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IETA COMMENTS ON CALIFORNIA AIR RESOURCES BOARD'S PROPOSED AMENDMENTS TO CALIFORNIA CAP-AND-TRADE REGULATION

The [International Emissions Trading Association](#) (IETA) welcomes the opportunity to provide comments on California Air Resources Board (ARB)'s *Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation*, released in December 2016.

IETA applauds ARB's recognition that a fully-functional market mechanism is a vital, cost-effective cornerstone tool in California's climate policy architecture. As the leading voice for the world's international business community on climate markets and finance, IETA is a staunch supporter of California's strong commitment to cap-and-trade and tangible market links with other jurisdictions.

IETA remains a consistent, progressive multi-sector business voice that supports climate action and strongly believes that market solutions as the best means to: drive climate action and investment across key sectors of the economy; meet climate targets cost-effectively; and accelerate low-carbon transformative economic and societal changes. Our members include some of California's biggest emitters, entrepreneurs focused on delivering climate solutions and greenhouse gas (GHG) reductions, and markets-focused (NGO) registries that represent the backbone of environmental integrity in California's cap-and-trade market and international markets.

IETA encourages California to stay the course and maintain its cap-and-trade program. The program has resulted in significant environmental benefit to the State and global climate, and California arguably occupies this global and national position of climate leadership in large part because of this market-based program. **The destabilizing impact of California changing course on this critical policy now would be significant and detrimental to progress on climate action at home and beyond.**

Through its cap-and-trade and offsets program, California is also bringing full benefits of the clean economy transition to disadvantaged communities. California must focus its efforts on continuing to set the high-water mark for environmental integrity through its cap and trade and offset programs, and to putting auction proceeds to best use in addressing equity concerns.

KEY TAKEAWAYS & RECOMMENDATIONS

A selection of IETA's key observations and recommendations to ARB are summarized below.

1. **IETA supports the proposed use of a “straight-line” cap reduction path from 2020 to 2030 and clarity on the allowance budget to 2050.** Certainty on future allowance supply represents a cornerstone of a robust carbon market, providing transparency to participants and driving market liquidity and participation.
2. **The proposal to retire unsold allowances to the Allowance Price Containment Reserve (APCR) after a period of 24 months remains problematic. This approach may lead to future price spikes in the short to mid-term, which could raise political concerns around program efficacy due to market volatility.** IETA supports the modification to allocate resold allowances in advance of newly allocated allowances to successful auction participants.
3. **We applaud proposed support for cross-border linkages, including full and partial program linkages that create broader markets and a wider range of abatement opportunities.** These expanding market links will only strengthen California's climate leadership while sharing cost burdens and benefits of reducing GHGs with partner jurisdictions.
4. **We applaud clarity on offset regulatory compliance language.** However, proposed language related to ARB discretion on determining regulatory compliance - along with limiting “out of compliance” time periods to discrete offset project types - remains problematic.

STRUCTURE OF DETAILED COMMENTS

IETA's comments on the proposed amendments focus on technical input associated with specific sections and elements of the regulatory proposal. Comments are organized into the following topics:

1. Post-2020 Cap-Setting;
2. Cost-Containment & the APCR;
3. Linkage;
4. Compliance Offset Credits & Flexibility Mechanisms; and
5. Purchase Limits for Voluntary Participants.

1. POST-2020 CAP-SETTING

Extending cap levels beyond 2020 plays a critical role in contributing to the continuation of California's market program. **IETA supports the use of a “straight-line” cap reduction path from 2020 to 2030.**

IETA also applauds ARB for proposing to set initial allowance budgets through 2050. This signals a long-term trajectory of California's market program and helps to inform long-term investment decisions.

2. COST-CONTAINMENT & APCR

ARB has proposed significantly modifying the structure and pricing of the APCR. Developing and implementing a program structure that will promote a robust market with strong participation and liquidity, while maintaining political palatability to both California constituents and government, is of paramount importance to the long-term health of California's cap-and-trade program.

