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https://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=ct-3-2-18-wkshp-ws&comm_period=1

The Verified Emission Reduction Association, or VERA, offers the following comments on the initial documents related to amending the Cap and Trade regulation, pursuant to Assembly Bill (AB) 398 and Board Resolution 17-21. This rulemaking is critically important to the success of the Cap and Trade program, both now and into the future. We appreciate the opportunity to provide comments and look forward to working with you and your staff in the upcoming months.

VERA is made up of 11 individual companies with vast experience in achieving real greenhouse gas (GHG) reductions for the cost-effective use in California's landmark Cap and Trade Program. VERA strongly supports California's efforts to reduce statewide GHG emissions through a market-based program, including the use of high-quality carbon offsets. We are pleased that AB 398 codified the use of offsets in the extension of the Cap and Trade Program. With that codification, VERA would like to see CARB work to maximize the benefit of offsets' ability to contain costs and support the development of new innovative projects and technologies on a scale not achievable through regulation alone. The most effective way to accomplish this goal is to maximize offset use under the new AB 398 parameters.

Maximizing offset use can have a direct positive benefit within California, including allowing smaller businesses with a compliance obligation to manage costs most effectively, protecting California consumers and ratepayers. Additionally, offsets by *definition* are real, quantifiable, permanent, verifiable, and enforceable GHG reductions.

VERA, along with many other Cap and Trade stakeholders, 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, AB 398). Over 40 diverse program stakeholders submitted a letter to CARB following the October workshop stating support for offsets under the program¹.

¹ <http://climatetrust.org/wp-content/uploads/2018/03/Offset-Support-Letter-final.pdf>

VERA believes that fully utilizing the new statutorily authorized limits will benefit the program, the environment and California's economy. We are supportive of several key policy statements contained within in the Preliminary Discussion Draft (PDD) of the Cap and Trade Regulation,² including:

- The construction of § 95854(b)—Quantitative Usage Limit on Designated Compliance Instruments— Including Offset Credits.
- Timing associated with implementation of these new limits as depicted in slide 25 of the staff workshop presentation.³

The PDD highlighted a few policy and implementation issues for stakeholder input. VERA's recommendations are provided below, as well as an additional primary policy recommendation. Lastly, included for your attention is a set of suggestions aimed at reducing the time and effort required to secure offset approvals, without sacrificing any environmental reliability.

Implementation of Direct Environmental Benefit Provision of AB 398

VERA supports CARB's straightforward acceptance that any project which can show a direct reduction of an air pollutant, or which benefits waters of the state, has a direct environmental benefit to the state (DEBS). By this definition, Ozone Depleting Substance (ODS) offset projects would need to show that they collected ODS material within California to be deemed to have a DEB. Likewise, a forestry project located within a watershed that provides California surface or ground water, would receive a DEBs designation.

Similarly, VERA supports CARB's assertion that many other types of projects, regardless of the proximity to California can, and do, provide direct environmental benefits to the state. Having a clear and straightforward process for project developers to demonstrate a DEBS will benefit the program's implementation and incent more projects with California benefits. Moreover, because science has shown that emissions of GHGs around the globe have a climatic impact on California and its waters^{4,5} CARB's

² https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_pdd_02232018.pdf

³ https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_workshop_3-1-18.pdf

⁴ See, for example, Hayhoe et al. "Emissions pathways, climate change, and impacts on California." National Academy of Sciences of the USA. August 2004 - <http://www.pnas.org/content/pnas/101/34/12422.full.pdf>. This paper finds that, while under a low emissions scenario snow pack losses in California's Sierra Nevada range from 29-72% while under a high emissions scenario losses of 73-89% are anticipated. As described in the paper, loss of snowpack has cascading impacts on "streamflow, and water storage and supply." Avoiding and reducing greenhouse gas emissions is key to maintaining California's snow pack. Reducing greenhouse gas emissions anywhere clearly reduces or avoids a pollutant that has an adverse impact on the waters of California.

