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Thursday, August 11, 2011

Chairman Mary Nichols and ARB Staff
Air Resources Board, California Environmental Protection Agency
1001 I Street
Sacramento, CA 95812

RE: 15-day changes to Cap and Trade Regulation

Dear Chairman Nichols:

Finite Carbon is a forest carbon offset project developer with extensive experience within California and throughout the United States. Finite Carbon staff have decades of combined carbon and forestry experience with four foresters including a California Registered Professional Forester, two certified CAR verifiers including the lead verifier on three registered CAR projects, a broker with experience transacting CAR forest carbon, a member of the CAR forest carbon working group, two members of the Forest Carbon Offset Standards Committee, an author of an American Carbon Registry forest carbon methodology, and an adjunct professor specializing in forest carbon and ecosystem markets.

We currently have eleven forest carbon projects listed on the Climate Action Reserve making us a leading forest carbon developer under CAR. We expect that our hands-on experience implementing these projects throughout the country over the past two years will provide critical insights for ARB staff as you proceed with amending and adopting the final Regulation.

We thank you for your consideration and would be happy to answer any questions you may have.

Sincerely,

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Comments on the July 25, 2011 Draft Regulation

§ 95802. Definitions.

Page A-18 (103) “forest owner.” The definition of forest owner as “the owner of any interest in the property involved in a forest offset project” is far too broad. Under this description, if a party owns recreation rights which allow it exclusive hunting rights and the owner in fee created an intentional reversal, the recreation rights owner would be liable for replacement. The same is true for working forest conservation easements which focus solely on precluding conversion from forest to alternative land uses but that do not define or regulate desired forest management or condition. Furthermore, while Federal lands are excluded, numerous forest owners have easements held by the USDA under the Wetland Reserve Program and in these cases the current definition of forest owner would necessarily include the US government.

The forest owner should be defined as the entity with managerial control over the timber asset. This may or may not include the fee simple landowner and/or easement holder. It will always include the holder of the perpetual timber rights which is often not the fee simple landowner. Since timber rights are a wholly separate property right from the land, the owner in fee should not be held accountable for reversal associated with timber right holders. In this case, an owner in fee does not have any management control over timber rights and therefore should have no liability for intentional or unintentional reversals.

We recommend the definition be amended so that a forest owner is “the owner of any interest with active managerial influence over the timber holdings.” If there is more than one entity with active managerial influence then all parties will be held responsible for intentional reversals. Ownership shall be represented to ARB through an attestation declaring which entity(ies) holds an interest in the timber asset and that no other entity(ies) has any other active managerial influence.

Page A-22 (133) “intentional reversal.” Including reversals caused by negligence is very broad while the consequences are severe. For instance, if a landowner maintains a highly stocked stand in order to maximize carbon and this increases fire risk which causes a reversal, is this negligence? Or if a landowner chooses not to preemptively thin a stand which is vulnerable to disease in order to maximize carbon and the entire stand is affected by disease causing a reversal, is this negligence? **We recommend the definition be amended to reflect the current Climate Action Reserve Forest Carbon Protocol language that an intentional reversal is a result of “intentional or grossly negligent acts of the forest owner.”**

Mineral Rights. Nowhere in this Regulation is the status of mineral rights contemplated. **We request ARB clarify that third-party ownership of mineral rights do not qualify as a forest**

owner and any reversals associated with the exercising of mineral rights are categorized as unintentional reversals.

Authorized Project Designee. While the definition of authorized project designee is straightforward, the liabilities associated with this designation are significant since they can ultimately be held liable for replacing offsets affected by an intentional reversal or invalidation. It is advantageous to project owners to designate a third-party to take on the task of project development. These third-parties are often consultants and other small businesses. While the ability to assign an APD has utility to project owners, the liabilities associated with it will prevent consultants from taking on this role. **We recommend that liabilities for reversals and invalidation exclude the Authorized Project Designee under this Regulation.**

§ 95973. Requirements for Offset Projects Using ARB Compliance Offset Protocols.

