May 18, 2018

Via Electronic Submission

Rajinder Sahota
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Industrial Strategies Division
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments of IPRE on CARB's April 26, 2018 Cap-and-Trade Workshop

Dear Ms. Sahota:

Thank you for the opportunity to comment on the California Air Resources Board's ("CARB") April 26, 2018 Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation. We write to provide the comments of Indigenous Peoples Reducing Emissions ("IPRE") on several of the issues relating to offsets that were addressed during the workshop – in particular the potential application to offsets generated prior to 2021 of AB 398's quantitative limit on the use of offsets that "no more than one-half may be sourced from projects that do not provide direct environmental benefits in the state" ("DEBS"). We refer CARB to our earlier comment letter dated Mach 19, 2018 for additional discussion of the DEBS requirement. We reaffirm but do not repeat those comments here.

1. Indigenous Peoples Reducing Emissions ("IPRE")

IPRE is an association of Alaskan Native and American Indian entities that are actively engaged in creating sustainable climate solutions. IPRE members partner with California's climate change initiatives through the Cap-and-Trade Program. Our members primarily do so by developing forest offset projects, most of which are on lands outside of the state. Among IPRE's members are some of the most disadvantaged communities in the United States; they are often faced with a Hobson's choice of enduring brutal poverty whilst sustaining their forests and their traditional cultures as they have for thousands of years, or cutting down their forests to meet immediate economic needs. For this reason we believe that some IPRE communities are environmental justice ("EJ") communities.

IPRE commends CARB for its leadership in combatting climate change. Its Cap-and-Trade Program serves as an important national and international model. The offsets program enables this model to be more than an inspiration: it provides a means for communities outside of the state – including EJ communities – to partner with California in the global fight against climate change. By creating incentives for others to partner with California, CARB's offset program has been a critical component of California's global leadership on climate issues.

2. The DEBS Requirement Does Not Apply to Offsets Generated Prior to 2021

On Slide 33 of its presentation at the April 26 Workshop, CARB stated that "Most stakeholders did not support retroactively applying DEBS to offset credits issued prior to 2021," and noted that most stakeholders expressed "support for exempting from or automatically meeting DEBS standard for previously issued offset credits." In addition to strong stakeholder support for that interpretation, there is strong legal support. For the reasons set forth below, IPRE believes that the DEBS requirement simply does not apply to offsets issued prior to 2021 and calls upon CARB to amend the Cap-and-Trade Regulation accordingly.

a. *The Plain Language of Health & Safety Code Section 38562 Makes Clear that DEBS Does not Apply to Offsets Issued Before 2021*

The DEBS limitation is not a standalone statute. AB 398 amended the California Health & Safety Code ("HSC") and its provisions must be construed within their statutory context. The DEBS provision is set forth in Subsection E of HSC Section 38562(c)(2). It is one of many subsections that provide specific directions to CARB under Section 38562(c)(2)'s overarching direction: "**In adopting a regulation applicable from January 1, 2021, to December 31, 2030**, inclusive, pursuant to this subdivision, the state board shall do all of the following: . . . ." (Emphasis added.) Thus, the plain language of the statute that includes the DEBS provision directs CARB to develop regulations applicable only to the specified period post-2020.

HSC Section 38562(b) precedes Section (c) and provides general direction to CARB. Several provisions of Section (b) make clear that the DEBS limitation should not be construed to apply to offsets generated prior to 2021:

- Subsection (b)(1) establishes the overarching direction to CARB to "[d]esign the regulations . . . in a manner that . . . encourages early action to reduce greenhouse gas emissions." Interpreting DEBS to apply pre-2021 would *discourage* those that took action early to reduce GHG emissions by developing offset projects.

- Subsection (b)(5) directs CARB to "[c]onsider [the] cost-effectiveness of these regulations." Offsets are a key cost flexibility mechanism and drastically limiting existing offsets would increase the cost that the Cap-and-Trade Program imposes.

- Subsection (b)(7) directs CARB to "[m]inimize the administrative burden of implementing and complying with these regulations." Developing a process by which CARB would determine "ways to address existing projects where the offsets have not been used for compliance" CARB Preliminary Discussion Draft at 18, would be hugely burdensome for the agency, both to develop such a process and then to apply it to the existing projects and the offsets generated by them.

b. ***Absent Action by CARB to Exempt Pre-2021 Offsets from DEBS It Will Have an Improper and Illegal Retroactive Effect***

If CARB does not amend the Cap-and-Trade Regulation to establish that offsets generated pre-2021 either are exempt from the DEBS limitation or automatically meet it, the DEBS usage limit will impact pre-2021 offsets despite the fact that AB 398 does not directly apply to them. While the point of regulation for the DEBS usage limitation is the surrendering of offsets post-2020, there is no question that it nonetheless impacts offsets generated pre-2021. Offsets are compliance instruments issued by CARB for the sole purpose of being used to meet compliance obligations under the Cap-and-Trade Program. If that sole usage is limited, the offsets are impacted. Thus, though the language of AB 398 does not address pre-2021 offsets, it does impact them. The value of pre-2021 offsets that are not either deemed exempt from or to automatically meet DEBS will be greatly diminished.[1] "A statute is retroactive if it affects rights, obligations, acts, transactions and conditions performed or existing prior to adoption of the statute and substantially changes the legal effect of those past events." *In re Marriage of Reuling*, 23 Cal.App.4th 1428, 1439 (1994)(citations omitted). Absent appropriate regulatory action by CARB, the DEBS provision will have retroactive impact. That raises a significant legal issue.