⁵ Central Valley Regional Water Quality Board – Climate Change Work Plan December 2017, pp. 9 – 17.

https://www.waterboards.ca.gov/centralvalley/board_decisions/tentative_orders/1712/20_climatechange/3_climatechange_wkpln.pdf

Los Angeles Region Framework for Climate Change Adaptation and Mitigation, July 2015, pp. 8-12, 20-22.

https://www.waterboards.ca.gov/losangeles/water_issues/programs/climate_change/docs/2015/Climatechange-frameworkforclimatechangeadaptation-final7-20-2015.pdf

The Effect of Climate Change on Water Resources and Programs, U.S. EPA, pp. 9 – 19.

https://cfpub.epa.gov/watertrain/pdf/modules/Climate_Change_Module.pdf

California Climate Adaptation Strategy, Chapter 7 – Water Management, p. 80 – 85.

http://www.climatechange.ca.gov/adaptation/documents/Statewide_Adaptation_Strategy_-_Chapter_7_-_Water_Management.pdf Using

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understanding that the clause “direct environmental benefits” can be broadly reviewed is advantageous for California and should help inform this process. Finally, VERA believes that once a project type has been deemed to have a DEBS, CARB should implement a system where substantially similar projects are awarded DEBS determinations with minimal additional expense.

In contrast, were CARB to establish a firm “in-state” vs “out-of-state” paradigm focused exclusively on political boundaries – not science – it would open the regulation to legal challenges⁶. This legal determination has, in fact, already been acknowledged by CARB in the original Cap and Trade staff report⁷. It is far more important to incent real, quantifiable, verifiable, enforceable and cost-effective GHG reductions than to inject additional legal uncertainty into the program. Retaining stability, and minimizing legal risk, will certainly incent additional offset reductions to occur, including in many California urban and rural communities.

VERA has serious concerns about CARB’s proposal to retroactively evaluate over 90 Million previously issued credits. These compliance instruments are already in the marketplace, have value, and represent early actions and investment by both the offset developer and the offsets current owner. Additionally, waiting until the end of 2021 to learn if your assets has changed in value is a significant market disruptor. Lastly, such an exercise is a significant expenditure of resources on all stakeholders, including CARB. Therefore, VERA recommends that all offset projects that are listed prior to the finalization of this rulemaking, not be subject to the DEBS evaluation process, and be categorized in a way that does not be subject them to the new DEBS usage limitations imposed for offsets post 2020.

California has long adhered to the basic rule that statutes operate prospectively unless the Legislature has clearly indicated it intended retroactive or retrospective application.⁸ Absent an express retroactivity provision, a statute will not be applied retroactively unless it is clear from extrinsic sources such as legislative history that the Legislature intended that effect.⁹ The presumption against retroactivity applies with particular force to laws creating new obligations, imposing new duties, or exacting new penalties because of past transactions.¹⁰ In AB 398, there is no such express statement that it applies retroactively. In addition, applying AB 398 to existing projects would create new obligations to classify projects with issued credits as DEBS, which would be prohibited as a matter of law. Applying AB 398 to projects that

Future Climate Projections to Support Water Resources Decision Making in California. California Climate Change Center, pp. 45-45.
https://www.water.ca.gov/LegacyFiles/pubs/climate/using_future_climate_projections_to_support_water_resources_decision_making_in_california/usingfutureclimateproitosuppwater_iun09_web.pdf

“How climate change could threaten the water supply for millions of Californians,” *Sacramento Bee*, June 30, 2017.

www.sacbee.com/news/local/article158679214.html

“Gauging climate preparedness to inform adaptation needs: local level adaptation in drinking water quality in CA, USA,” *Climatic Change*, Feb. 2017; see section 2.2 “Climate change impacts.” <https://link.springer.com/article/10.1007/s10584-016-1870-3>

⁶ <https://climatetrust.org/latest-in-state-offset-proposal-will-raise-legal-challenge-dormant-commerce-clause-analysis/>

⁷ <https://www.arb.ca.gov/regact/2010/capandtrade10/capv2appd.pdf> (Page 8, Comment D-46).

