

Frequently Asked Questions

Project Based Compliance Offsets under California's Cap-and-Trade Program

Prepared by the Verified Emission Reduction Association (VERA)¹

There are two types of compliance instruments under AB 32 California Cap-and-Trade Program (Program). Both compliance instruments are valid under California statute and regulation, with each one representing a different value.

- 1) State issued **Allowances** are distributed directly or purchased at auction. Allowances represent the *right to emit* a ton of CO₂e, or carbon dioxide equivalents.
- 2) **Compliance Offsets** are certified project based CO₂e *reductions approved in advance of issuance by CARB*.

California has demonstrated the effectiveness of these twin regulatory devices since Program inception in 2012. As designed, the GHG cap on statewide emissions has continually decreased year over year, the price of carbon has increased, and project-based instruments have achieved over 265 million tons of certified, verified, permanent, additional, and enforceable greenhouse gas (GHG) emission reductions.

Reversing course on offset policy would significantly increase compliance costs to California-based employers, energy consumers, and ratepayers while undermining California's climate leadership and the investment credibility of the Program, while significantly increasing compliance costs to California-based employers, energy consumers, and ratepayers. According to an analysis by cCarbon, a leading market analytics firm, CCOs can produce almost \$7 billion in program savings through 2045.

The following set of frequently asked questions are intended as a primer on an important cost-containment principle of the Program. The primary voice of California Compliance Offset developers, the Verified Emissions Reduction Association, or VERA, which was formed during the 2020 Program extension legislative efforts. Additional resources can be found on VERA's website www.californiaoffsets.com, or by contacting Jon Costantino.

What are Project-Based Compliance Instruments?

Project-Based Compliance Instruments are also known as California Compliance Offsets, or CCOs. One CCO credit represents the reduction or avoidance of one metric ton of CO₂e. Under California's Cap-and-Trade Program entities may use a small percentage of these project-based compliance instruments offsets to comply with their GHG emissions obligations in lieu of state-issued allowances.

What types of projects create CCOs?

Only domestic GHG reduction projects are eligible for CCO crediting by CARB. Project types include those that:

- (a) maintain or enhance carbon stocks in forests;
- (b) capture and destroy methane generated by livestock operations;
- (c) collect and destroy ozone-depleting substances, such as refrigerant gases; and
- (d) capture and destroy methane escaping from mines.

How can the public be sure the GHG reductions are really occurring?

Before a CCO is issued by CARB all credited GHG reductions are subject to rigorous accounting methodologies and several rounds of audit and verification by CARB-certified project registries and independent verification bodies. As an additional check on validity, CARB thoroughly reviews the verifiers' and the registries' assessment of project performance (i.e. actual GHG reductions) before any CCO is issued.

¹ Find more information at www.californiaoffsets.com or contact Jon Costantino at jon@tradesmanadvisors.com.

Is this aspect of the Cap-and-Trade Program regulated and protected against fraud?

Yes. All emission reduction projects must meet strict regulatory requirements as prescribed by CARB, including extensive monitoring and verification to ensure compliance. Additionally, projects are subject to local and federal environmental, health, and safety regulations that must be followed for CCOs to be issued. Projects that fail to adhere to all applicable environmental regulations are subject to investigation and credit invalidation by CARB. To date, CARB has invalidated *less than 0.06%* of the nearly 265 million project-based compliance instruments it has issued, showing CARB will not hesitate to enforce its invalidation rules.²

Why not just require compliance entities to rely solely on allowances?

The “cap” on emissions, combined with emissions trading, achieves only part of the statutory objective to reduce statewide GHG emissions. CCOs provide both a lower cost alternative of compliance to both the individual entity and to the market as a whole (i.e. California citizens). In addition, CCOs expand the reach of the Program to areas that are not, or cannot be, directly regulated by the state, e.g. fugitive methane and refrigerant emissions both powerful GHG pollutants many times more potent than direct CO₂ emissions.

Are there other co-benefits associated with CCOs?

Yes. There are numerous environmental and economic co-benefits associated with each project. Local water and soil quality benefits are especially common. Local economic benefits are also often associated with projects. Projects target emission sources outside the regulated space, which are often then providing local benefits in tribal, rural and disadvantaged communities. Reducing emissions from these sources generates positive environmental outcomes for those communities. Further, the success of the program spurs innovation and additional capital for future emissions reduction projects.

Do CCOs allow large emitters to pollute more, particularly in disadvantaged communities?

No. Compliance must be met by purchasing Program allowances, CCOs, or by directly reducing emissions on-site. Cap-and-Trade allows emitters to choose the lowest cost option among these three choices. CCOs can only be used for a small percentage of an entity’s compliance plan—4% currently and 6% from 2026-2030. To date, dozens of compliance projects have been located in disadvantaged communities, providing direct and local environmental benefits throughout California.

How are offsets counted under AB 32 cap setting, i.e. are they “over or under the Cap”?

As explained in Appendix E – Setting the Program Emissions Cap within the 2010 Cap-and-Trade initial regulatory documents, the original cap setting by CARB took into account the expected use of offsets when determining total expected reductions³. When the program was extended in 2018 (after the Legislature statutorily affirmed the role of offsets), CARB again took the use of offsets into consideration when adjusting the program’s fundamental element—the actual ‘cap’. Therefore, any assertion that offsets are ‘over’ the cap, i.e. additional emissions isn’t accurate.

California’s cap setting is fundamentally different from how Washington chose to account for offset usage. California’s approach is more conservative in terms of GHG accounting.

Meeting the goals of AB 32 and SB 32 require actual emission reductions to occur. The fundamental accounting for determining compliance with the 2020 and 2030 targets, 1990 and 40% below 1990 levels respectively, is accomplished independent of how many offsets are, or are not, used. Statutory reduction mandates are based on actual emissions from California regulated sources at each milepost.

Why aren’t all projects limited to California?

Due to the limited supply of in-state reduction opportunities, since most emission sources are already regulated under the cap, there are very few opportunities outside of the cap for project-based compliance instruments to be

² <https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program/offset-credit-invalidation>

³ <https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2010/capandtrade10/capv3appe.pdf>

created and they tend to be more expensive, thus raising the cost-basis of the Program. In addition, project-based reduction Offsets provide a strategic pathway to encourage other jurisdictions to adopt California's climate policies, exposing other parts of the country to the benefits of GHG emission reduction efforts. Over time, sectors engaging in offset projects will see advancements in standard practices as innovative technologies become commonplace. Limiting offsets to California would undermine regional and national efforts to address a global problem. The Program does limit the geographic scope of offsets used to those in North America.

What would be the impacts of reversing the existing CCO policy?

Scaling back the use of CCOs would substantially raise the cost of the Program. According to an analysis by cCarbon, a leading market analytics firm, CCOs can produce billions in program savings through as the program stringency tightens in the out years.⁴ It would also remove incentives for large scale project finance to reduce emissions not directly regulated by California. This, in turn, would undermine California's climate leadership – in North America and globally – and the credibility of the program. Reversing course on offsets would also prevent additional real, verifiable, enforceable, permanent and quantifiable GHG reductions from occurring.

⁴ cCarbon Analysis, March 2025.