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To: California Air Resources Board Staff (ccplan@arb.ca.gov)
Re: NRDC Comments on Offsets
Date: April 18, 2008

NRDC submits these comments in response to the presentations and discussion at the technical stakeholder workshops on April 4, 2008. These comments in no way pre-suppose whether CARB will eventually adopt a cap and trade program, and they do not constitute an endorsement of the use of offsets for compliance purposes. Offsets could undermine efforts to achieve the goals of AB 32. NRDC believes there are better policy tools to achieve emission reductions in California's uncapped sectors.

It is important to note that offsets are not a necessary part of a cap and trade program, nor are they unique to a cap and trade program. In other words, it is possible to have a cap and trade program without allowing any offsets to be used for compliance purposes, and it is possible to use offsets for compliance purposes as part of any regulatory scheme.¹ Voluntary offsets are very different from offsets for compliance, and are not addressed here. These comments address the use of offsets for compliance with a cap and trade program; the concerns described below would apply even more strongly if offsets were to be used for compliance with a regulatory program because the offsets would risk undermining achievable, minimum reductions established by the regulations.

1. Should California have an offsets program for compliance purposes?

CARB should exercise an abundance of caution when contemplating an offsets program for compliance purposes. *If* offsets are allowed as part of a cap and trade program, the cap *must* be set tightly, and the offsets *must* be real, additional, verifiable, permanent, and enforceable.

Offsets do not achieve any additional GHG emissions reductions compared to the established cap in a cap and trade program; they merely offer an alternative path to achieve the required amount of GHG reductions. Offsets do not offer any additional environmental benefits, but they do present several substantial risks.

¹ In a cap and trade program, offsets for compliance purposes would be verified emissions reductions from an uncapped source which capped sources could purchase and use as allowances to meet their compliance obligations in the cap and trade program. In a regulatory program, offsets for compliance purposes would be verified reductions from an unregulated source that a regulated source could purchase and use to comply with its regulatory requirements.

a. Real, Additional, Verifiable, Permanent, and Enforceable

The primary risk is that offsets will not actually achieve the GHG reductions they claim to achieve. All stakeholders agree that offsets must be real, additional, verifiable, permanent, and enforceable, yet the fact remains that achieving these goals is fraught with difficulties. In many cases, if regulators could have substantial certainty about the GHG reductions from a type of project, then those projects would be covered by a regulatory or market-based program, not left outside as offsets.

If we can achieve real, additional, permanent, verifiable and enforceable GHG reductions and all of the co-benefits required by the law at a lower price, then we can all agree that that would be a wonderful result. However, the tricky part is making sure these offset reductions actually are real, additional, verifiable, permanent and enforceable, and are also providing the co-benefits required by the law. The question of whether *these offset* reductions are still cheap is the harder question. Experience with offsets under the Clean Development Mechanism has shown that it is very difficult to guarantee that offsets projects actually achieve real, additional, verifiable, permanent and enforceable GHG reductions, much less achieve the environmental, health, economic, and other co-benefits required by AB 32.² Many proponents of offsets simply assume that reductions will be real, additional, verifiable, permanent and enforceable, and will also meet California's other goals (see below), but provide no analysis of how much it will cost to meet these criteria before reaching the summary conclusion that offsets are less expensive than other reductions.³ In effect, they conclude that offsets will be cheaper before accounting for all the costs.

b. Co-Benefits

Another critical risk is that offsets will not achieve the environmental, health, economic and other co-benefits that would be achieved by reductions from capped or regulated sources, and that are required by law. Any market-based or regulatory program under AB 32 must take into account “localized impacts,” must not “disproportionately impact low-income communities,” must not increase “emissions of toxic air contaminants or criteria air pollutants” nor interfere with “air quality standards” and efforts to reduce

² See *U.N. Effort To Curtail Emissions In Turmoil*, Wall Street Journal page A1, April 12, 2008, available at <http://online.wsj.com/article/SB120796372237309757.html>

³ CRA's presentation of Chevron-funded modeling at the April 4 workshop was an example of this conclusive thinking. This modeling “unequivocally” concluded that offsets would be cheaper than reductions under the cap and trade program, and then added as an afterthought that the offsets would have to meet California's strict requirements that they be real, additional, permanent and verifiable. See Chevron Presentation, slide 12, available at http://www.arb.ca.gov/cc/scopingplan/economics-sp/meetings/040408/chevron_slides_for_arb_workshop_offsets_v4.pdf.

“toxic air contaminant emissions,” and must maximize “additional environmental and economic benefits for California” and consider “overall societal benefits.”⁴ It is not certain that offsets will achieve these co-benefits for Californians. For example, a facility which would concurrently reduce toxic pollutants with localized impacts when reducing GHG emissions could be allowed to instead purchase offsets in the form of a forestry project that would not reduce these co-pollutants. Or, an electricity generator could purchase offsets instead of switching out an older, polluting power plant and thus risk exposing its consumers to even higher costs under a future federal or international reduction scheme.

c. Innovation

Finally, offsets could undermine one of the most important goals of AB 32 – driving technological innovation and infrastructural change in the state’s key emitting sectors.⁵ At the April 4 workshop, many stakeholders mentioned the importance of driving technological innovation. However, only a few acknowledged the conclusion reached by the Economic and Technology Advancement Advisory Committee (ETAAC), that offsets could “reduce the pressure to be creative within a given sector and weaken price signals for would-be innovators.”⁶ The Co-Chair of ETAAC emphasized this point during the April 4 workshop, reminding us that we must keep up the pressure to force technological change and innovation, and that allowing offsets will reduce that pressure.