⁸ *Evangelatos v. Superior Court* (1988) 44 Cal. 3d 1188, 1207

⁹ 44 Cal. 3d at pp. 1209-1210

¹⁰ *In re Marriage of Reuling* (1994) 23 Cal. App. 4th 1428, 1439; see *Wienholz v. Kaiser Foundation Hospitals* (1989) 217 Cal. App. 3d 1501, 1505, 267 Cal. Rptr. 1

would not qualify as DEBS could also be construed as a penalty, as it would significantly undermine the value of the issued credits for such projects retroactively. We strongly encourage CARB to reconsider.

Update to the Invalidation Provisions under the Current Cap and Trade Rulemaking

The PDD makes minor changes to the invalidation provisions of the Program. VERA believes the time is right for more substantial changes to this anachronistic provision. California offsets have proven to be highly reliable sources of GHG emission reductions. The current invalidation framework of buyer liability limits offset usage for all but the largest entities, whose scale justifies understanding and managing the risk and associated legal and accounting complications. Historically compliance entities have only, in aggregate, used roughly half the offsets allowable under the offset limit. Without a change to invalidation rules we expect this used portion of the offset limit to remain relatively consistent. Given impending drastic offset limit reductions, buyer liability for invalidation therefore impedes the ability of the offset mechanism to contain carbon prices in California's cap-and-trade system.

California should update the framework for invalidation such that it follows the Ontario model in which some causes of invalidation are covered by seller liability and others are covered by an Environmental Integrity Account, as outlined below. The idea of a buffer pool has some regulatory precedent within CARB's existing regulatory structure. California has endorsed Ontario's improved approach; in preparing for linkage, the Governor's Transmittal Response to CARB on Findings under SB 1018 wrote "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."¹¹ Adopting this improved invalidation framework removes the majority of the price risk of invalidation from the market and provides greater incentive to both produce and purchase offsets while at the same time protecting the integrity of the program.

- VERA recommends that seller liability be limited. The sellers of offset credits should be liable to replace any credits associated with double selling (as defined by the current regulatory language as credits which "ARB determines have been issued in any other voluntary or mandatory program within the same offset project boundary and for the same reporting period in which ARB offset credits were issued"). If at any point a liable seller is not able to replace invalidated credits, the Environmental Integrity Account (see below) would be called upon to make the system whole.
- VERA recommends the creation of an "Environmental Integrity Account" for use to replace invalidated credits for all other causes of invalidation. This would require all offset projects to surrender into an Environmental Integrity Account 3% of issued credits (set to reflect the Ontario approach and provide more than adequate coverage based on the historical rate of

¹¹ https://www.arb.ca.gov/cc/capandtrade/linkage/response_to_sb_1018_request.pdf

credit invalidation)¹². This Environmental Integrity Account would be managed similar to the existing Forest Buffer Account. If offsets are later invalidated for causes of material overstatement or regulatory nonconformance (as defined by the current regulatory language as credits which "ARB determines the OPDR contains errors that overstate the amount of GHG reductions or GHG removal enhancements by more than 5.00 percent" and "the offset project activity and implementation of the offset project was not in accordance with all local, state, or national environmental health and safety regulations"), invalidated credits would be replaced from the Environmental Integrity Account.

Under the Cap and Trade regulation, as well as through the attestations provided in the listing, Offset Project Data Report and Request for Issuance of CARB Offset Credits forms, CARB retains the ability to separately punish bad actors committing fraud or perjury. In addition to these new provisions around invalidation, CARB would, of course, retain its ability to enforce these additional damages. In these cases, an offset would already have been replaced by the Environmental Integrity Account, so the environmental integrity of the mechanism would not be dependent upon that enforcement.

Having a clear and simple mechanism to mitigate risks associated with invalidation should make it easier for stakeholders to participate in the offset market stimulating the development of new offsets projects inside and outside of California and removing an obstacle to access the cost containment benefits provided by emissions reduction projects.

Update to Regulatory Compliance under the Current Cap and Trade Rulemaking

The current requirements for regulatory compliance require projects to fulfill all local, regional, state and national requirements on national environmental health and safety laws and regulations. While limiting the temporal scope of regulatory compliance requirements for some project types in its last rulemaking, CARB also included language in Appendix E¹³ that projects "must be in compliance with all requirements that have a bearing on the integrity of the offsets." No specific standard, however, is set for what requirements have a bearing on the integrity of the offsets. CARB should use this rulemaking to further narrow the scope of these requirements to reduce the broad regulatory compliance risk posed and therefore increase the available financing for greenhouse gas reduction projects.

