

California Air Resources Board Offset Credit Regulatory Conformance and Invalidation Guidance

This document is prepared by the California Air Resources Board to provide additional information on the regulatory conformance requirements that must be demonstrated prior to the issuance of ARB offset credits, including the role of offset verification bodies in reviewing regulatory conformance. This document also provides additional information on the scope of activities that are subject to review by the Executive Officer as part of any offset investigation that may lead to invalidation of ARB offset credits.

1. BACKGROUND

Under the Cap-and-Trade Program, covered entities may use ARB offset credits to satisfy up to eight percent of their compliance obligation.¹ This limit applies to each individual covered or opt-in covered entity for each compliance period. ARB offset credits are tradable credits that represent verified greenhouse gas (GHG) emission reductions or removal enhancements from sources not subject to a compliance obligation in the Cap-and-Trade Program and resulting from one of the following: (1) a project undertaken using an Air Resources Board (ARB or Board) approved Compliance Offset Protocol pursuant to Subarticle 13 of the Cap-and-Trade Regulation (Regulation); (2) an offset credit issued by a linked jurisdiction pursuant to Subarticle 12 of the Regulation; or (3) a sector-based offset credit issued by an approved sector-based crediting program pursuant to Subarticle 14 of the Regulation. These GHG emission sources are typically outside of the industrial, energy, and transportation sectors. The inclusion of offset credits supports the development of innovative projects and technologies from sources outside capped sectors that can play a key role in reducing GHG emissions both inside and outside California.

As required by Division 25.5 of the Health and Safety Code (Assembly Bill 32 or AB 32), any reduction of GHG emissions used for compliance purposes must be real, permanent, quantifiable, verifiable, enforceable, and additional (Health and Safety Code §38562(d)(1) and (2)). Meeting these criteria ensures the integrity of the ARB offset credit and its eligibility for use in the Cap-and-Trade Program. Any offset credits issued by ARB must be quantified according to Board-approved Compliance Offset Protocols. The Regulation includes provisions for collecting and submitting the appropriate monitoring and reporting documentation to support the verification and enforcement of reductions realized through the generation of ARB offset credits. The regulatory provisions and the requirements of the Compliance Offset Protocols will ensure that the reductions are quantified accurately, represent real GHG emissions reduction, and are

¹ “Compliance obligation” is defined as “the quantity of verified reported emissions or assigned emissions for which an entity must submit compliance instruments to ARB.” Title 17, California Code of Regulations, section 95802(a).

not double-counted within the Cap-and-Trade Program. Compliance Offset Protocols are regulatory documents and are made publicly available so that anyone interested in developing an offset project can do so if their project meets Board-approved standards. Information on existing and proposed protocols can be found here:

<http://www.arb.ca.gov/cc/capandtrade/offsets/offsets.htm>

All compliance offset projects must be determined to be in conformance with all state, federal, and local environmental, health, and safety regulations applicable to the offset project location before ARB issues ARB offset credits. This determination ensures that ARB only credits reductions that result from activities that are in compliance with applicable requirements. Offset Project Operators (OPO) and Authorized Project Designees (APD) are voluntary participants in the Cap-and-Trade Program and ARB must ensure that it does not incentivize projects that violate applicable regulations while being implemented and credited for GHG reductions and removal enhancements. In addition, compliance offset projects may occur outside the State, and therefore, the regulatory conformance determination serves to ensure that projects credited under California's program are meeting applicable regulations in the various states.

The Regulation also includes a mechanism called invalidation that may be triggered after ARB offset credits have been issued. Even though ARB has a rigorous and multi-step review process prior to the issuance of ARB offset credits, subsequent new information may result in a determination that the ARB offset credits were generated from projects that did not conform to the requirements of the Regulation. The invalidation process ensures that the program's environmental integrity, or true accounting of GHG emissions and GHG emission reductions, is maintained if an ARB offset credit is issued and then used for compliance and later found to not meet the requirements of the Regulation. ARB may implement its invalidation provisions if it finds that an ARB offset credit does not meet the requirements of the Regulation. If ARB determines that an ARB offset credit is invalid after it is issued, ARB will cancel the ARB offset credit in the Compliance Instrument Tracking System Service (CITSS) and the user of the ARB offset credit is required to replace it with another valid compliance instrument if that offset credit was surrendered and retired for compliance. If the ARB offset credit is invalidated, but has not been surrendered and retired for compliance, ARB does not require the account holder to replace that offset credit with another valid compliance instrument; however, that offset credit would no longer be available to be surrendered for compliance at a later time or traded to another market participant. Requiring the user to replace the invalidated ARB offset credit with another valid ARB offset credit or allowance, if it has been surrendered for compliance, ensures that purchasers and users of offsets do their due diligence in seeking out offset credits that meet the full regulatory requirements.

