



July 13, 2010

California Air Resources Board  
1001 I Street  
Sacramento, California 95812

Subject: Comments on ARB's cost containment presentation held on June 22, 2010

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## I. Introduction

These comments are submitted by the Offsets Working Group ("OWG"), a collaborative team of publicly-owned electric utilities serving customers in California. The OWG includes representatives from the Modesto Irrigation District, City of Redding, City of Roseville, Sacramento Municipal Utility District, and Turlock Irrigation District. These utilities comprise approximately one-third of the electricity load in California served by publicly-owned electric utilities.

## II. ARB should implement a speedy transition to an offset compliance program through linkage with the Climate Action Reserve.

The OWG encourages the Air Resources Board ("ARB") to take immediate action to develop a compliance-grade offset program that incorporates the principles of integrity, flexibility, certainty, transparency, and simplicity. In its comments on the Preliminary Draft Regulation ("PDR") submitted on January 11, 2010, the OWG supported the PDR's two methods for developing a compliance offset program.<sup>1</sup> The first method, described in PDR §§ 95850(b) and 96220 *et seq.*, has ARB as the internal credit issuing body. The second method, described in PDR § 96150 *et seq.*, has ARB pursuing linkages with other systems that would serve as credit issuing bodies. The PDR also stated that ARB may consider using Climate Reserve Tonnes ("CRTs") issued by the Climate Action Reserve ("CAR") as potential compliance instruments.<sup>2</sup> The OWG restates its support for the two-track approach and particularly, for ARB's initiation of a process for approving CRTs as compliance instruments. The OWG proposes the general approach as follows:

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<sup>1</sup> PDR Subarticles 12 and 13.

<sup>2</sup> PDR § 95860.

- 1. OWG Recommendation: ARB should immediately initiate a formal regulatory process to link with CAR as the initial credit issuing body in order to provide regulatory certainty for covered entities.** At this time of budget constraints and continuing market uncertainty for covered entities, ARB's initial efforts and expenditures should not be spent duplicating a successful and functioning program that already exists. ARB should use the CAR protocols without modification to the maximum extent possible. CAR's protocols have been developed with broad stakeholder input, including ARB staff engagement at all stages. The protocols can support a cap-and-trade program today with only minor adjustments to verification and enforcement to meet regulatory requirements. Further, any changes considered by ARB should be undertaken in partnership with CAR to ensure consistency and functionality. This will result in a clear and rapid transition to the regulatory program.

CAR substantially meets the requirements for an approved external offset crediting system as proposed in the PDR.<sup>3</sup> Case in point, CAR has published standards and quantification methodologies that were developed through a lengthy public process. Additionally, the CRTs issued by CAR are registered and tracked in a publicly accessible registry. The CAR Program Manual describes the formal process by which protocols are considered and adopted. The Program Manual provides that project protocols are developed using "a balanced multi-stakeholder voluntary workgroup, drawing from industry experts, state and federal agencies, environmental organizations, and other various stakeholders."<sup>4</sup> The workgroup conducts an iterative development of draft protocols that are considered at public workshops, public review periods, and culminate in a public adoption by the CAR Board. Throughout the process, the workgroup provides expert review and direct input into the project protocol development.

- 2. OWG Recommendation: ARB should structure the formal regulatory process for establishing either ARB or CAR as a credit issuing body in a manner that ensures the start of a compliance offset program no later than January 1, 2011.** The OWG urges for regulatory certainty in order to encourage additional investment in, and the development of, emission reduction projects. The continuing policy uncertainty at the federal and state levels has kept many prospective buyers from purchasing offsets.<sup>5</sup> The OWG understands that one or more aspects of the CAR Forestry Project Protocols have generated controversy and that ARB has cause to proceed cautiously and consider modifications to those protocols to minimize the potential for litigation. This threat appears to be preventing ARB from adopting those protocols as they currently exist and continues to cause uncertainty for developers, investors, and buyers. However, other CAR protocols have not raised similar concerns. Therefore, it may be most expedient for ARB and all prospective covered entities, for ARB to expedite the establishment of its compliance offset program by quickly adopting the non-controversial CAR protocols. This fast-track process, beginning with adoption of the protocols with minimal changes in

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<sup>3</sup> PDR § 96170.

<sup>4</sup> Climate Action Reserve Program Manual, Section 4: *Project Protocol Development Process*, at 29-31.