Page A-170 (c) Early Action Offset Project Commencement Date. This section allows projects with start dates prior to December 31, 2006 to register under the ARB Compliance Protocols provided that they transition from an Early Action Offset Program. In order for a forest project to transition from the Climate Action Reserve to an ARB Compliance Protocol, the forest owner would have to terminate the Project Implementation Agreement (PIA) with CAR. CAR has a provision which may allow an owner to cancel the PIA in order to transition to a state or regional compliance program. However, if a project has a pre-2005 start date, the project will be unable to transfer 2001-2004 offsets to ARB as the Regulation currently stands. This will either result in forest owners being prevented from transitioning to the ARB Compliance Protocol or require the forest owner to pay a penalty to CAR for all 2001-2004 offsets issued in order to terminate the PIA. Of the 72 forest carbon projects listed or registered on the Climate Action Reserve, 29 have pre-2005 start dates. **We recommend that ARB allow forest owners avoid this obstacle by allowing them to transfer 2001-2004 offsets to ARB's registry provided they are immediately retired (or allow them to be eligible for compliance use).**

§ 95977. Verification of GHG Emission Reductions and GHG Removal Enhancements from Offset Projects.

Page A-184 (d) Timing for Submittal of Offset Verification Statements to ARB or an Offset Project Registry. This section conflicts with Section 95977(c) – Schedule for Verification of Sequestration Offset Projects. Section 95977(c) allows sequestration projects to verify annual Offset Project Data Reports at up to 6 year intervals. Section 95977(d) requires that a verification statement be submitted within 9 months after the conclusion of each Reporting Period. **We recommend that this section is amended to allow for the provision for sequestration projects.**

§ 95977.1. Requirements for Offset Verification Services.

Page A-205 (b)(3)(D) Site Visits for Offset Projects. The adoption of a “less intensive verification” is critical for sequestration projects facing excessive verification costs; however, it is not defined in the Regulation. **We recommend that this term be defined in the regulation and that the definition explicitly state that ARB Offset Credits can be issued upon the submission of a non-qualified less intensive verification opinion.**

§ 95985. Invalidation of ARB Offset Credits.

We recommend ARB adopt a buffer pool approach to manage the risk of invalidation.

Invalidating an offset after it has been verified and issued significantly increases the risk profile of offsets and reduces their value. In order for offsets to be considered equivalent to allowances, end-use buyers cannot be subject to cancellation of retired offsets whether it be 8 or 80 years after issuance. Offsets currently trade at a significant discount to allowances in today’s pre-compliance market (\$11 vs. \$17). The entities which will benefit from this provision will be large diversified emitters which are capable of building diverse offset portfolios which can mitigate the risk of invalidation. There are very few of these entities covered under the Regulation with only a handful of all entities needing more than 50,000 offsets a year for compliance. The result is that these large self-insuring entities will be able to buy offsets from project developers at significant discounts and then resell them to entities not willing to take on the risk at a significant premium. With 230 million offsets allowed for use by 2020 and a \$5.00 premium for a risk-mitigated offset over one subject to buyer liability, **this policy could result in over a billion dollars being diverted from offset projects to large emitters.** This runs counter to the purpose of an offset as a price-mitigating tool and will result in higher compliance costs for small emitters and less money invested in forests and farmers.

The Regulation places the liability for replacing invalidated credits from forest projects on forest owners, insulating end-users from liability to invalidation. While this will result in a significant premium for forest offsets under the program, it requires forest owners to take on the same liabilities as end-users face for other offset types. While the possibility of one of the outlined circumstances occurring is low, these are not discrete enough for forest owners to accurately judge the risk and will limit participation. In particular, the leeway for arbitrary interpretation of what qualifies as “not true, accurate, or complete” is especially concerning for forest owners. And although ARB allows for the creation of insurance products, the lack of discrete risk parameters and historical actuary data will guarantee this insurance will be priced far higher than the actual risk. This will again result in transferring money that should be invested in mitigating climate change into the hands of large entities looking to profit from market inefficiencies.