California's current regulatory structure only allows unsold allowances to be offered back to the market once two auctions are fully subscribed in a row. If auctions remain even marginally undersubscribed over the next few quarters, large volumes of allowances could be allocated to the APCR without giving the market a second opportunity to purchase this volume. **IETA cautions ARB that implementing this design feature could create an unintended result of short-term market pricing spikes due to a significant allocation of unsold allowances to the APCR.** Having significant oscillation in market pricing between the auction floor and APCR soft pricing ceiling, over a relatively short period of time, could bring the cap-and-trade program under significant scrutiny, both by industry and California consumers.

In light of the above observations, **we recommend that ARB consider lengthening the time period for allocation of unsold allowances to the APCR.** Increasing the timeframe for consideration of implementation for this mechanism from 2018 to 2020 will allow the market time to receive both regulatory and legal certainty around the continuation of cap and trade post-2020. This clarity will address the reduced market participation and liquidity issues that have arisen in the short-term in California and created (government) concern around auction revenue generation.

By allowing additional timing flexibility for unsold allowances before allocation to the APCR, the market will be given an opportunity to purchase these compliance units again under the standard auctions at a price reflective of current market fundamentals. California can thus avoid artificially creating significant market pricing volatility; an unintended consequence of a regulatory change intended to incent consistent participation at auction.

3. LINKAGE

Linkage with Ontario and External GHG Emissions Trading Systems & Programs

Throughout ARB's robust consultation process, IETA has been a consistent voice advocating for the multitude of benefits of cross-border linkage. We applaud Staff's recognition of linkage benefits in its Initial Statement of Reasons (ISOR) report.¹ **Linkage is a valuable cost-containment mechanism that increases compliance flexibility and market liquidity, thereby driving down program costs while driving up clean projects, jobs, and investment opportunities.**

In particular, **IETA applauds the leadership California has shown during the development of Ontario's compliance cap-and-trade program, launched on 1 January 2017.** ARB's deep and frequent engagement with Ontario officials, through the province's design and implementation process, will go a long way towards ensuring the future California linkage process goes smoothly in 2018. This will also reap benefits as parties seek structural and policy alignment post-2020. California's commitment to expanding trading partners is also important given the rising number of North American jurisdictions, including Mexico, that are proposing/considering climate market mechanisms that link, fully or partially, to the WCI market.

IETA strongly supports the two new linkage options proposed by ARB – neither of which would require the same level of operational integration as the California-Québec (and soon to be Ontario) style program. As IETA has consistently communicated across North America, the inherent flexibility of WCI's model creates an ideal framework to functionally embrace and enable these proposed types of one-way unit flows.

4. COMPLIANCE OFFSET CREDITS & FLEXIBILITY MECHANISMS

A. Modifications to Regulatory Compliance & Additionality Requirements

IETA is deeply concerned about the inclusion of ARB discretion in determining whether a project is out of regulatory compliance. While most proposed language in Section 95973(b) adds clarity about whether an offset project will (or will not) be eligible to receive credits, the following statement is extremely problematic and has the potential to undermine added clarity: *"...whether enforcement action has occurred is not the only consideration ARB may use in determining whether a project is out of regulatory compliance..."* One serious potential effect of lack of clarity and uncertainty may be to chill the development of robust offset projects. **IETA strongly urges ARB to remove this language in the final amended regulation.**

¹ ARB. [Staff Report: Initial Statement of Reasons](#), pg. 17.

As proposed, the above language will spawn uncertainty and risks for offset project operators (OPOs) as well as verifiers. The current regulatory compliance standard references regulatory oversight bodies, which make it clear for OPOs and verifiers who they should look to in order to confirm regulatory compliance. If the amended Regulation allows ARB the discretion to make its own determination of regulatory compliance (above and beyond the applicable regulatory oversight body), this creates an unclear and inconsistent regulatory compliance standard. For instance, if ARB decides that a project has violated its permit, even if the oversight body has not issued a violation, it is impossible for the verification body to verify the project to the requirements of 95973(b) without sending all project EH&S information to ARB for review. It is unclear how a verification body would be able to verify that a project has met the requirements of 95973(b) without first having ARB confirm that a project is in regulatory compliance.

