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*Sent Via Electronic Transmission - ccworkshops@arb.ca.gov*

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Kevin Kennedy  
California Air Resources Board  
1001 I Street  
Sacramento, CA

Re: **NORTHERN CALIFORNIA POWER AGENCY Comments on March 23  
Workshop Regarding *Quantitative Limits on Offsets in a Cap-and-Trade  
Program***

Dear Kevin:

In accordance with the direction provided during the March 23 Workshop, *Implementing a Quantitative Limit on the Use of Offsets in a Cap-and-Trade Program* (March 23 Workshop), the Northern California Power Agency<sup>1</sup> (NCPA) hereby submits these comments.

## **I. COMMENTS**

### **A. Introduction**

Offsets are an important tool that must be available to entities with a greenhouse gas (GHG) reduction obligation for assisting compliance entities in reaching their emissions reductions targets. NCPA provides these comments with the expectation that any cap-and-trade program applicable to California will include the robust development of offsets that meet the criteria set forth in Assembly Bill 32 (AB 32); namely that offsets are “real, permanent, quantifiable, verifiable, and enforceable by the state board,” (Health & Safety (H&S) Code § 38562(d)(1)) and that “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.” (H&S Code § 38562(d)(2)) In order to ensure the proper qualitative and quantitative limits on offsets, it is important that offsets be properly defined to meet the requirements of AB 32 and also serve as an effective tool to facilitate reaching the mandated emissions reductions prescribed in the statute.

### **B. Quantification of Offsets**

Achieving mandated emissions reduction targets will have a financial impact on

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<sup>1</sup> NCPA members include the cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah, as well as the Bay Area Rapid Transit District, Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District, and whose Associate Members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

compliance entities<sup>2</sup> and all Californians. To best control these effects in a cap-and-trade program, California's offset program must not be constrained by some arbitrary rule which limits its use. Until such time as the technological and financial impacts of AB 32 implementation have been fully evaluated, it is far too premature to impose specific caps on the use of offsets. Indeed, imposing such a cap at the beginning of a program could be unduly restrictive and hinder attainment of emissions reduction goals as well as the development of innovative offset projects.

As a practical matter, the use of offsets should not be viewed as a mechanism by which to reduce the overall emissions cap. To do so would be counterproductive to the development of a vital and robust offset market, or the use of offsets as an emissions reduction and cost control mechanism. Offsets must be allowed in excess of the total cap with the realization that offsets represent emissions reductions, albeit in other locations. Within the electricity sector, the use of offsets can help control costs, while also furthering the development of offset and GHG emission reduction programs and measures that likely would not otherwise be advanced at this time.

### **C. Use of Offsets**

As noted earlier, offsets can be an invaluable tool in attaining emissions reduction goals. Without question, offset projects should not be confined to specific geographic boundaries. Offsets should also be recognized synonymously with an allowance, and entities should be able to trade and surrender allowances and offsets in a like manner and with an equivalent value.

Offsets allow compliance entities an alternate method for reducing GHG emissions and an alternative to procuring allowances. Whether an entity surrenders an allowance or an offset, the total amount of emissions in the atmosphere declines, consistent with the ultimate goal of AB 32. Any California offset program must provide opportunities for the use of such alternative mechanisms, rather than limiting their use. In the end, whether through the surrender of offsets or allowances, it is better for an entity with a compliance obligation to meet their emissions reductions targets rather than be subject to penalties for non-compliance.<sup>3</sup> Unlike compliance enforcement mechanisms, alternative compliance mechanisms – such as the use of offsets – provide for real emissions reductions.

While there may be a need to utilize greater offsets during the nascent stages of the cap-and-trade program, CARB should not restrict use of offsets in later years. A viable and flexible offset program will recognize that new offset projects will need to begin from “scratch.” This start-up period will result in significant investments in projects that may not begin generating actual “offsets” until a later date. In order to encourage the continued development of offset projects, restrictions should not be placed on the program in later years. As today's offset projects become a viable part of emissions reduction strategies, they will no longer meet the offsets criteria and will become mainstream emissions reduction options. At the same time, new technologies and new projects that do result in real, permanent, quantifiable, verifiable, and additional emissions reductions will continue to be developed. California should not create a program which inadvertently limits or inhibits the advancement of such emissions reduction alternatives.

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2 The terms “compliance entities” and “entities with a compliance obligation” are used synonymously.

