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The Offsets Group-- Comments on October 12, 2017 Staff Workshop

Thank you for providing the opportunity to comment on the initial workshop to implement Assembly Bill (AB) 398 and Board Resolution 17-21. This upcoming rulemaking is critically important to the success of the existing Cap and Trade program. We look forward to working with you and your staff in the upcoming months.

With the passage of AB 398 (Garcia, Ch. 135, St. 2017) in this year's legislative session, and with its direction to update the current Cap and Trade Program (Program) through regulatory amendments, the Offset Group has developed this Position Paper to help guide the California Air Resources Board (CARB). The scope of the paper is limited to key policies relating to compliance offsets.

The Offsets Group is made up of 13 individual companies with vast experience in achieving real greenhouse gas (GHG) reductions for the cost-effective use in California's successful Program. Along with many other Program stakeholders, we view offsets as critical in achieving the statutory GHG emission reductions at the lowest cost possible – as mandated under California's key climate legislation (AB 32, SB 32, et al). Furthermore, CARB and a wide variety of stakeholders have recognized that a vibrant offset component of a market-based carbon reduction program supports the development of new innovative projects and technologies on a scale not achievable through regulation alone.

To summarize our positions, we offer the following recommendations:

1. "No more than one-half…" should be viewed in the simplest, most direct mathematical manner – as 2 percent and 3 percent maximums of "non-direct benefit" offsets for the period 2021-2025 and 2026-2030, respectively. This provision should only apply to obligations starting in 2021.

2. “Direct Environmental Benefits in the State” can and should be viewed broadly in order to maximize the benefits to the Program while recognizing the science behind the fundamental nature of GHGs and global climate change.

3. When expending funds to achieve emissions reductions, on at least a metric ton for metric ton basis after the price ceiling is reached, CARB should have in place swift and transparent mechanisms to purchase emission reduction instruments. In order to meet the standards set forth in the legislation, we recommend the State rely solely on offsets already issued by CARB.

4. CARB should pursue regulatory amendments which will allow for greater offset utilization by smaller compliance entities who are not currently utilizing offsets at all, or to their fullest.

5. When determining “equivalent or stricter” for linkage determinations, the key factor is the validity of offset tons, and not an equivalency on geographic or numeric parameters.

6. CARB should revisit the Program’s invalidation provisions to reflect Program maturity and the high confidence level of offsets demonstrated to date.

7. Appointments to the New Compliance Offsets Protocol Task Force should include compliance offset experts and professionals who have experience with actual offset reduction projects.

8. CARB should endeavor to maintain a healthy offsets sector to ensure this vital Program component is available to serve its intended purpose—achieving real, permanent, quantifiable, verifiable, enforceable, and additional cost-effective GHG reductions.

These positions are discussed in greater detail below.

Recommended Policy Details

1) AB 398 states: "no more than one-half may be sourced from projects that do not provide direct benefits in state;" and should be implemented with simple mathematics such that a 2 percent maximum of offsets with "non-direct benefits" for years 2021-2025, and 3 percent maximum for years 2026-2030 is clearly established. [Section 38562(c)(2)(E)(i)]

This section should simply be read in the most straightforward manner – that is, half of 4 percent is 2 percent (and likewise, half of 6 percent is 3 percent). Therefore, the maximum number of offsets deemed to not have direct in-state benefits for the period covering 2021-2025 would be 2 percent, and 3 percent for the period covering 2026-2030 (see also discussion below in point #2). This calculation is independent of the number of offsets deemed to have direct benefits which are developed, used in aggregate, or retired by the individual compliance entity in any given compliance period.

2) "Direct Environmental Benefits" should be defined broadly in order to maximize benefits associated with offsets and rely on the scientific consensus fundamental to GHGs and global climate change.

Section 38562(c)(2)(E)(ii) states:
For purposes of this subparagraph, "direct environmental benefits in the state" are the reduction or avoidance of emissions of any air pollutant in the state or the reduction or avoidance of any pollutant that could have an adverse impact on waters of the state.

To ensure a robust offset market in California's Cap and Trade Program we urge CARB to not be overly prescriptive in defining "direct environmental benefits in the state." The implementation must be sufficiently broad in order to capture as many environmental benefits for the state as possible and to not further limit the supply of eligible offsets.

One clear example includes the projects creating GHG reductions today in California under the current Ozone Depleting Substances (ODS) protocol. These projects collect ODS in California, before having the material aggregated and transported out-of-state for destruction. These projects yield significant in-state benefits by the removal of these powerful gases, which by definition are "pollutants." This example clearly meets the spirit of this provision.

