The ClimateTrust®

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Clerk of the Board
Air Resources Board
1001 I Street
Sacramento, CA 95814

Comments on the second 15-day amendments proposed for the California Cap and Trade Program

Thank you for providing The Climate Trust with the opportunity to submit comments regarding the California Air Resources Board's cap and trade program rules. We sincerely commend the Air Resources Board (ARB) for its pioneering leadership in greenhouse gas emission reduction policy.

The Climate Trust is a 501(c) (3) nonprofit organization headquartered in Portland, Oregon. Our mission is to provide expertise, financing, and inspiration to accelerate innovative climate solutions that endure. The Climate Trust was created in 1997 in response to the United States' first regulation of greenhouse gases (GHG) under the Oregon Carbon Dioxide Standard. The Trust solicits, negotiates, and contracts to purchase carbon credits on behalf of regulated utilities, businesses, and governments. We have over 10 years of experience, investing more than $16 million into numerous high quality GHG reduction projects in nine states and nine sectors.

As a pioneer in the carbon market, The Climate Trust offers a unique perspective to comment on ARB's proposed rules. These comments focus on the use of offsets and early action credits under the proposed cap and trade program to support a fluid, market-based mechanism to move the Western region towards a low carbon future.

1. Fully realizing supply from, and recognizing the value of, small scale projects

Small scale projects offer many benefits. The ability of small scale projects to access a market is a sign that the market is designed in an efficient and transparent manner. ARB has taken several steps to improve the flexibility of the market and encourage a robust and diverse supply of offsets. Nonetheless, there are several requirements that discourage the implementation of small scale projects, which could lead to a market characterized by one or two large scale sectors. Such a market is less sustainable, as supplies will inevitably diminish or the market will experience a backlash as different stakeholders will see it as supporting a limited set of larger scale activities. To ensure an efficient and robust market mechanism that encourages both small and large scale projects, The Climate Trust recommends ARB consider the following.

- *Developing a fixed ton invalidation threshold for small scale projects*- Under 95985(c)(1) an overstatement of more than five percent. For a 5,000 ton per year project, an overstatement of 250 tons could trigger a costly review and reverification process. Setting a minimum threshold of 1,000 tons provides small scale project developers flexibility, while still ensuring there is strong disincentive to overstating emission reductions in an Offset Project Data report.

- *Simplifying the verification process*- The complexity of verification and the associated costs are the principal barriers currently facing many credible small scale projects from entering the market. The current rules contain examples of verification prescriptions that translate into

65 SW Yamhill Street, Suite 400
Portland, OR 97204
Phone: 503.238.1915
Fax: 503.238.1953
info@climatetrust.org
www.climatetrust.org

additional costs, but seem to have little benefit in terms of enhancing project credibility. These include:

- Section 95977.1(b)(2)(b)- requiring verifiers to "understand data management systems" is a broad and subjective term that could lead to an excessive review, when a clear requirement such as review data management systems to verify adherence to protocol requirements is sufficient; and

- Section 95977.1(b)(3) (R)(1)- requiring an independent reviewer within the verification body who is not involved in the project could further limit the availability of qualified verifiers and lengthen the process for projects to receive issued credits. There are verification firms who lack sufficient personnel to have an additional independent qualified reviewer to fulfill this role although this may change over time. Rather, the requirement could be limited to a lead verifier providing approval and attestation before submission to ARB.

2. Invalidation of issued offsets and the current designation of liability will interfere with the development of an efficient and cost effective offset market

ARB has taken positive steps towards providing greater clarity on what constitutes grounds for invalidation. Additionally, giving offset projects the flexibility to reduce the Timeframe for Invalidation (Section 95895(b)) from eight years to three subject to meeting certain conditions is a significant step in the right direction.

However, rather than focusing on liability provisions, ARB rules could be directed towards ensuring offsets should be subject to rigorous verification and certification standards that would eliminate the need to invalidate credits to only the rarest of circumstances. The Trust believes that ARB has set up strict rules to ensure that only high quality credits are used to meet compliance obligations. In unusual situations where credits must be invalidated, a straight forward, efficient method of replacing the credits could be made available.