VERA believes that only those requirements that have an impact on the GHG reductions associated with a project have a bearing on the integrity of the offsets and should fall under the regulatory compliance requirements. If an entity that operates a project is out of compliance for issues that do not impact the project's ability to reduce greenhouse gas emissions -- not having proper eye washing facilities in place or paperwork errors or tardiness, for example -- the actual GHG reductions of a project are not affected. Similarly, compliance issues that arise irrespective of the project's implementation need not be automatically labeled as project activities -- such as crop nutrient management issues on a farm that hosts

¹² Of the 87.6 million issued to date, less than 0.1% have been invalidated, and those were for non-GHG protocol related events. Moreover, the very limited credits that have been invalidated were associated with an early action reporting period. Therefore, *zero* credits associated with compliance offset protocols have been invalidated.

¹³ https://www.arb.ca.gov/cc/capandtrade/capandtrade/unofficial_ct_100217.pdf

a manure digester. Project owners will still be required to go through the enforcement action associated with the violation from the proper regulator, and therefore have every incentive to avoid violations.

If CARB believes that further penalizing projects beyond that enforcement action is essential, ARB should further define a threshold of what constitutes a material violation of regulatory compliance. The regulation should give CARB the flexibility to determine which enforcement actions result in material adverse environmental impacts. Only those enforcement actions with material adverse impacts should trigger a violation of regulatory compliance. Material issues must be treated differently than minor administrative violations.

VERA believes this change could significantly enhance the viability of future California generated offset projects.

Administrative Efficiency Improvement Recommendations

VERA believes there are a number of steps CARB can take to make the offset program less costly, less time-intensive for staff, more efficient and more transparent. To that end, we offer the following program suggestions for your consideration:

Review Process Transparency

- Data has shown that the average review cycle length of offset project reporting periods is substantially longer than the 45-day intent of the regulation and is also highly variable. While long review times are problematic for the market, so too is uncertainty and unpredictability of timing.
 - Need for Additional Staff Resources- Certain project types have enjoyed shorter review cycles while other types' review cycles have only increased. VERA suggests CARB take measures to reduce review cycle times for all project types, up to and including hiring additional staffing resources, to move review cycles closer to the intended 45-day timeframes.
 - Duplication of Verifier and OPR Functions- Market perception is that throughout a project's review cycle, much of the work completed by CARB-authorized verifiers and Offset Project Registries (OPRs) is needlessly repeated by CARB staff. VERA perceives many issues raised by staff are matters of interpretation rather than errors, and counter to the expertise of CARB-approved bodies. The current regulatory amendment package seems to push more responsibility onto the OPRs (e.g. for RFI information previously requested of OPOs/APDs and now formally requiring an issues log), which VERA fully supports. Furthermore, we suggest CARB use this change to streamline its own reviews by focusing solely on the registry's issue log and any accompanying audit documentation.
 - Eliminate Compliance Inquiries from ARB Staff- Similar to the note above on duplicative efforts, CARB staff has taken the compliance investigations upon themselves after the VB has already done so per their routine services. This not only is a duplication of efforts, but it can result in conflicting information that might be misconstrued without the proper

context. The subject of these inquiries can be delicate matters and should always include the authorization or participation of the OPOs and APDs.