2. EVALUATION OF REGULATORY CONFORMANCE

Verification Requirements

Prior to issuance of ARB offset credits, an offset project operator must contract for offset verification services from an offset verification body of their offset project. The purpose of verification is to ensure there is an independent review of the offset project and the quantification of any claimed GHG emissions reductions.

The verifier must perform a review of an offset project's regulatory conformance as part of these offset verification services. The verifier's scope of assessing regulatory conformance includes a determination of whether the project has received any public, written notice of actual, alleged or potential non-compliance that: (1) is directly applicable to the scope of offset project-related activities as applicable to each project type; (2) was issued by any local, state or federal regulatory agency with authority over the project-related activities; and (3) identifies any actual or alleged violations of any local, regional, or national environmental, health, or safety regulation(s) at any time during the reporting period (or during the offset project-related activities for an ozone depleting substances (ODS) project) being verified. The scope of offset project-related activities is discussed in the context of different types of offset projects in Part 4 below. This review for regulatory conformance is a ministerial task and does not require a verifier to independently determine if an actual or alleged violation exists separate from the review or investigation conducted by a regulatory agency. However, if during its review of a project a verifier finds any activities or practices that it believes may be a regulatory nonconformance it should contact the ARB offset program staff.

In general, a verifier may determine whether the project is in regulatory compliance by: 1) examining documents provided by the OPO, APD, or a technical consultant; 2) accessing publicly available websites for relevant regulatory agencies that maintain databases of violations; and 3) contacting appropriate regulatory agencies, which would involve reasonable due diligence including, but not limited to, making more than one attempt to contact agency representatives and allowing a reasonable amount of time for the agency to respond. When attempting to contact agency representatives, verifiers should contact agency representatives through email as well as phone calls, and consider keeping a record of the number of attempts made to contact the representative and any responses received. Verifiers are encouraged to contact ARB if they have any questions on scope of their review or any potential findings. ARB staff will also periodically update the guidance and FAQs on its website in response to questions that apply to offset project verification.

Ultimately, it is ARB's responsibility to issue offset credits only for projects it has determined are in regulatory conformance based on the verification process and any

additional information that may be made available to ARB prior to issuance. ARB is not bound to make this determination based solely on the verifier's ministerial assessment of regulatory conformance. This final step by ARB ensures that only compliance instruments that are considered to meet the requirements of the Regulation are issued. Market participants must have confidence in these compliance instruments and confidence that ARB has done its due diligence in reviewing and issuing valid ARB offset credits just as market participants should do their due diligence when contracting for ARB offset credits.

3. INVALIDATION CRITERIA AND PROCESS

Regulatory Criteria for Invalidation

As set forth in section 95985 of the regulation, after ARB offset credits are issued, ARB may invalidate an offset credit in any of the following scenarios:

- **Overstatement of GHG Reductions or Removal Enhancements:** ARB offset credits may be invalidated if ARB finds that the amount of the GHG reductions or removal enhancements that were issued credit were overstated by more than 5 percent than what the offset project actually achieved within the applicable Reporting Period.
- **Double Issuance for GHG Reductions or Removal Enhancements:** ARB offset credits may be invalidated if ARB finds that non-ARB offset credits have been issued for the same GHG reductions or removal enhancements within the same offset project boundary and for the same time period (Reporting Period) in which ARB offset credits were issued.
- **Non-Compliance with Laws and Regulations:** ARB offset credits may be invalidated if ARB finds that the offset project's activities were not in accordance with applicable local, state, and national environmental and health and safety regulations during the applicable crediting time period (Reporting Period).

While not an exclusive list, determining that offset project activities were not in accordance with applicable environmental and health and safety regulations could be triggered by the existence of the following types of activities, by any regulatory or enforcement agency, the United States Department of Justice, any State Attorney General, or District or City Attorney:

- Issuance of a citation that cannot be withdrawn by subsequent administrative action;
- Issuance of a Notice of Violation;
- Entry of a civil injunction and penalty;

- Entry of a plea of guilty or no contest to criminal felony or misdemeanor charges;
- A finding of guilt on criminal felony or misdemeanor charges;
- Issuance of an abatement order, compliance order, cease and desist order or order of similar effect by a regulatory agency.

