The Role of Offsets in Cap-and-Trade

Consideration of a Process for the Adoption of Offset Accounting Protocols for Compliance Purposes

February 25, 2010
California Air Resources Board
What Is Cap-and-Trade?

- A statewide limit on greenhouse gas emissions from covered sources that declines over time to achieve an emission reduction goal
- Allowances are tradable permits that give one-time permission to emit a metric ton of greenhouse gases
- Each year, California will issue allowances equal to that year’s cap
- Other cap-and-trade programs we link to (e.g., WCI partner programs) would also issue allowances that California sources can acquire to meet their compliance obligations
What’s Tradable in the Program?

• “Compliance Instruments” that can be traded include:
  – Allowances issued by California
  – Offsets issued by California
  – Allowances and offsets from linked programs, e.g., WCI
What is an Offset in the Context of a Cap-and-Trade Program?

- An offset is a credit for a verified emission reduction from a source outside the cap-and-trade program.
- Offsets can be used by covered entities to meet their cap-and-trade obligations instead of using emission allowances or reducing on-site emissions.
What Role Do Offsets Play in Cap-and-Trade?

• Reduce compliance costs for covered entities
• Spur emission reductions in sectors not covered by the program
• Encourage the spread of clean, low carbon technologies outside California
• Provide environmental, social and economic benefits
Offsets in the Scoping Plan

• All offsets must meet high quality standards
  – Real, additional, quantifiable, permanent, verifiable and enforceable

• Limit on amount of offsets that can be used
  – Encourage emission reductions by California covered entities
  – Transition California to a clean-energy, low-carbon economy

• No geographic limits on offset projects
Public Process for Stakeholder Involvement

• ARB public meetings on offset-related topics
  – Quantitative use limits
  – Criteria for compliance-grade offsets
  – Offset review/approval process
  – Linkage to other GHG trading programs
  – International offsets

• Working with WCI to develop consistent offset approach
Preliminary Draft Regulation (PDR)

- Released for public review and comment in November 2009
  - Advances dialogue on regulatory design features, including offsets
- Includes both preliminary regulatory language and concepts for public comment on the issuance, approval and use of offsets
- Staff will continue to work with stakeholders to refine program design and draft regulation
Proposed Limits on Offset Use

- Offsets limited to no more than 49% of program reductions
- PDR proposes a method to quantify this limit for each covered entity
  - 49% of program reductions translate to 4% of a facility’s emissions that can be covered by offsets
  - 4% use limit strikes balance among program goals, including stringency and need for cost containment
- Staff continues to analyze offset limit options
Visualizing Allowances and Offsets Limit Within the Cap*

*For illustrative purposes only, all sectors included in 2012 cap
How Would the Proposed Limit on Offsets Affect Program Costs?

• Offsets are expected to cost less than allowances and provide an additional supply of compliance instruments in the market
  – Net effect is reduced compliance costs for covered entities

• Updated economic analysis for the Scoping Plan is evaluating economic effect of offsets on program
  – Updated economic analysis to be released and presented to the Board in March
How Are Offset Credits Created?

• Offset credits must be created, or issued, by a credit issuing organization

• The credit issuing organization ensures that emission reductions are correctly quantified, monitored, and verified
Who Could Issue Offsets?

• Offset credits issued by ARB
  – Offset projects use an ARB-approved and publicly available offset methodology
• ARB accepted/approved offset credits issued by an external program
  – Programs would need to be approved by ARB through public process
  – Examples could include the Climate Action Reserve, Clean Development Mechanism, or WCI Partner Jurisdictions
Ensuring Compliance with Offset Program Requirements

• Environmental integrity of the overall program is key

• Those subject to the regulation are accountable

• Reciprocity with jurisdictions where offset project are located
Action Item
Voluntary Offset Protocols

• Climate Action Reserve (CAR) adopted protocols for the voluntary offsets market
• The Board adopted 4 CAR voluntary protocols
  – Recognized rigor of voluntary accounting procedures for voluntary offsets
  – Since ARB’s adoption, CAR has continued to update these protocols
Moving Towards Compliance-Based Offsets

- ARB is transitioning to a regulatory cap-and-trade program
- Focus on protocols for compliance program
- Perform environmental analysis on compliance protocols
- Comply with AB 32 verification and enforcement requirements
- Voluntary protocols will continue to be used in the voluntary market
Process for Adoption of Compliance Protocols

- Evaluate Board-approved voluntary protocols for compliance purposes
- Perform an environmental analysis on compliance protocols
- Beginning in April, hold public workshops on evaluating protocols for compliance prior to Board consideration
- Bring compliance protocols to the Board for approval
Previously Issued Voluntary Offsets

- CAR has approved projects and issued voluntary offsets under ARB approved voluntary protocols
- Staff will evaluate these projects and determine verification and enforcement requirements that would be needed for ARB to accept credits from these projects for compliance purposes
Recommendation

• Withdraw adoption of the voluntary accounting protocols
• Approve the process outlined by Staff