emissions in 2005." ACES §702. Thus, ACES provides for a 20 percent economy-wide reduction in emissions from the 2005 level by 2020. The reduction target for sources that are covered by the ACES cap-and-trade program is "83 percent of the quantity of greenhouse gas emissions from such sources in 2005." ACES §703. Thus, ACES provides for a 17 percent reduction in emissions by cap-and-trade covered entities from the 2005 level by 2020.

The AB 32 economy-wide reduction goal is reduce GHG emissions to 1990 levels by 2020. Cal. H&S Code §38550. California's 1990 statewide GHG emissions were 427 MMTCO2e. Scoping Plan, p. 12. California's 2005 GHG emissions were 476 MMTCO2e. California Greenhouse Gas Inventory for 2002-2006. http://www.arb.ca.gov/cc/inventory/data/tables/ghg_inventory_scopingplan_2009-03-13.pdf ("GHG Inventory"). Thus, California would have to reduce its economy-wide emissions only by about 10 percent (49 $MMTCO_2e$) from 2005 levels to reach the AB 32 goal of 427 $MMTCO_2e$ by 2020. In terms of percentage points, California's economy-wide reduction goal for 2020 is about half as ambitious as the ACES goal.

Unlike ACES, AB 32 does not provide for a cap-and-trade program. Accordingly, AB 32 does not specify a 2020 target for emissions reductions by sources that would be subject to a cap-and-trade program. However, the Scoping Plan proposes a cap-and-trade program to implement AB 32. The Scoping Plan establishes a 2020 target of 365 MMTCO2e for the sectors (transportation, electricity, commercial and industrial, and industry) that would be included within the cap-and-trade program. Scoping Plan, p. 32. The 2005 emissions for the capped sectors were 430 MMTCO2e. GHG Inventory, *ibid.* Thus, the cap-and-trade program that is envisioned in the Scoping Plan would result in emissions reductions of about 15 percent (65 $MMTCO_2e$) from the 2005 level by 2020 within the capped sectors , two percentage points less that the 17 percent 2005-2020 reduction that would be required under ACES for capped sectors.

of emissions reductions that occurred at the site of a non-covered entity somewhere in the world, the offset represents an actual ton of emissions reductions. The acquisition of the offset by a covered entity represents the precise equivalent of reducing emissions by a ton at the site of the covered entity. The emissions reduction represented by an offset would be fully attributed to the covered entity that obtains an offset, and the use of the offset is entirely consistent with meeting a cap-and-trade limit. The limit is not rendered more or less stringent by the degree to which covered entities are allowed to take advantage of offsets.

IV. STANDARDS AND AGREEMENTS SHOULD BE DEVELOPED IN TIME FOR OFFSETS TO BE AVAILABLE FOR THE FIRST COMPLIANCE PERIOD.

If the ARB intends to establish standards by which to assess offsets, the ARB should move expeditiously to develop the standards. Likewise, to the extent to which the ARB intends to enter into agreements with developing countries or provinces to establish sectoral crediting baselines, ARB should to do so expeditiously. The first compliance period begins on January 1, 2012. Scoping Plan, p. 31. Offsets should be available for the electricity generators and large industrial facilities that will be covered by the cap-and-trade program in the first compliance period.

If standards or sectoral crediting baselines are not going to be available in order to certify offsets by the beginning of the first compliance period, the ARB should approve offsets on a project basis until the standards and sectoral crediting baselines are established. Delaying the use of offsets until standards or sectoral crediting baselines can be established would deprive potential recipients of offset funding and cap-and-trade covered entities of the multiple benefits that can flow from recognizing high quality offsets in the cap-and-trade program.

V. ALTERNATIVE POINTS OF ENFORCEMENT SHOULD BE CONSIDERED SO THAT THE BENEFITS OF INTERNATIONAL OFFSETS CAN BE DERIVED WHILE SATISFYING ARB'S OBLIGATION TO ENFORCE OFFSETS.

At the July 30, 2009 workshop, the staff asked: "How could ARB enforce international offsets?" Staff Presentation, Slide 12. Emission reductions obtained through international offset projects must be enforceable in addition to being real, additional, quantifiable, permanent, and verifiable. Cal. H&S Code §38562(d)(1-2). Enforcement can be facilitated by agreements among jurisdictions. The availability of international offsets should not be deferred indefinitely, however, while California tries to negotiate agreements that would permit full enforcement of California offset regulations in other jurisdictions.

In the absence of agreements permitting effective California enforcement over offset projects in other jurisdictions, the ARB should consider imposing enforcement obligations upon California cap-and-trade covered entities that contract for offsets in other jurisdictions. The ARB clearly has jurisdiction over those entities. Allowing the California holders of offsets to be the point of enforcement for offset projects that are located outside of California would allow enforceable high quality offsets from projects that are physically located in other jurisdictions to be used in the California cap-and-trade program, pending the negotiation of enforcement agreements with other jurisdictions.

Some California covered entities may not be in a financial position that permits them to take on the risk of being subject to enforcement for offset projects that are located in other jurisdictions. However, there is a counter-balancing upside to assuming the risk that is associated with being the directly regulated party for an offset project. Assuming the risk of being the point of enforcement for an offset project that is located outside of California could reduce the cost of the offset for the cap-and-trade covered entity that contracts for the offset.

VI. CONCLUSION.

SCPPA urges the ARB staff to consider these comments in crafting a proposed cap-and-trade regulation. SCPPA appreciates this opportunity to submit these comments to the ARB.

Respectfully submitted,

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