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

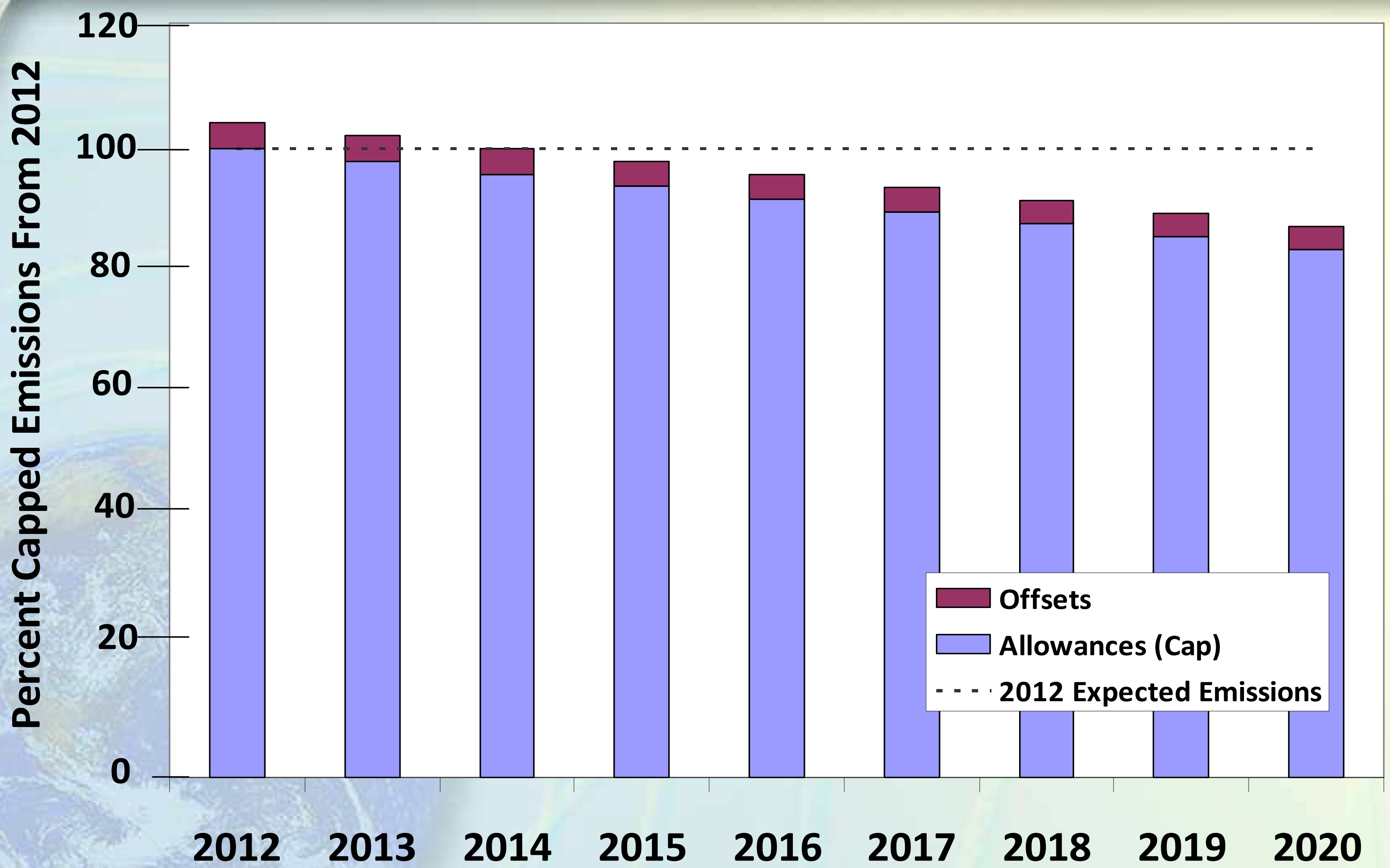
Preliminary Draft Regulation (PDR)

- 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, <u>or issued</u>, 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