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Update Regarding the Proposed Offset Component of the California Cap-and-Trade Program July 29, 2010

As part of developing a cap-and-trade regulation, the California Air Resources Board (ARB) staff has proposed that offset credits can be used for compliance. On June 22 and 23, 2010, ARB held two workshops to discuss how offset credits could be used for cap-and-trade compliance. This document provides an update on how ARB staff is approaching the design of the offset system for California's cap-and-trade program and reflects stakeholder comments received during and following the workshops.

The Role of Emission Reductions from Offsets

ARB recognizes that emission reductions from offsets can reduce the cost of compliance in a cap-and-trade program. Offsets are greenhouse gas emission reductions from sources outside the cap-and-trade program. Because offsets can cost less than some potential emission reductions in capped sources they can reduce the cost of achieving the overall emissions target. Economic analyses, including ARB's recent analysis, underscore the effectiveness of offsets as a cost control mechanism, even when offsets are used in limited quantity as proposed by ARB.

The Importance of Quality

To maintain the environmental integrity of the cap-and-trade program, emission reductions from offsets must be high quality. To assure quality, ARB is:

- Conducting analyses to ensure that compliance-eligible offset credits meet all AB 32 requirements.
- Ensuring the cap-and-trade program meets all California Environmental Quality Act requirements.
- Taking a conservative approach to ensure that all offsets used in the program are real, additional, permanent, verifiable, and enforceable.
- Proposing that all emission reductions from offset projects be verified by third-party verifiers accredited by ARB.

The energy challenge facing California is real. Every Californian needs to take immediate action to reduce energy consumption. For a list of simple ways you can reduce demand and cut your energy costs, see our website: <http://www.arb.ca.gov>.

California Environmental Protection Agency

The Importance of Supply

ARB staff proposed the idea of promoting the supply of compliance-eligible offsets in November 2009, and is continuing to consider multiple paths for generating offset credits in 2010, including: (a) ARB issuing offset credits for projects using ARB-approved protocols; and (b) ARB recognizing offset credits from ARB-approved offset programs. These could include sectoral programs such as those reducing emissions from deforestation and forest degradation in developing countries (REDD). Offset credits from ARB-approved linked cap-and-trade programs (such as WCI Partner jurisdictions) are also proposed to be compliance-eligible in California's cap-and-trade program.

ARB staff is planning to incorporate provisions in the cap-and-trade regulation that would allow multiple methods to be used to make offset credits available following Board approval of specific protocols or programs. To develop the approach to issuing compliance-eligible offset credits based on specific protocols, ARB staff is:

- Proposing to work with qualified third-party offset programs to bring emission reductions from new projects into the offset system: ARB recognizes that third-party offset programs (such as the Climate Action Reserve) have existing capabilities and infrastructure that can be deployed quickly to enhance the supply of compliance-eligible offsets. ARB is exploring the conditions and processes by which third-party offset programs can use the ARB-adopted protocols to help generate compliance-eligible offsets.
- Relying on the Climate Action Reserve (CAR) work on four protocols: forestry, manure management digesters, urban forestry, and ozone depleting substances (ODS): ARB recognizes the extensive contributions that stakeholders and experts have made to the CAR protocols, including fashioning effective solutions to difficult problems. Accordingly, ARB is relying on this work to help support ARB's offset quality objectives as well as provide continuity and stability for offset projects both within California and other parts of the United States. As part of its evaluation of these protocols, ARB staff is examining several aspects for potential adjustment, including:
 - Evaluating mechanisms for ensuring permanence in forestry projects to ensure that they are effective and enforceable by ARB.
 - Reviewing technical details to determine whether to incorporate minor adjustments, such as whether to require credits for the ODS protocol to be limited to destruction at facilities with Resource Conservation and Recovery Act permits.

- Recommending minor modifications to each protocol to align with requirements of the cap-and-trade program, such as aligning project start eligibility dates and crediting periods, or alignment of terms and definitions.
- Proposing to recognize emission reductions from existing CAR projects under the four protocols: ARB staff is developing a process so emission reductions from qualified existing CAR projects can be brought into the compliance system and become compliance eligible. Recognizing existing projects will help to create an initial supply of offset credits for the cap-and-trade program. The definition of the eligible start date for existing projects is under consideration. The process must be adopted by the Board as part of the cap-and-trade rulemaking and be consistent with applicable verification and enforcement provisions of the final regulation.
- Proposing to review and adopt additional protocols. ARB staff will evaluate additional offset project types and protocols in the future. Protocols developed by third parties will be reviewed and, if acceptable, be considered for adoption by ARB.

Rulemaking Requirements

ARB's offset program is being developed as part of the cap-and-trade rulemaking. The rulemaking will include the requirements for a verification program that is consistent with international standards and subject to ARB oversight. This oversight includes verifier accreditation, requirements for verification services, and conflict of interest requirements. The rulemaking will also include enforcement provisions that would apply to parties that participate in the offset program. Those parties may include project developers, verifiers, and compliance entities. Finally, the rulemaking also will include a process for cooperation with qualified third-party offset programs.

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