If CARB adopts a cap and trade program in California, the capped sectors would be the largest sources of GHG emissions and co-pollutants, and the sectors in which we *must* achieve transformative change and innovation in order to meet our 2020 and especially our 2050 goals.⁷ If California’s capped entities invest their capital in offset projects rather than in creating new and innovative technologies and achieving reductions themselves, then that capital and innovation will leak out from under the cap. For the crucial capped sectors, we need to focus on driving the technological and infrastructural changes in the near-term that will be absolutely necessary for meeting our long-term emissions reduction goals. Other mechanisms, including voluntary offsets, could be used to drive innovation in uncapped sectors.

⁴ California Health & Safety Code §§ 38570(b); 38562(b)

⁵ See Health and Safety Code § 38501(h).

⁶ *Recommendations of the Economic and Technology Advancement Advisory Committee (ETAAC) FINAL REPORT: Technologies and Policies to Consider for Reducing Greenhouse Gas Emissions in California*, February 14, 2008, page 9-6, available at <http://www.arb.ca.gov/cc/etaac/ETAACFinalReport2-11-08.pdf>.

⁷ See Health and Safety Code § 38501(h).

2. If offsets are allowed for compliance purposes, what should the project approval and quantification process be for approving projects?

If California allows offsets, California should adopt strict protocols for specific offset project types, and approve and quantify offset projects according to those protocols. The California Climate Action Registry has already developed several sets of protocols that could be used for these purposes. Approval, verification, and monitoring of projects should be performed by a California-certified third-party verifier.

Third-party verifiers should be assigned to projects by CARB, in order to avoid the possibility that offsets providers could “shop” for their own verifier, thus compromising the integrity of the verification system. CARB should have enforcement authority over every offset provider.

The costs of approval, as well as on-going costs of monitoring and verification, should be borne by the offsets provider.

3. If offsets are allowed for compliance purposes, should there be quantitative limits on the use of offsets for compliance purposes? If so, how should the limit be determined?

Yes. If offsets are allowed, they should be limited to a small percentage, possibly 1%, of the total allowances in a cap and trade program.⁸ This will ensure that the integrity of the cap is not compromised, will help to keep the pressure on the key capped sectors of the economy to drive technological innovation, and will prevent leakage of co-benefits.

4. If offsets are allowed for compliance purposes, should California establish geographic limits or preferences on the location of projects that could be used to generate credits within the offsets system? If so, what should be the nature of those limits or preferences?

If offsets are allowed for compliance purposes, they must not only reduce GHG emissions but must contribute to AB 32’s co-benefits goals. Any market-based or regulatory program under AB 32 must take into account “localized impacts,” must not “disproportionately impact low-income communities,” must not increase “emissions of toxic air contaminants or criteria air pollutants” nor interfere with “air quality standards” and efforts to reduce “toxic air contaminant emissions,” and must maximize “additional environmental and economic benefits for California” and consider “overall societal

⁸ The RGGI states only allow offsets to account for 3% of allowances. See RGGI Model Rule, p.63, available at http://www.rggi.org/docs/model_rule_corrected_1_5_07.pdf

benefits.”⁹ These statutory requirements mean that California’s attempts to reduce GHG emissions under AB 32 should also result in reductions of co-pollutants, and other benefits to the health and safety of Californians.

If offsets do not provide these co-benefits for Californians because they are outside of California, then CARB must disallow or strictly limit those offsets in order to secure the overall integrity of the California program and to prevent leakage of co-benefits outside of the state.¹⁰ One possible way to ensure that offsets do not undermine AB 32’s co-benefits goals would be to only allow capped entities to purchase offsets that achieve similar co-benefits.

In addition, as discussed above, if offsets are allowed for compliance purposes, they must be real, additional, verifiable, permanent, and enforceable. If California does not have the ability to enforce its strict requirements on offsets projects outside the state, then those offsets could not be allowed for compliance purposes.

Any cap and trade program, with or without offsets, should include trading ratios designed to protect disadvantaged communities by discouraging polluting entities within those communities from meeting their obligations through trading instead of through on-site emissions reductions. This ratio for disadvantaged communities would be also act as a multiplier for discounted offsets (see below). For example, if a source inside a disadvantaged community is subject to a 2x trading ratio, it will have to purchase two allowances from outside the community for every one allowance it needs for compliance purposes. If all offsets are also discounted by 50%, then the source would have to buy 4 offsets from outside the community for every one allowance needed for compliance.

5. If offsets are allowed for compliance purposes, should California discount credits from offset projects?

Yes. All stakeholders agree that offsets must be real, additional, verifiable, permanent, and enforceable in order to be used for compliance. However, the reality is that it will not be possible to guarantee this with 100% certainty. The value of the offset should be discounted to reflect this uncertainty.

⁹ California Health & Safety Code §§ 38570(b); 38562(b)

¹⁰ See California Health & Safety Code § 38562(b)(8)