Regulatory Process Requirements for Invalidation

If, after the issuance of ARB offset credits, ARB receives or discovers information that calls into the question the regulatory conformance of the offset project that resulted in issuance of the ARB offset credits, the Regulation requires ARB to take specific steps to investigate, and potentially invalidate, the ARB offset credits in question. These steps include:

- Per section 95985(d) of the Regulation, ARB must block transfers of the ARB offset credits under investigation until a final determination of invalidation is made. ARB will block transfers of ARB offset credits as they reside in the holders' accounts and will not need to transfer them out of the holders' accounts for the duration of the investigation.
- ARB will provide an email notification of the investigation to all holders of the ARB offset credits under investigation, per section 95985(f) and a general notification to all market participants.
- Holders of the ARB offset credits under investigation have 25 calendar days from the date of notification to provide additional information to assist ARB in the investigation. ARB may also request specific additional information to aid in the investigation. This request could be made of any entity involved in the generation of the ARB offset credit, such as the verifier, offset project developer, or approved offset project registry. The request could be made via a subpoena or other format of ARB's choosing.
- The Executive Officer has 30 calendar days from the day that all the information is received to make a final determination whether to invalidate any ARB offset credits under investigation. This 30-calendar day process is not immediately triggered at the end of the 25-calendar day process listed above. In making this final determination, the Executive Officer has the discretion to issue a preliminary determination with a comment period to solicit additional information. The Executive Officer may determine, on a case-by-case basis, that he has sufficient information and does not need to issue a preliminary determination.
- After the issuance of the final determination, ARB will remove the block on transfers of any valid ARB offset credits back to the holders. Any ARB offset credits determined to be invalid will be transferred into ARB's invalidation account.

4. REGULATORY CONFORMANCE AND INVALIDATION SCOPE FOR SPECIFIC PROJECT TYPES

ARB Regulatory Conformance and Invalidation Scope in the context of the Ozone Depleting Substances (ODS) Projects Compliance Offset Protocol

ARB interprets the invalidation provision of “in accordance with all local, state, or national environmental and health and safety regulations” to mean: (1) all requirements that have a bearing on the integrity of the generated offsets; and (2) all environmental and health and safety requirements associated with the collection, recovery, storage, transportation, mixing, and destruction of ODS, including the disposal of the associated post-destruction waste products.

ARB Regulatory Conformance and Invalidation Scope in the context of the Livestock Projects Compliance Offset Protocol

ARB interprets the invalidation provision of “in accordance with all local, state, or national environmental and health and safety regulations” to mean: (1) all requirements that have a bearing on the integrity of the generated offsets; and (2) all environmental and health and safety requirements associated with the installation and operation of the biogas control system that captures and destroys the methane. Project related activities begin at waste collection and end at onsite biogas usage and the disposal of associated digester effluents.

ARB Regulatory Conformance and Invalidation Scope in the context of the U.S. Forest Projects Compliance Offset Protocol

ARB interprets the invalidation provision of “in accordance with all local, state, or national environmental and health and safety regulations” to mean: (1) all requirements that have a bearing on the integrity of the generated offsets; and (2) all environmental and health and safety requirements associated with activities within the project area that directly affect carbon stocks. This includes, but is not limited to, site preparation, planting, harvesting, and monitoring. Activities external to the project area, such as transportation of logs to mills, mill operations, and landfilling, are outside the project regulatory conformance assessment.

ARB Regulatory Conformance and Invalidation Scope in the context of the Urban Forest Projects Compliance Offset Protocol

ARB interprets the invalidation provision of “in accordance with all local, state, or national environmental and health and safety regulations” to be applicable to: (1) all requirements that have a bearing on the integrity of the generated offsets; and (2) all

environmental and health and safety requirements associated with tree planting, care, and monitoring. In situations where it is unclear if a project activity is within the scope of the project as described in the project listing information, ARB will consider the activity within the scope of the project.

ARB Regulatory Conformance and Invalidation Scope in the context of the Mine Methane Capture Projects Compliance Offset Protocol

ARB interprets the invalidation provision of “in accordance with all local, state, or national environmental and health and safety regulations” to mean: (1) all requirements that have a bearing on the integrity of the generated offsets; and (2) all environmental and health and safety requirements associated with the installation and operation of equipment used to collect, treat, transport, or destroy mine gas or ventilation air. The scope also includes the drilling and completion of additional wells or boreholes that are part of implementing the project. The drilling and completion of wells, boreholes, or vents at active underground mines for the purposes of mine safety is excluded from the project. Installation and operation of mine safety equipment such as a ventilation system at an active underground mine is also excluded from the scope of determining regulatory conformance and the scope of invalidation.

ADDITIONAL INFORMATION

Regulatory guidance for the compliance offset program can be accessed at:

<http://www.arb.ca.gov/cc/capandtrade/guidance/guidance.htm>

Technical guidance for offset verification can be accessed at:

<http://www.arb.ca.gov/cc/capandtrade/offsets/verification/verification.htm>