ARB has already established a precedent whereby risk which cannot be adequately obtained or priced in the free market is handled through a buffer pool mechanism. The most appropriate place for the risk of invalidation to lie is in a buffer pool managed by ARB. ARB currently has

numerous layers of quality control in its system which is extraordinarily expensive for project owners to comply with including paying for an experienced and trustworthy project developer, and ARB-approved verifier, and registration fees to either an approved offset registry or ARB itself to review the project. These layers of quality control should provide the necessary comfort to ARB to manage the very small remaining risk through a buffer pool system. Otherwise, project owners may face price discounts upwards of 30 percent for offsets in the marketplace.

§ 95990. Recognition of Early Action Offset Credits.

Holders of Early Action Offset Credits. Section 95990 allows holders of Early Action Offset Credits to submit projects for listing, pay for verifications, receive issued ARB offsets, and requires them to provide attestations binding them to comply with the Regulation. We commend ARB for including this option and recognize its necessity during the program through 2014. **We request that ARB make it explicit that project owners who have sold Early Action Offset Credits and subsequently have those offsets submitted to ARB by holders of Early Action Offset Credits are not subject to the liabilities associated with such credits under ARB, specifically in regard to sections 95983 – Forestry Offset Reversals and 95985 – Invalidation of ARB Offset Credits (specifically as it pertains to forest owners).**

Page A-264 (c)(1) Compliance Vintages. The language limits early-action compliance vintages to 2005-2014. The justification for the earliest vintage to be 2005 is that it is the first year Climate Action Reserve offset protocols were available for verification. This justification is problematic for the following reasons:

- a. Although it was the first year the Climate Action Reserve protocols were available for verification, there is nothing in the ARB Regulation which limits early-action criteria to Climate Action Reserve projects only. Another registry which may be approved by ARB may have had its first protocol available for registration in 2002 or 2004 or any of a number of dates.
- b. While 2005 is the year in which the protocols were first available to be used for verifications, the Climate Action Reserve Protocols allow for projects to receive verified CRTs as far back as 2001.
- c. The early action criteria do not have a cut-off for early start dates. Therefore, a project may start in 2001 but its 2001-2004 vintages would not be considered compliance-grade while its 2005 vintages are. There is no scientific or policy reason that a 2004 vintage offset and a 2005 vintage offset from the same project do not constitute equal quality emissions reductions.

Forest carbon projects in particular are adversely impacted by this provision. Forest carbon offset projects tend to have a significant number of offset credits issued in the first year of the project with annual offsets issued to a much lesser extent. If a project were to have a start date of 2001, the majority of the project offsets would come at that time. If 2001 vintages are excluded as compliance offsets, they will lose significant value in the market and make it difficult if not impossible for the project to pay for the 100+ year compliance costs let alone the opportunity cost for foregone harvest. Of the 72 forest carbon projects listed or registered on the Climate Action Reserve, 29 have pre-2005 start dates. **We recommend that ARB revise the early action vintage date to 2001 which corresponds to the signature of California Senate Bill No. 527 so that the justification is rooted in a California precedent and is not specific to an independent registry which may be one of many ultimately approved.**

Page A-271 (i)(1)(D)(2) Source of ARB Forest Buffer Account Credits. This section states that Buffer Account Credits *may* either come from the registry which issued the credits or be subtracted from the number of EAOCs submitted for ARB Offsets. This policy leaves the policy decision for transfer of Forest Buffer Account Credits from the Early Action Offset Program to ARB in the hands of the Early Action Offset Program. Since ARB has the capacity to create the terms under which an EAOP is accepted under the Regulation, it should require that an EAOP must transfer any Forest Buffer Account Credits associated with EAOCs which are submitted for ARB Offsets. This would provide a more certain environment for project owners to submit early action forestry projects to EAOPs while awaiting the ability to submit directly under the ARB Compliance Offset Protocols. **We recommend that ARB amend the language so that: “ARB offset credits placed into the Forest Buffer Account *must* come from a buffer account held by the Early Action Offset Program, if they are determined to meet the criteria of section 95990(h); or, if there are insufficient forest buffer account credits to meet the requirements of ARB, or subtract the difference between the available forest buffer account credits and the amount determined in section 95990(i)(1)(D)(1) from the total number of ARB offset credits issued pursuant to this section.”**