The California Supreme Court has established a two-part test for determining if a statute has an improper retroactive effect. First, the Court must determine if the legislature intended the statute to be retroactive. If not, that ends the discussion. If so, then the Court must determine whether the application of the retroactive law is unconstitutional. *In re Marriage of Buol*, 39 Cal.3d 751, 756 (1985)("Legislative intent, however, is only one prerequisite to retroactive application of a statute. Having identified such intent, it remains for us to determine whether retroactivity is barred by constitutional constraints.").

i. ***The Legislature Did Not Intend DEBS to have Retroactive Effect***

California courts have held that for a statute to have a retroactive effect the legislature must have clearly and expressly stated that that it does so. "[It is a] well-established presumption that statutes apply prospectively in the absence of a clearly expressed contrary intent . . . ." *Californians for Disability Rights v. Mervyn's, LLC*, 39 Cal.4th 223, 230 (2006), *citing Evangelatos v. Superior Court*, 44 Cal.3d 1188, 1218 (1988). In determining this issue, courts look to the language of the law to determine if a statute was intended to be retroactive. "[Legislative intent] is always considered significant because, '[t]he Legislature is well

[1] It has been suggested that those that invested in offset projects anticipated this because the Cap-and-Trade Program was due to sunset after 2020. That is not correct. Prior to the adoption of AB 398 CARB maintained that it had the authority to continue the Program post-2020 and repeatedly stated that it would do so. Many independent legal analyses supported CARB's position. Those that invested in offset projects reasonably relied on CARB's statements and had a reasonable expectation that the Program would continue post-2020.

acquainted with the rule requiring a clear expression of retroactive intent, and the fact that it did not so express itself or did not make the amendment effective immediately is a significant indication it did not intend to apply the amendment retroactively.'" *Wienholz v. Kaiser Found. Hosps*., 217 Cal.App. 3d 1501, 1505 (1989), *citing Perry v. Heavenly Valley* 163 Cal.App.3d 495, 500 (1985). In addition to the plain language of HSC Section 38562 discussed above, the legislative record of AB 398 makes clear that the Legislature did not intend the DEBS limitation to have retroactive impact upon pre-2021 offsets.

In *Wienholz*, the absence of express language providing retroactivity took on special significance as certain sections of the relevant statute contained express references to retroactive application, whereas the challenged provision did not. That is the case here as well. AB 398 also added Subsection C to HSC Section 38562(c)(2), which "[r]equire[s] that current vintage allowances designated by the state board for auction that remain unsold in the auction holding account for more than 24 months to be transferred to the allowance price containment reserve." Thus, when it adopted AB 398, the Legislature knew how to make it apply to existing compliance instruments. That it did not do so for Subsection E of this same provision makes it clear that it did not intend for the DEBS limitation to have retroactive impact.

Moreover, there is nothing in the legislative history of AB 398 that indicates that the Legislature intended for DEBS to apply immediately. The Legislature issued seven different reports pertaining to AB 398 and not one of them discusses the application of DEBS to pre-2021 offsets much less sets forth an express intent for DEBS to apply prior to the specified period of January 1, 2021, to December 31, 2030.[2] The absence of any reference to AB 398's retrospective application, indicates that it was not the intent of the legislature to have it do so. "A statute's silence as to retroactivity is an authoritative indication the Legislature intended a prospective application." *Reuling*, 23 Cal.App.4th at 1439-1440.

Another factor that courts consider is whether the statute's purpose would be "served significantly by its application to transactions which preceded the change and the principle that retrospective imposition of increased liabilities is to be carefully avoided". *City of Los Angeles v. Shpegel-Dimsey, Inc*., 198 Cal.App.3d 1009, 1019-1020 n. 2 (1988). The purpose of AB 398 is to strengthen the Cap and Trade Program. Retroactive application of AB 398 will have the opposite effect. It would alter the value of existing carbon offsets, undermine the economic assumptions of the participants in the Program, and add uncertainty to the carbon market.

