Chairman Mary Nichols and ARB Staff

Air Resources Board

California Environmental Protection Agency

1001 I Street

Sacramento, CA 95812

RE: September 15-day changes to Cap and Trade Regulation

Dear Chairman Nichols:

Thank you for the opportunity to comment on the forthcoming cap and trade program under AB32.

New Forests manages approximately $1 billion in institutional capital for investments in sustainable forestry and associated environmental products, such as carbon, biodiversity and water. The company is headquartered in Sydney, Australia, with offices in San Francisco and Singapore. New Forests has been active as a company in forest carbon markets for over five years: New Forests’ staff participated in the committee that developed an early version of the CAR forestry protocol, contributed to the Verified Carbon Standard’s AFOLU guidelines, contributed to the development of the New South Wales Greenhouse Gas Abatement Scheme, participated in the stakeholder working group that assisted CAR with the development of its aggregation guidelines, and currently participate in the CAR Mexico Forest Project Protocol committee. New Forests’ joint venture investment vehicle, the Eco Products Fund, has invested actively in forest carbon projects for the California market, and we are currently investing capital in forest carbon offset projects through a new fund vehicle, Forest Carbon Partners.

We hope that the practical experience in project development and offset project investment that informs our comments and suggestions proves useful to staff as they finalize the regulations for the future offset program. Thank you for considering our comments, which we have attached to this cover letter.

Sincerely,

Brian Shillinglaw

Manager, Carbon Investments and Policy

New Forests

**1. Consider clarifying the status of Forest Owners in the event of credit invalidation under §95985.**

Because of an ambiguity in the definition of a Forest Owner, we would recommend amending §95985(i)(1) and (2) to state that only the Offset Project Operator (*not* the Forest Owner) must replace ARB offset credits in the event of invalidation of a credit in a Retirement Account pursuant to §95985.

“Forest Owner” is defined in §95802(a)(109) (page A-21) to include “the owner of any interest in the real . . . property involved in a forest offset project”, excluding government agency third-party beneficiaries of conservation easements, but a single Forest Owner must be designated as the Offset Project Operator. We noted in our August 8, 2011 comments that this could be interpreted to include real property interest holders who have no control over forest management, such as a right-of-way easement holder, and recommended that the definition of “Forest Owner” be limited to those with real property interests that affect forest management – the fee owner, any holder of timber rights, and any holder of a working forest conservation easement that touches or concerns forest management, as applicable.

Only the Offset Project Operator is required to submit an attestation with the project affirming voluntary participation in the cap and trade scheme and agreeing to personal jurisdiction and venue in California courts pursuant to §95975(c)(2) (page A-202). At the same time, the credit invalidation and replacement provisions in §95985(i) (pages A-288 to A-290) state that “The *Forest Owner* . . . must replace ARB offset credits” in the event that credits in a Retirement Account are invalidated (emphasis added).

ARB and the State of California will not, however, have clear jurisdiction to enforce the cap and trade regulations against Forest Owners who are not required to submit an attestation to ARB pursuant to §95975(c)(2). Furthermore, because the definition of Forest Owner is drafted so broadly as to include owners of real property interests that have no impact on forest management, it would be unnecessary and infeasible to seek attestations from all entities that qualify as Forest Owners as that definition is currently drafted. (Real property interest holders with no capacity to affect forest management should not be Forest Owners. For example, it would be unrealistic to structure the regulation such that an owner of a private driveway through a forest area could face a contingent financial liability due to the forest management of an entirely different party).

In summary, while “Forest Owner” is defined to include all holders of a real property interest on the project area, in the most recent draft only one Forest Owner is the Offset Project Operator, and only the Offset Project Operator submits an attestation submitting to personal jurisdiction and venue in California courts. However, in the section on credit invalidation, the Forest Owner rather than the Offset Project Operator is responsible for replacing invalidated credits that have been retired. The change in the definition of “Forest Owner” in this draft indicates an appropriate and reasonable intention to hold (in the first instance) only the Offset Project Operator legally liable for proper and lawful operation of the offset project. We would therefore recommend that ARB amend §95985(i)(1) and (2) to state that only the Offset Project Operator (*not* the Forest Owner) must replace ARB offset credits in the event of invalidation of a credit in a Retirement Account pursuant to §95985. We would also recommend that §95985(e)(3) be amended to read “The Offset Project Operator and Authorized Project Designee~~, and, for forest offset projects the Forest Owner(s)~~.” This would ensure that §95985 properly reflects the changes to the definition of Forest Owner, with only one being designated an Offset Project Operator, and the scope of the State of California’s enforcement capabilities pursuant to §95985(c)(2).