Further, because the increasing concentration of atmospheric carbon is a global concern and not limited to what reductions take place within California's borders, GHG reductions anywhere will achieve the same climate goals as emission reductions in California. When considering the social cost of carbon—the future costs of releasing the next ton of GHG are calculated globally—all carbon reductions eligible to generate offsets under the ARB compliance offset protocols result in a long-term net benefit to California, including waters of the state.

3) Mechanics of Program Integrity when the Price Ceiling is Reached.

The "price ceiling" provisions of AB 398 require CARB to maintain the integrity of the Program by securing "emissions reductions, on at least a metric ton for metric ton basis, that are real, permanent, quantifiable, verifiable, enforceable by the state board 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." This language is essentially defining offsets issued by California, or linked-jurisdictions.

Using Program-issued offsets is the most direct and effective methodology for securing these reductions.

CARB should establish mechanisms such that those purchases are made in a transparent manner and immediately after securing necessary funds. Developing contracts with offset providers should be initiated sooner rather than later. This will require CARB to carefully plan well in advance to ensure no delays occur.

4) CARB Should Pursue Opportunities for Greater Offset Utilization.

We believe that full utilization of allowable compliance offsets should be a goal of CARB. Offsets projects provide meaningful carbon reductions, reduce the cost of the Program and provide many additional co-benefits. That being said, the current utilization rate of offsets is below the program's original usage limit (8 percent).

To ensure high levels of utilization, regardless of individual entity maximums, CARB should consider implementing rules to encourage more offset creation and usage. Though not limited to the following, these issue areas have been highlighted as having the most opportunity to do just that:

- Allow banking of individual offset usage limits across multiple compliance periods;

- Reduce hurdles to offset development, implementation and administrative costs (invalidation issues are discussed in detail below);

Evidence also points to smaller firms having offset utilization rates far below the current maximum, suggesting that CARB should therefore look for ways to expand the appeal of offsets in this section of the market.

5) Care Must be Given in Determining "Equivalent or Stricter" When Considering Linkage with Other Jurisdictions.

Senate Bill (SB) 1018 (Committee on Budget and Fiscal Review, Ch. 39, St. 2012) requires a demonstration of stringency before future Linkages with California can occur—that "the jurisdiction with which the state agency proposes to link has adopted program requirements for GHG reductions, including, but not limited to, requirements for offsets, that are equivalent to or stricter than [California's],"— and should be limited to ensuring the validity of GHG reductions in a manner consistent with California. These parameters include being real, permanent, quantifiable, verifiable, enforceable and additional, but should not include jurisdictional-specific geographic or numeric criteria. Such additional jurisdiction-specific criteria do not impact the "stringency" of other programs.

The recent linkage of California's program to Ontario, Canada was not based on these new restrictions on the program. Potential future partners considering linkage, such as Oregon, should likewise not be subject to the direct environmental benefits or lower offset usage provisions of AB 398. The key to a successfully linked market-based program is maintaining consistent environmental integrity.

CARB should define "equivalent or stricter" in this manner and should use care to avoid nullifying potential linkage with other partner jurisdictions. By CARB providing appropriate guidance here to not be overly restrictive and viewing programs with equivalent levels of integrity broadly, linkage with other jurisdictions should continue to expand, which is fundamentally complementary with the program's goal of reducing GHGs and slowing the impacts of climate change globally.

Offset validity and accounting should be the standards for which this evaluation is judged. The original requirement spelled out in AB 32 of real, permanent, quantifiable, verifiable, enforceable and additional, must be the standard to meet. It should not, for example, be based on a political maximum allowable percentages or geographical limitations of offsets. So long as a "ton is a ton," the validity of California's program will be securely intact.

6) The Existing California Invalidation Process and Policy Should be Revised.