<sup>5</sup> *US Offset Markets in 2010: The Road Not Yet Taken*, Point Carbon (March 1, 2010), at 7.

the next few months and completed in 2010 with adoption of the regulatory requirements, allowing ARB to begin issuing and/or accepting compliance offsets as early as January, 2011.<sup>6</sup> To be perfectly clear, the OWG places its full support behind the speedy adoption of the CAR Forest Project Protocols as they currently exist because forest-based projects are a significant source of emission reductions that also provide substantial environmental co-benefits. By presenting this pragmatic recommendation, however, the OWG is plainly stating that ARB should not delay implementing an offset compliance program during the pendency of discussions regarding a single protocol.

**3. OWG Recommendation: Regardless of whether CAR is linked as a credit issuing body, ARB should accept, i.e., grandfather, CRTs from projects that were implemented during the period that ARB had approved the voluntary protocols.**

This grandfathering should include all CRTs issued to date, plus all future CRTs from those projects that will be issued within the first ARB crediting period applicable to that protocol. As a result of the thorough protocol development process followed by CAR,<sup>7</sup> ARB should accept CRTs from existing projects that followed the CAR Forest Project Protocol, Urban Forest Protocol, or Livestock Project Protocol. ARB collaborated in the development of these protocols and has led industry to expect that offsets recognized by CAR would meet AB 32 mandated criteria. The OWG believes that the existing CAR protocols generally meet all AB 32 mandated criteria apart from minimal changes to comply with the California Environmental Quality Act. Changing substantive requirements for such offsets would drive entrepreneurs and investment capital away from California because it would appear that California regulators are changing the rules in the middle of the game.

**III. ARB should increase or remove the quantitative limits on offsets.**

An offset credit represents an emission reduction at an uncapped source that is in addition to any reduction otherwise required by law or regulation or that would otherwise occur.<sup>8</sup> Therefore, an offset emission reduction provides exactly the same beneficial effect as provided by a direct emission reduction at a capped source: (1) in reducing the global mix of GHGs;<sup>9</sup> and (2) in achieving the statewide GHG limit.<sup>10</sup> In AB 32, the “Legislature finds and declares [that] . . .

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<sup>6</sup> For example, the ODS Protocols, Livestock Project Protocols, and Urban Forestry Protocols appear to have generated less opposition than the Forest Project Protocols.

<sup>7</sup> Described in the OWG Recommendation 1, above.

<sup>8</sup> The regulations adopted by ARB, including those that will apply to offset credits, “shall ensure all of the following: (1) The greenhouse gas emission reductions achieved are real, permanent, quantifiable, verifiable, and enforceable by the state board; (2) For regulations pursuant to Part 5 (commencing with Section 38570), the reduction is 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; (3) If applicable, the greenhouse gas emission reduction occurs over the same time period and is equivalent in amount to any direct emission reduction required pursuant to this division.” Health & Safety Code § 38562(d); *See e.g.*, PDR §§ 95802(a)(4), (97), 96220(a), 96240(c).

<sup>9</sup> *See* “Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act; Final Rule,” 74 Federal Register 239 (Dec 15, 2009), pp. 66516.

<sup>10</sup> Health & Safety Code §§ 38505(n), 38550, 38562.

[g]lobal warming poses a serious threat to the economic well-being, public health, natural resources, and the environment of California.<sup>11</sup> In addition to their GHG reduction-related benefits to California, many offset projects also provide economic, environmental, and public health benefits to the state. These include water purification, mitigation of floods and droughts, temperature reduction, detoxification and decomposition of wastes, noise reduction, odor reduction, generation and renewal of soil fertility, pollination of crops and natural vegetation, pest control, climate stabilization, air pollutant reduction, and many other positive attributes.<sup>12</sup> The benefits of many types of ecosystems services provided by an offset project are measurable.<sup>13</sup>

ARB is required to adopt GHG emission reduction measures “to achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions in furtherance of achieving the statewide greenhouse gas emissions limit . . . .”<sup>14</sup> Offsets are mechanisms that allow covered entities to mitigate compliance costs while at the same time contributing to the overall reduction in global CO<sub>2</sub> levels. Offset projects will assist California in achieving the maximum technologically feasible emission reductions by promoting innovation and encouraging emission reductions at sources that would not otherwise be reached by ARB’s regulations.<sup>15</sup> Offsets provide compliance flexibility for covered entities and thus promote the essential criterion of AB 32 for cost-effectiveness.

