

Rajinder Sahota, Chief
Climate Change Program Evaluation Branch, Industrial Strategies Division
California Air Resources Board
1001 I Street, Sacramento, California 95814

Submitted online to: https://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtrade16&comm_period=A

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 Resource Board (ARB)'s [Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation](#), released in August 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. We fully support the agency's post-2020 commitment to extend California's Cap-and-Trade program, along with all major provisions to ensure greenhouse gas (GHG) emissions reduction certainty into the future.

IETA remains a consistent, multi-sector business voice that regards 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.

KEY TAKEAWAYS AND RECOMMENDATIONS

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

1. ARB's use of a "straight-line" cap reduction path from 2020 to 2030 paired with the proposed APCR structural changes support a robust carbon market, incenting consistent participation and market liquidity.
2. ARB's recommendation to retire unsold allowances to the APCR after a period of 24 months could lead to a short-term undersupply of allowances and market pricing volatility.; to mitigate future price spikes, we urge the use of a separate, lower, APCR price for unsold allowances.
3. We applaud ARB's proposed support for cross-border linkages, including full and partial program linkages that create broader markets and a wider range of abatement opportunities. With passage of both Ontario's cap-and-trade regulation (May 2016) and Washington State's Clean Air Rule (September 2016), California's leadership and move to support linkage is recognized.
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 proposed regulatory changes and are organized into the following topics:

1. Post-2020 Cap-Setting;
2. Cost-Containment and the Allowance Price Containment Reserve (APCR);
3. Linkage;
4. Compliance with the Federal Clean Power Plan (CPP);
5. Compliance Offset Credits & Flexibility Mechanisms; and
6. Registration & Disclosure.

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 pairing of the "straight-line" cap reduction path from 2020 to 2030 with the allocation of surplus allowances, the delta between the standard and adjusted caps, to the APCR. The alignment of the adjusted cap with forecasted 2020 emissions should incent market participation and liquidity by producing a balanced market.

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, is of paramount importance to the long-term health of California's Cap-and-Trade program. The alignment of California's adjusted cap with forecasted 2020 emissions, with allocation of the surplus allowances to the APCR, will produce a balanced market over time – this will help promote liquidity, while driving trading and a meaningful price signal. Pairing this structural change with the transfer of unsold allowances to the APCR, after two years, should facilitate this movement to a balanced market, transitioning oversupplied allowances out of the market while providing a buffer for future needs.

However, we caution ARB on implementing design features that could create short-term market pricing spikes due to an artificial undersupply of allowances driven by these structural changes. A lack of market participation for over relatively short period of time could lead to significant allotment of allowances into the APCR. These allowances may then be needed to meet short term market demands, with no ability to access volume again outside of tapping into the APCR, leading to a significant increase in market pricing over a relatively short period of time.

IETA recommends that ARB revisit the pricing structure for the APCR design, setting a separate, lower, price for the unsold allowances that are allocated to the APCR. A balance will need to be struck between a price signal that is strong enough to incent continued, and hopefully growing, market participation while not leading to aggressive pricing spikes that could harm the integrity of California’s overall Cap-and-Trade program. IETA believes this balance could be found with an APCR for unsold allowances priced at the floor + USD \$15, sending the appropriate signal to the market.

3. LINKAGE

A. Linkage with Ontario & 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 cap-and-trade program. ARB’s close consultation and planning with Ontario officials throughout the process will go a long way to ensuring that the process goes smoothly in 2018, including structural and policy alignment in the post-2020 timeframe. California’s commitment to expanding trading partners is also important given the increasing number of North American jurisdictions considering adopting market mechanisms and exploring both full and partial linkage opportunities with Western Climate Initiative (WCI) partners. Most recently, this was evidenced by the [Joint Declaration](#), signed by Québec, Ontario and Mexico, at the 2016 Climate Summit of the Americas. The declaration commits existing and future California partner jurisdictions to “deepen their collaboration...on carbon markets” and to “jointly promote the expansion of carbon market instruments...in North America.”²

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 on both sides of the Canadian-US border and beyond, the inherent flexibility of WCI’s model creates an ideal framework to functionally embrace and enable these proposed types of one-way unit flows.

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

² [Joint Declaration Between the Ministry of Environment and Natural Resources of the United Mexican States, the Government of Ontario, and the Gouvernement du Québec](#), released 31 August 2016.

B. Sector-Based Crediting Programs

IETA encourages ARB to support the inclusion of international sector-based/REDD+ offsets into California's program as early as practical and effective. For detailed input on technical and policy aspects of sector-based/REDD+ offset credits, please visit IETA's library of related 2016 submissions to ARB.³

4. COMPLIANCE WITH THE FEDERAL CLEAN POWER PLAN

IETA strongly supports the use of California's cap-and-trade program as the backbone of the state's Clean Power Plan (CPP) State Implementation Plan (SIP). Enabling alignment of the market program's structure – for both compliance periods and coverage – to meet CPP requirements will place California at the forefront of compliance with the future federal program.

5. 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...*" IETA strongly urges ARB to remove this language in the final amended regulation.

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.

³ See [IETA Comments on California Air Resource Board's Sector-Based Offsets Workshop & White Paper](#), submitted 8 April 2016; and [IETA Comments on California Air Resource Board's Linkage & Sector-Based Offsets Workshop](#), submitted 13 May, 2016.

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 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, ODS, and Rice Cultivation offset projects the opportunity to demonstrate that a regulatory non-compliance period limited – 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. We understand, and endorse, Ontario taking a similar approach to the EIA. 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.⁴

Specific to proposed forest reversal invalidation amendments, we recognize that Section 95985⁵ 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.

⁴ See [IETA Comments on California Air Resource Board’s Workshop on Potential 2016 Amendments to Cap-and-Trade Regulation](#), submitted to ARB 11 March 2015.

⁵ 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 subarticle 4, within six months of notification by ARB pursuant to section 95985(g)(2)”

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.

6. REGISTRATION & DISCLOSURE

A. *Account Application*

IETA applauds ARB for proposing modifications that facilitate a more streamlined approach to market participation. The modification to allow an entity to have CITSS accounts across multiple jurisdictions for which they hold obligations is a much needed amendment to the program.

B. *Change of Representatives*

ARB's proposed move to streamline the registration and re-designation process is another welcome change to improved efficiencies in procedure and removal of unnecessary administrative burdens.

C. *Disclosure of Corporate Associations*

We support changes to OPOs from the corporate disclosure requirements. This provides greater flexibility while reducing administrative workload for ARB. We recommend that ARB allow existing OPOs, who have made corporate disclosures to ARB, to opt-out of corporate disclosure requirements going forward.

CONCLUSION

IETA appreciates the opportunity to help inform California's proposed amendments and future market. If you have questions or require more information, please contact Katie Sullivan, IETA's Director of the Americas and Climate Finance, Katie Sullivan (sullivan@ieta.org).

Sincerely,



Dirk Forrister
IETA President and CEO