- Review Process Transparency- Regardless of the duration of review cycles in general, much can be done to increase transparency throughout the process, thus limiting inbound phone calls to staff and providing for more stable market behavior. Presently the timing uncertainty that exists causes real financial harm both to covered facilities and to offset developers. Over-procurement, forfeited contracts and lost opportunities are a few of the very real challenges currently being faced by these parties. Specifically, CARB could implement the following practice changes to help manage expectations:
 - Openly communicate where projects are in process and in various queues, as applicable, published on CARB's website.
 - At the time a reporting period is submitted for review, provide a real-time estimation to the submitting entity as to the projected review time.
 - Prior to the initial 45-days following submission of materials, facilitate a call with the submitting entity to discuss any initial findings and timing projections.
 - Do not delay the acknowledgment of receipt of information when a Request for Information and accompanying materials are submitted (and thus, the start of the 45-day review period). Sometimes several weeks will pass before receipt is acknowledged, but the regulation clearly states that the clock should start at the time of receipt of complete and accurate information.
- Publishing Guidance- Guidance that CARB gives in response to developer, OPR and verifier requests should be routinely published so that all program participants have access to the same information without certain participants being given an unfair advantage. Additional guidance available in the public domain will also reduce staff time spent on inbound questions.

Implementation Issues Related to Current Invalidation Procedures

- Significant time and resources are spent by CARB staff and offset developers to conduct double verifications for purposes of reducing the period during which an offset credit can be invalidated from 8 to 3 years. These double verifications are of questionable value, however, given the highly robust review completed by CARB staff following verifier and OPR reviews. This, in conjunction with the extremely low percentage of offsets invalidated or brought under formal invalidation investigation (roughly 0.1% of the offset credits issued to date), leads VERA to the conclusion that double verifications to reduce the invalidation period from 8 to 3 years are an unnecessary part of the program that does not contribute to program integrity. Instead, all offset credits issued should initially have a 3-year invalidation period. CARB staff could evaluate the following considerations in assessing this request:
 - Staff time spent reviewing 2nd verifications that could be saved with this approach
 - Whether any double verification has ever failed or revealed a material problem with the first verification

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- Whether any investigations have occurred beyond the first 3 years following issuance (i.e. Are issues that could lead to invalidation demonstrably discoverable within the first 3 years?)
- The potential that a repeat verification could undermine the first, due to differences of interpretation between verification bodies.
- A prior regulatory amendment package reduced the invalidation period for an event of regulatory nonconformance from the entire reporting period in which an event of nonconformance occurred to the period of actual nonconformance for all offset project types except forest carbon. This approach provides a valuable incentive for projects out of regulatory compliance to get back into compliance as soon as possible. VERA recognizes that the reason this change was not applied to forest carbon projects is because the protocol does not specifically provide for calculating offset credits in short periods of time less than the length of a reporting period. We therefore recommend that the US Forest Project Protocol be updated to allow for such calculations to restore parity across all offset project types.

Materiality

- A lack of materiality threshold for reporting period reviews, as well as regulatory language such as, “any correctable error must be corrected,” prohibit excusing truly insignificant errors. If an error is not something that affects a project’s applicability or materially alters the volume of a reporting period, VERA believes CARB should consider such errors to be immaterial and therefore excused. The current stance toward immaterial errors results in extra staff time spent on reviews and adds to delays in review cycles. It also tends to conflict with the standard to which verification bodies are held, which has a 5% materiality threshold for reasonable assurance. VERA believes the current regulatory amendment process should be used to address language preventing CARB staff from applying common thresholds for materiality in its assessments. Specifically, VERA recommends implementing a materiality threshold that limits errors that must be corrected to those in excess of 5%, yet not to exceed 500 tCO₂e (or other predetermined level) in magnitude.

Amendments to Existing Protocols

VERA understands that CARB is working to establish the new Offset Task Force outlined in AB 398. Likewise, the Compliance Offset Protocol Task Force is directed to give CARB guidance on new protocols that can increase in-state offset development. This could be a drawn out process to get to actual recommendations. Though VERA supports the creation of the Task Force, we also know that the existing set of approved offset protocols can be improved. These improvements can themselves lead to greater in-state GHG reductions. Therefore, we recommend CARB begin the process of reviewing and updating existing protocols, and believe that opening up the protocols can be independent of the Task Force and its specific mission to promote new in-state protocols.

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Conclusion

VERA is committed to a robust offsets market and our members are available to answer questions on these recommendations. We look forward to working with CARB on these important regulatory changes. VERA can be reached through Jon Costantino at Tradesman Advisors, at: 916-716-3455, or via email at jon@tradesmanadvisors.com.