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See attached PDF on a concern over proposed implementation of offsets under the cap and a proposed alternative approach.

Alternative Implementation for Offsets Under the Cap

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Comment submitted to CARB on

Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market- Based Compliance Mechanisms Regulation

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Background

Under AB1207, CARB must lower the cap 1-for-1 for offsets used in the cap-and-invest program. The timing of when allowances are to be reduced was not specified. Should the allowance removal be **before** actual offset usage or **after** actual offset usage?

In the CARB Proposed 2026 Amendments to the Cap-and-Invest Regulation (released 1/20/26), it was proposed that offsets be removed from the cap **before** actual usage. Specifically, the proposed policy (implemented in Section 95871) would:

- Establish a new separate account for withheld allowances to account for offset usage.
- Withhold 6% of annual allowances each year and deposit those allowances into this separate account
- At the end of each compliance period, allowances in the account would be retired equal in number to the system-wide offsets used during that compliance period.
- Any remaining allowances in the account at the end of the compliance period would be added to the allowances available in the next compliance period.

Concern

The goal of offsets is to provide cost-containment. To that end, a compliance entity should make a choice between buying an allowance or an offset based on their prices. And the allowance permit price faced by compliance entities should reflect actual offset usage, not **presumed** offset usage. The current proposal presumes that total offset usage annually is 6% of the annual cap (which has not been historically the case). Thus, when a compliance entity makes an offset purchase decision, <u>it is facing an allowance price that already assumes how many offsets will be used.</u> This odd circularity distorts the functioning of the carbon market by raising allowance prices and driving more offset usage.

The rationale for adjusting the cap before actual offset usage presumably is to avoid discrete jumps in the annual cap (and thus GGRF revenue). But the current proposal does not eliminate that problem: there would still be a jump in the annual cap and GGRF revenue, in the form of a positive jump at the start of every compliance period as unused allowances in the offset account from the previous compliance period is added back to the annual cap. In other words, this proposal creates a positive spike in the cap and GGRF revenue at the start of every compliance period rather than the current negative spike.

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An alternative approach

The key is to lower caps **after** actual offset usage; that is to lower the cap in a subsequent compliance period after actual offset usage in the preceding compliance period. To avoid a negative spike in the cap and GGRF revenues in the first year of the next compliance period, the adjustment can be prorated across the years of the subsequent compliance period.

For example, suppose 100 tons of offsets were used across all compliance entities during the 2027-2028 compliance period as reported at the end of 2028. CARB can lower the cap by 50 tons in 2029 and by 50 tons in 2030 during the 2029-2030 compliance period. This will then be repeated in subsequent compliance periods.

In summary, an alternative implementation that CARB can adopt is to (i) reduce the cap in a subsequent compliance period following actual offset usage in a given compliance period and (ii) to prorate that cap reduction annually across the years of the subsequent compliance period.