[2] *See* Assembly Floor Bill Analysis AB 398 (2017-2018 Reg. Sess.), July 17, 2017; Senate Floor Bill Analysis AB 398 (2017-2018 Reg. Sess.), July 17, 2017; S. Comm. on Appropriations, Bill Analysis AB 398 (2017-2018 Reg. Sess.), July 17, 2017; S. Comm. on Environmental Quality, Bill Analysis AB 398 (2017-2018 Reg. Sess.), July 12, 2017; Assembly Floor Bill Analysis AB 398 (2017-2018 Reg. Sess.), May 30, 2017; A. Comm. on Appropriations Bill Analysis AB 398 (2017-2018 Reg. Sess.), May 15, 2017; and A. Comm. on Appropriations, Bill Analysis AB 398 (2017-2018 Reg. Sess.), March 30, 2017.

ii. *If Read to have Retroactive Effect DEBS is Unconstitutional*

The second issue is the question of constitutionality. The California Supreme Court has "long held that the retrospective application of a statute may be unconstitutional if it is an *ex post* facto law, if it deprives a person of a vested right without due process of law, or if it impairs the obligation of a contract." *Buol*, 39 Cal.3d at 756. The statute at issue in *Buol* was held to be unconstitutional as it deprived the plaintiff in the case a vested right without due process of law.

Here, if the DEBS provision is construed to apply to existing offsets it likely would be found to be unconstitutional by depriving the holders of those offsets of a vested right without due process. Last year it was definitively determined that compliance instruments – which include offsets – consist of property rights that may not be taken absent due process. *See California Chamber of Commerce v. State Air Resources Bd.*, 10 Cal. App. 5th 604, 646-649 (2017). The Court's analysis is thorough and well-reasoned.[3] The Court began with the observation that "the due process and *takings clause* concepts of property are not coterminous," and that the "*due process clause* recognizes a wider range of interests in property." *Id.* at 647 (citations omitted). It held that while compliance instruments may not constitute property vis-à-vis the government, "this does not mean compliance instruments, including emissions allowances, lack value *to the holders*. [They] . . . consist of valuable, tradable, private property rights. *Id.* at 649. If CARB does not amend the Cap-and-Trade Regulation to make clear that offsets issued prior to 2021 are either exempt from or meet the DEBS requirement, then the holders of those offsets would be deprived of their property rights without due process and may well seek legal recourse.

For all of the foregoing reasons, IPRE calls upon CARB to amend the Cap-and-Trade Regulation to make clear that offsets issued prior to 2021 are either exempt from or meet the DEBS requirement. Doing so would be consistent with the plain language of HSC 38562 and its directives to CARB, the intent of the Legislature when it adopted AB 398, the constitution, and good policy.

3. The Regulation's Invalidation Provisions Should Be Revised

On Slide 38 of its presentation at the April 26 Workshop, CARB invited stakeholder input on "[r]evising invalidation provisions to further narrow types of activities or actions that could result in an invalidation." In response to a question posed by IPRE during the workshop, CARB staff clarified that it invited input not only on narrowing the invalidation provisions but also on reconsidering the Buyer Liability approach to invalidation altogether. Staff expressed particular interest in getting input on these issues as they relate to forest offset projects.

IPRE supports and endorses the May 10 comments of the California Forest Carbon Coalition. Many forest offset projects are on or are part of larger tracts of forest lands where

[3] Notably, the California Supreme Court declined to review the case. 2017 Cal. LEXIS 4991.

timber is harvested. Like California, many states have extensive timber harvesting regulations, and thus minor infractions of environmental, health and safety ("EHS") regulations are not unusual on forest lands. These NOVs may have nothing to do with a forest offset project on or a part of these lands and yet under the current language of the Regulation's invalidation provisions such NOVs may result in the offsets generated by those projects being invalidated. That can be a particularly devastating result for forest offset projects because – unlike, say, ODS projects – the vast majority of a forest project's offset credits are issued at one time. If an unrelated NOV happens to occur during the same narrow period, virtually the entire project's offsets could be invalidated.

This same concern extends to other types of EHS regulations. We are aware of at least one significant forest offset project in Kentucky that was registered with CARB but recently was abandoned due to concerns about potential invalidation. In that instance, after having made significant investments in the forest offset project, the forest owner could not obtain adequate assurance that the offsets generated by its project would not be invalidated in the event that mining operations were conducted beneath the surface that might give rise to EHS violations (mines are subject to many regulations such that minor NOVs are not unusual) – even though the two activities would be wholly unrelated, one above ground and one below. Thus, in this particular instance, with the collapse of the forest project, the owner of the land will have little choice but to pursue coal mining at its property. That surely is not a result that California's climate policies are intended to further.

4. Conclusion

IPRE and its members are committed to continuing to partner with the State in its efforts to combat climate change. Implementation of AB 398's DEBS criteria presents considerable risks and challenges both to the Cap-and-Trade Program and California's efforts to get others to partner with its efforts. While the offsets program is a small part of California's multifaceted efforts to reduce GHG emissions, it is a critical component. It is the primary means by which CARB incentivizes those outside the State to join with it in the fight to combat climate change, including drawing in partners in states that often otherwise differ from California, thereby helping to broaden the support for the fight against climate change.

Sincerely,

Nicholas W. van Aelstyn

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cc: Jason Gray