- 4. OWG Recommendation: The offset quantitative usage limit percentage should either be eliminated or increased for all offsets.** This recommendation is supported by the principle of cost containment. The 4% limitation is substantially more stringent than other GHG reduction programs.<sup>16</sup> In the *Analysis of the California ARB’s Scoping Plan and Related Policy Insights*, the Charles River Associates determined that increasing the availability of offsets may reduce AB 32 implementation costs, i.e., the social costs, by many billions of dollars.<sup>17</sup> They concluded that program costs decreased substantially as the percentage of available of offsets was increased. The increase in offset availability

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<sup>11</sup> Health & Safety Code § 38501(a).

<sup>12</sup> See *OWG Comments on the offset provisions of the Preliminary Draft Regulations* (Nov 24, 2009), at footnote 15.

<sup>13</sup> *Id.* at footnote 16.

<sup>14</sup> Health & Safety Code § 38562(a).

<sup>15</sup> *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California*, Market Advisory Committee (Jun 30, 2007), at 61-62.

<sup>16</sup> The offset limit for the EU-ETS is 8% while the limit during the early years of the Waxman-Markey proposed legislation would be closer to 35%. *Comments of Michael Wara to the California State Senate Select Committee on Climate Change and AB 32 Implementation*, Informational Hearing on the Greenhouse Gas Emissions Cap-and-Trade: California Air Resource Board’s Preliminary Draft Regulation, January 7, 2010. The RGGI offset usage limit is 3.3% of reported emissions but increases to 5% (stage 1 trigger at \$5.00/ton) and then 10% (stage 2 trigger at \$10/ton) if certain allowance price levels are reached. RGGI Model Rule, section XX-6.5 (Dec 2008). California’s allowance prices are estimated to substantially exceed \$10/ton from the inception of the ARB cap-and-trade program.

<sup>17</sup> See e.g., *Analysis of the California ARB’s Scoping Plan and Related Policy Insights*, Charles River Associates (Mar 24, 2010), at 14, 18. This analysis was prepared pursuant to ARB Resolution 08-47.

would reduce allowance prices and also reduce “disincentives for investment in California.”<sup>18</sup>

5. **OWG Recommendation: In the alternative to OWG Recommendation 4, the offset quantitative usage limit percentage should either be eliminated or increased for offset credits from projects located in California.** This recommendation is supported by the principle of cost containment and the beneficial environmental attributes to California discussed above.<sup>19</sup> Increasing the usage limit percentage for offset projects in California can be shown to directly benefit Californians through greater reductions in co-pollutants and green jobs, among other things. This limit may also inhibit a covered entity (public or private) that has uncapped sources located in California from implementing cost-effective actions to reduce emissions directly at the uncapped sources if the reduction would exceed 4% of the entity’s covered emissions.<sup>20</sup>
  
6. **OWG Recommendation: In the alternative to OWG Recommendations 4 and/or 5, the offset quantitative usage limit percentage should either be eliminated or increased for compliance by the electric utilities.** The logic for this quantitative limit has less applicability to electric utilities than to other covered entities because electric utilities will be achieving significant levels of direct emission reductions as a result of implementing complementary emission reduction measures (including a proposed 33% Renewable Energy Standard or Renewable Portfolio Standard and the requirement to achieve all cost-effective energy efficiency savings).<sup>21</sup> These measures will assure that a substantial amount of emission reductions will come from covered sources in the electric sector. Eliminating the offset limitation for electric utilities would not frustrate this purpose.

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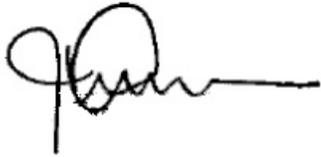
<sup>18</sup> *Id.* at 23.

<sup>19</sup> ARB staff has expressed concerns over dormant Commerce Clause issues related to this proposal. The OWG notes that ARB will eliminate any Commerce Clause issues by following the OWG Recommendation 4, above.

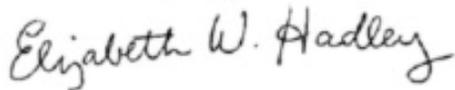
<sup>20</sup> For example, if a public entity emitted 30,000 MT CO<sub>2</sub>e per year from a covered sources (e.g., a gas-fired power plant) and had a more cost-effective option to substantially reduce emissions at an uncovered source (e.g., methane from a wastewater treatment plant) emitting 15,000 MT CO<sub>2</sub>e per year, it would be unable to use more than 1,200 offset credits to meet its own surrender obligation.

<sup>21</sup> AB 32 Scoping Plan, at 41-46. At an estimated cost of \$133/ton, the Scoping Plan states that the RES is the most expensive means of achieving emission reductions. *Id.* at 84.

The OWG thanks ARB staff for evaluating and considering the foregoing comments.



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