Page A-274 (k)(1) Transition of Early Action Projects to Compliance Program. This language does not allow projects to transfer to ARB Compliance Offset Protocols until after January 1, 2013. There is no reason to prevent projects from transferring to the Compliance Protocols as soon as these protocols are available. Many projects are only registering with Early Action Offset Programs because they have no other option. By forcing a project to remain under an Early Action Offset Program until after 2013, a project will face double verification costs (once under the EAOP and another under ARB) which could add up to \$35,000 in unnecessary duplicative verification costs. **We recommend ARB delete this requirement and allow projects to transition to the ARB Compliance Offset Protocols as soon as these protocols are available.**

Page A-275 (i) Early Action Invalidation. This section states that section 95985 – *Invalidation of ARB Offset Credits* applies to entities submitting Early Action Offset Credits for ARB Offsets. It

also contains language which states the entity which submits the EAOs for ARB Offsets is liable in the event an offset is invalidated and the end-user is no longer in business. For forest owners who submit EAOs, this language directly conflicts with section 95985(g) – *Requirements for Forest Offset Projects*. **We recommend that ARB clarify this section so that the language in this section is specific for Holders of EAOs while the language in 95985(f) and (g) is referenced for the Offset Project Operator, Offset Project Designee, or Forest Owner if applicable if one of these is the entity which submits the EAOs for ARB Offsets.**

Comments on Compliance Offset Protocol U.S. Forest Projects

Page 10 – 2.1.2 Improved Forest Management (4). This section eliminates the opportunity for forest carbon projects which had previously been verified under other voluntary carbon offset programs such as the Chicago Climate Exchange (CCX) and the American Carbon Registry (ACR). Hundreds of thousands of acres of land submitted to the CCX in the mid to late 2000s. The associated offsets are currently worthless and many project owners were never able to sell their offsets before the market crashed. Landowners can cancel their commitments to the CCX as well as ACR by retiring 100 percent of their issued offsets. Once a project is free of all liens and encumbrances associated with a carbon offset registry, it is free to operate as it chooses. By excluding canceled CCX and ACR projects ARB is turning away landowners willing to commit to carbon increasing activities that would not otherwise take place. **We recommend that ARB modify this provision so that projects which have properly satisfied the terms of replacement and cancellation can register under ARB.**

Page 12 – 3.1 Additionality. Land use assessment (aka land use taxation and land use tax abatement) programs are common throughout US states and counties. These programs allow forest owners to commit to keeping forested properties as forestland and many require landowners to follow specific silvicultural guidelines. These programs are wholly voluntary to enter into and to exit. However, though while voluntary, once entered into they are legally enforceable until they are exited.

Page 17 – Table 3.1. The Compensation Rate for Improved Forest Management Offset Projects presented in Table 3.1 conflicts with text in the Regulation which requires offsets subject to intentional reversals to be replaced at a one to one ratio. The Regulation sets a precedent that all compliance instruments are equivalent and can be substituted interchangeably. **We recommend that ARB delete this table since it is not applicable given the terms of replacement in the Regulation.**

Page 17 – 3.5 Use of Qualified Conservation Easements. This section does not provide an adequate description of what a landowner must do in order to have ARB recognize a “Qualified conservation Easement.” **We request ARB issue specific language it requires an easement to contain.**

Page 17 – 3.5 Use of Qualified Conservation Easements section (b). Since a forest carbon offset project under ARB can be terminated due to both intentional and unintentional reversals (both under the control of the landowner and under provisions for automatic termination under conditions out of the control of the landowner), a Qualified Conservation Easement should not be perpetual. If a project is terminated under the Regulation, the easement naming ARB as a third-party beneficiary, or at the very least ARB's standing as a third-party beneficiary, should be able to be terminate at this time. **We recommend that ARB amend this section so that the easement will not have to be in force any longer than the project's carbon commitment and that if the easement is perpetual in nature, ARB's status as a third-party beneficiary be automatically terminated in the event of termination of the carbon project.**