**2. Consider amending §95985(c)(2) to acknowledge legal ambiguity and de minimis and inadvertent non-**

**compliance with applicable laws and regulations.**

§95985(c)(2) states that ARB “may determine that an ARB offset credit is invalid for the following reasons . . . The offset project activity and implementation of the offset project was not in accordance with all local, state, or national environmental and health and safety regulations during the Reporting Period for which the ARB offset credit was issued”. In the event of an invalidation for this reason, under the current draft the Forest Owner must replace all credits that were issued to an invalidated offset project data report and that had been retired after issuance.

As drafted, this provision does not account for common situations of legal ambiguity, inadvertent or de minimis non-compliance with applicable laws and regulations, and patterns of enforcement by agencies with enforcement discretion over applicable laws and regulations. We would recommend changes to §95985(c)(2) that would give ARB clearer discretion to avoid credit invalidation in situations of legal ambiguity, de minimis violations or pending actions by enforcement agencies.

For example, it is a common occurrence for appellate courts in the United States to interpret federal environmental laws and regulations in different ways. It can take years before these regional discrepancies are resolved by the Supreme Court, and in the meantime it may be impossible for forest owners to comply with a given court’s interpretation of an environmental law because the regulating agency has not yet created a permitting avenue for such compliance. In such cases a forest owner is technically in violation of a national environmental regulation but has no way to comply, and the law may change again in a year or two. ARB should have clear discretion to avoid credit invalidation in such instances where legal non-compliance is beyond the control of the landowner.

Similarly, many environmental regulations are complex and compliance is complicated. The California Forest Practice Rules, for example, contain detailed provisions related to logging roads and stream crossings. Regional Water Quality Control Boards may interpret applicable law differently and require different capital improvements of logging roads from Forest Owners. In most instances, if a forest owner is found by a regulating agency to not be in complete compliance with a regulation despite good faith efforts at adherence, the forest owner is given time by the regulating agency to comply with the regulation. ARB should not be in the business of second-guessing regulating agencies and imposing penalties for temporary non-compliance, and ARB should have clear discretion to avoid credit invalidation in situations of *de minimis* non-compliance.

While the permissive “may” language in §95985(c)(2) does make clear that ARB has enforcement discretion over credit invalidation, we would recommend that ARB clarify the extent of its discretion through the following changes to §95985(c)(2):

*The offset project activity and implementation of the offset project was found by a court or regulatory body of competent jurisdiction to be not in material accordance with all local, state, or national environmental and health and safety statutes and regulations, as interpreted by a court of competent jurisdiction from which an appeal cannot be taken, during the Reporting Period for which the ARB offset credit was issued.*

These changes would: (1) protect ARB from being forced to adjudicate legal non-compliance in areas that are regulated by a different agency; (2) protect ARB from being forced to invalidate credits for immaterial non-compliance; and (3) protect ARB from being forced to invalidate credits when a judicial interpretation of an applicable statute or regulation is not yet settled.

**3. Minor textual errors.**

§95985(i)(1)(A), (B), and (C) contain a misplaced reference, which should read “The Forest Owner identified in section 95985(e)~~(2)~~(3) . . .” as §95985(e)(2) refers to “The entity for which ARB transferred any ARB offset credits from the applicable Offset Project Data Report into the Retirement Account” and §95985(e)(3) refers to “. . . for forest offset projects the Forest Owner(s)”. In addition, as noted above in comment #1, we would recommend that these section read “The Offset Project Operator ~~Forest Owner~~ identified in section 959859(e)~~(2)~~(3) . . .”

§95985(b)(1)(A) and (B) should read “An O~~o~~ffset P~~p~~roject Data Report developed . . .”

§96985(e)(2) should read “The entit~~y~~ies for which ARB transferred any ARB offset credits . . .”

The definition of “TOTholding” might be clearer in §95985(g)(1) if it was rephrased as “’TOTholding’ is the total number of ARB offset credits from the applicable Offset Project Data Report currently being held in a Compliance and/or Holding Account by each party identified in section 95985(e)(1) ~~for the applicable Offset Project Data Report~~.”

Thank you for your time in considering our comments.

Sincerely,

New Forests