We recommend CARB reconsider the current offset invalidation requirements. As California's offset marketplace has matured and becomes more efficient, invalidations have shown to be extremely uncommon (less than 0.1 percent of all offsets issued to date have been invalidated). The current invalidation concept significantly increases the cost of offset credits, and that cost is ultimately passed along to California's ratepayers. Added program costs hit residents in low-income communities the hardest. In light of the success of the Program and the rigor involved in the multi-stage review and verification process, we recommend two important options for the invalidation provisions:

- Adopt the Ontario model with 3 percent of issuances retained in an "environmental integrity account." This pool would be used to cover instances of invalidation explicitly called out in the protocols, while enforcing seller liability for other invalidations from seller fraud or

misconduct. Developers would gladly contribute 3 percent of their offsets to this pool to avoid the complexities and deadweight losses created by the three-tiered CCO8/CCO3/GCCO framework currently in place. The Governor's Transmittal Response to CARB on Findings under SB 1018 endorses this approach to invalidation, writing: "While Ontario uses a different mechanism to correct any failure or invalidation of an offset, the approach is equally effective…both protect the program in the event that an offset is invalidated."

- If CARB chooses not to adopt the recommendation above, then it should:
  - Eliminate the CCO8 concept to simplify the market, especially in light of the additional bifurcation forthcoming for offsets with direct environmental benefits. All CCOs should initially be issued with a 3-year invalidation period. No second regulatory verifications would occur. This would simplify the CARB issuance reports, reduce developer costs, reduce CARB and Registry costs, and would help to allow smaller emitters to access the offset mechanism.
  - Eliminate non-offset related violation invalidation risk, thus keeping invalidation to issues within offset project owner control.

7) Offset Projects that are Listed with an Offset Registry Should be Grandfathered

While the passage of AB 398 calls for substantial changes to the Program, equity must be considered for existing offset projects that were under development at the time of its passage. The substantial policy shift associated with lower offset limits undercuts entities that had spent considerable time and capital to develop projects under the existing program.

AB 398 seems to ignore this concern, and CARB should act to protect the investments made on its behalf. Consequently, CARB should consider "grandfathering" offset projects that are listed with an offset registry but not issued by the State of California so that the time and money spend under the current rules isn't stranded and that these projects are fully developed and actively monitored. We are interested in meeting with CARB to work through this concept.

8) Appointments to the New Compliance Offsets Protocol Task Force should include real-world compliance offset experts and professionals.

We support the idea behind Section 38591.1(a) calling for the establishment of a new Compliance Offsets Protocol Task Force with the goal increasing the number of California-centric protocols. This section specifies membership requirements from several key fields, including: carbon market experts, forestry experts, agriculture experts, conservation advocates, dairy experts, and others. Given the importance of this provision, we strongly recommend that only those with actual experience in reducing GHG emissions, such as compliance offset developers, Registry staff, or other current market participants, be considered for the various positions for which they are qualified—Carbon Markets, Emissions Reduction, Agriculture, Dairy and Forestry.

9) Maintaining a Healthy Offsets Sector is Vital to the Overall Success of the Program.

As CARB well knows, the ultimate success of California's Cap and Trade Program is contingent upon maintaining a healthy and cost-effective program. The ultimate success of the policy goal is to reduce GHG emissions globally on a scale that slows the impacts of global climate change. Offsets are a key component to that success, as they provide significant, long-term environmental benefits, both in California and beyond.

A recent study by Stanford verified what we already knew, forestry offset projects provide real benefits. Additional studies have shown that 600-800 gigatons of sequestration is needed in addition to GHG emission reductions. Furthermore, the Climate and Clean Air Coalition identifies methane and black carbon (short-lived climate pollutants, or SLCPs) as the two most important pollutants to reduce in the near-term in order to slow global warming. Offsets provide meaningful SLCP reductions. Offsets can also reduce uncontrolled, unregulated emissions, which can provide important health benefits to local communities, while providing added flexibility and meaningful cost savings for companies subject to the regulation.

With the development of the original Cap and Trade regulation, CARB effectively created carbon offsets in California. It is incumbent upon CARB to ensure upcoming design changes to the regulation are done in a manner that not only continues to support a healthy offset market, but also endeavors to fully utilize offsets as an effective tool for carbon reductions. We strongly support the maximum use of offsets to cost effectively achieve the GHG emission reductions required under statute.

Importantly, with the drop from the current limit for offsets under AB 398 of 8 percent down to 4 percent (2021-2025), the offsets market is already being sharply constrained and should not be additionally burdened.

Conclusion

The Offsets Group is committed to a robust offsets market and we hope that this document is helpful as CARB prepares to establish policies for the Cap and Trade Program, post-2020. We appreciate the opportunity to share our thoughts and recommendations in order to continue a healthy and effective offsets market in California.

We are happy to answer any questions you may have; which can be directed to Jon Costantino at Tradesman Advisors, at: 916-716-3455, or via email at jon@tradesmanadvisors.com.