Once again, **IETA urges the removal of this language from the final amendment package.**

We also have concerns about fair treatment of invalidation timeframe limits across all offset project types. IETA welcomes ARB's proposal to place clear limitations on the invalidation timeframe for regulatory compliance issues for livestock, ODS and mine methane capture projects. As previously communicated to Staff, these modifications will give developers greater incentive to bring projects back into compliance as quickly as possible, while limiting the penalty for regulatory non-conformance to the period of time during which the project was out of conformance. **However, we strongly encourage ARB to extend modified language related to invalidation timeframe limits to all compliance offset project types.** ARB should maintain the flexibility to allow forestry and Rice Cultivation offset projects the opportunity to demonstrate that a regulatory non-compliance period – one associated with a particular time period during a reporting period – does not impact the entire reporting period's achievements. Where possible, all offset project types should be given the same regulatory treatment, consistent with previous regulatory changes.

B. Modifications to Invalidation & Forest Reversal Requirements

IETA has previously encouraged ARB to improve its invalidation approach. This includes our consistent recommendation to eliminate California's current buyer-liability approach altogether in favor of adopting a model similar to Québec's Environmental Integrity Account (EIA) mechanism. With IETA's support, Ontario has also opted to the EIA approach in its recently-proposed offset regulation. California would significantly benefit from taking a similar approach to their partner jurisdictions.

By eliminating the current buyer-liability approach in favor of an EIA-type mechanism, California would lower the costs of offset creation by reducing the cost of verification, streamlining the process for ARB staff and mitigating the need for compliance entity risk management. A lower cost of offset creation, while maintaining the same level of program rigor and integrity, equates to cost mitigation for compliance entities and more broadly to California ratepayers and residents. In addition, we continue to urge ARB to

provide heightened clarity on invalidation investigation timing, process, and overall communications to all regional market participants – not just those impacted by a given investigation.²

Specific to proposed forest reversal invalidation amendments, we recognize that Section 95985³ revisions attempt to address perceived risk that credit invalidation could lead to buffer pool credit elimination that had already been retired to compensate for unintentional reversals from other projects. However, a more effective approach to addressing this issue – rather than implement an arbitrary 50% buffer replacement requirement – should be considered by ARB.

In the case of forestry invalidation, IETA recommends that the number of buffer account credits required to be replaced be calculated on a project-by-project basis and based on the total percentage of buffer pool credits that have been retired to compensate for reversals up to the date of invalidation. Ultimately, this approach would ensure integrity of the buffer pool and allow for a defensible, justifiable amount compared to a blank 50% amount.

C. Modifications to Reporting & Verification Requirements

Under Section 95976(d), ARB's proposal to mandate continuous reporting of offset projects is a reasonable requirement. IETA also supports the flexibility ARB has incorporated into verification requirements, including: allowing verifications to start 10 days after ARB receives documents; changes to verifier rotation; and providing developers greater choice in identifying suitable verifiers.

However, we remain concerned that a condensed timeframe of 15 days will not provide adequate time for modifications given the amount of work required. We therefore **encourage ARB to include provisions that, upon request by ARB, give verifiers 30 days to revise verification statements and reports.**

5. PURCHASE LIMITS FOR VOLUNTARY PARTICIPANTS

IETA strongly supports the increase in the purchase limit for voluntary participants to 25% at advance auctions beginning in 2018. The proposed approach will enable additional market liquidity and participation for future vintages. We applaud ARB for supporting this important modification.

² See [IETA Comments on California Air Resource Board's Workshop on Potential 2016 Amendments to Cap-and-Trade Regulation](#), submitted to ARB on 11 March 2015.

³ Under Section 95985(h)(3) – “The Offset Project Operator, identified in section 95985(e)(3), of an offset project that had ARB offset credits removed from the Forest Buffer Account pursuant to section 95985(g)(1)(A)3. or (g)(1)(B) must replace 50% of ARB offset credits removed from the Forest Buffer Account, rounding up to the next whole number, with a valid ARB offset credit or another approved compliance instrument pursuant to sub-article 4, within six months of notification by ARB pursuant to section 95985(g)(2).”

CONCLUSION

IETA reaffirms our strong support for California's cap-and-trade program, and our community encourages the State to stay the course on its world-leading market approach to effectively, efficiently, and fairly reducing GHG emissions.

We appreciate the opportunity to help inform California's program amendments and future market. If you have questions about IETA's submission or require more information, please contact Katie Sullivan, IETA Managing Director, at sullivan@ieta.org.

Sincerely,



Dirk Forrister
IETA President and CEO