3 Penalties provide only an economic impact but no net decrease in emissions, and in the end the State is no better off in terms of reducing harmful emissions.

#### **D. Offset Limits**

A vital offsets market must employ a system that is administratively simple. If CARB determines that some quantitative limit must be applied to offsets, *usage* limits will provide the most efficient alternative.<sup>4</sup> Usage limits place the limitation on the entities using the offsets, not on the total offsets that can be developed and offered into the market for use. It provides the simplest process for the administration of offsets since the State would not be required to develop a separate market mechanism. In this instance, offsets would be treated the same as allowances, surrendered in the same manner as emissions allowances. Usage limits also allow the compliance entity to more directly control the types of programs that can be developed and more pointedly direct resource commitments. At the same time, such a mechanism would encourage or facilitate the development of potentially smaller projects or more localized investments in offset projects.

Supply limits – a means of limiting offsets that provides a specified number of “offset credits” to project developers – creates greater profit motive and limits the ability of compliance entities to control offset projects.<sup>5</sup> To the extent that the offset credits are “assigned” to a non-compliance entity, greater opportunities for manipulation of the offset market are created.

Under a supply limit mechanism, offsets are essentially obtained by project developers with no link to a compliance obligation and no requirement to ensure that the offsets are made available to compliance entities. In essence, such a structure benefits only large project developers, and developers are not the proper party to obtain and distribute offsets. Since developers do not have a compliance obligation, different factors influence and constrain the ability of developers to build/design offset programs, such as siting, labor costs, and material costs. The cost of purchasing allowances by the complying entity should drive the competitive benchmark for pricing of offsets, and not solely the profit motive of the project developer. If the market relies solely on project developers, then smaller offset projects will likely not be pursued, particularly if parties can obtain allowances more cost effectively and efficiently than offsets, regardless of the potential success of the prospective offsets project.

The so-called hybrid approach should also be avoided.<sup>6</sup> Not only does such an approach suffer from the same pitfalls as a supply limit approach, but it would also be administratively burdensome. Additionally, while clearly a tempting notion in light of the current budget constraints faced by the State, the offsets market should not be viewed as a potential revenue source for the State. Such a design only adds to the overall costs incurred by compliance entities and increases not only the price of the underlying offsets, but compliance costs overall. Instead, offsets should be viewed as cost control mechanisms for entities with GHG reduction compliance obligations, allowing them the option to purchase offsets from emissions reducing projects in lieu of allowances.

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4 See slides 19 and 20 from the March 23 Workshop Presentation.

5 See slides 19 and 21 from the March 23 Workshop Presentation.

6 See slide 23 from the March 23 Workshop Presentation.

## **E. WCI and Offsets**

The most robust offset market will be one that has a seamless transition between partner jurisdictions throughout the entire Western Climate Initiative (WCI) jurisdiction. Accordingly, California should advocate for similar offset rules throughout the region. It is important to note that excessive restrictions on the use of offsets in a California program will detrimentally impact the State's ability to develop viable offset projects, and further impair the ability of compliance entities to meet their emission reductions obligations. Less stringent rules in WCI partner jurisdictions would drive development out of state and increase costs for compliance entities in California.

## **F. Integrated Issues**

Certain issues surrounding the use of offsets must be addressed in concert with related issues. Indeed, discussion on the use and quantitative limits of offsets should be integrated with other issues, including determinations regarding the manner in which allowances are allocated amongst compliance entities.

Additionally, it is imperative for stakeholders to know that the process for development of the offsets program is transparent. A viable and vibrant market depends on all market participants (from compliance entities to project developers) knowing how offsets are created, used, and retired to give the market the confidence to use offsets.

There must also be transparency in the means by which offsets projects will be verified. The verification process should allow for different certification protocols for different sized offset programs (i.e. offset programs under 10,000 pounds or over 25,000 pounds GHG emissions would have different certification/verification requirements). The verification process should not be such that small projects cannot be developed because they do not have the scale to afford a large and complex certification/verification process.

## **II. CONCLUSION**

NCPA appreciates the opportunity to offer these comments and looks forward to continued efforts towards the development of a viable offset program within the context of the State's cap-and-trade program. If you have any questions regarding these comments, please do not hesitate to contact the undersigned or Scott Tomashefsky at 916-781-4291 or [scott.tomashefsky@ncpa.com](mailto:scott.tomashefsky@ncpa.com).

Sincerely,  
**MCCARTHY & BERLIN, LLP**



C. Susie Berlin  
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