One of the driving forces for the rise of standards and certifications was to take the risk out of purchasing credits by creating accepted protocols and verification standards. As stated above, ARB has included appropriate verification and subsequent certification standards to ensure that only quality credits enter the market. Once credits are certified by ARB, invalidation of the credits should be an extraordinary occurrence. However, if ARB finds it necessary to retain the option of invalidation, a buffer account could be established for all credit categories, similar to the buffer account for forestry projects. Also, compliance entities would have more flexibility to meet the short replacement timeline if ARB allowed the 8% for offsets to be used across compliance periods and if a sufficiently large holding limit for allowances is established.

The buyer liability approach set out in the draft rules could be more efficient at addressing the problem of invalidated credits. Under ARB's proposed rules, the holder or user of a credit is presumptively liable. If that party is no longer in business, ARB will require the Offset Project Operator or Authorized Project Designee to replace the invalidated ARB credits. The Trust recommends that the Authorized Project Designee be removed from this requirement. The Authorized Project Designee is defined in section 95802(a)(22) as "an entity authorized by an Offset Project Operator to act on behalf of the Offset Project

Operator". There are many situations where the Authorized Project Designee only performs limited administration duties and has no influence or control over project outcomes.

While ARB has asserted that the various entities can manage their risk through appropriate contracts, the reality is that the credits frequently go through a chain of ownership that would have to be unraveled in order to determine contractual liability upon invalidation. Many medium-sized organizations would avoid these open-ended risks and the market could be composed solely of contracts between large corporations able to bear such liability, thus creating inequity in the market and limiting credit diversity and market participation of medium-sized entities.

3. Quantitative limits on the use of offsets may prevent cost effective greenhouse gas reductions

As long as ARB has rules in place to ensure that offset credits are high quality, there is no reason to implement artificial limits on their usage. ARB could be more encouraging investment in projects and could be more supportive during the long time horizon required for planning and investing in projects. Limits on the use of offsets will serve to inhibit investment and create uncertainty regarding the monetization of the carbon reduction portion of the projects. If ARB believes that a limit is needed on the use of offsets, the Trust recommends that ARB extend the time period for the quantitative limit to the full length of the program (from 2013-2020). This allows a maximum number of years for a compliance entity to invest in projects, or purchase credits in the market, in an efficient and cost effective manner. This is especially important because it is most efficient for projects to execute a single emission reduction purchase agreement for all credits. It is also more efficient for the compliance buyer to implement long-term contracts and they are involved in the projects for a longer period of time if they have flexibility to use offsets across all compliance periods rather than to meet obligations of a single compliance period.

4. The procedures for transitioning Early Action Offset Credits need tightening and clarification

The process set out in the rules for transitioning early action credits to ARB verified offsets remains burdensome. A few particular comments follow:

- Section 95990(d) could be modified to allow holders or owners of early action credits to register with ARB in addition to Offset Project Operators and Authorized Project Designee; and

- Section 95990(k) could be modified to include a defined and sufficiently long period under which eligible early action projects can transition to ARB Compliance Offset Protocols. An unclear window of time creates the risk that otherwise credible projects may no longer supply the market. The Trust recommends ARB establish a definitive transition period in which eligible early action projects can make the transition to ARB. A sufficiently long and clearly communicated transition period, such as January 1, 2014- December 31, 2015, will ensure flexibility as registries receive and implement ARB requirements.

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5. Offset Protocol Comments

The Trust reviewed the Livestock and Forest project protocols and has the following comments for ARB's consideration.

- *Livestock protocol* could use the most up to date data available. The default values listed in the protocol are not consistent with the latest default values from the U.S. EPA's Inventory of Greenhouse Gas Emissions and Sinks. The protocol could be updated to reflect the latest data and clarify that project developers may use the latest publicly available EPA data even if it has not yet been added to an updated version of the protocol in order to anticipate future updates.

- *Forest protocol* requires landowners to continue to monitor, verify and replace all carbon lost through reversals for 100 years following the last issuance of credits. This requirement currently exists in the voluntary market and has regularly been cited as the primary reason impeding forest carbon project supplies. As such, ARB offset supply projections from the forest sector should expect severely limited forest carbon supplies in the compliance market if a more flexible permanence period is not possible.

Thank you for the opportunity to submit these comments. The Trust genuinely values the hard, ground-breaking work ARB is doing to establish a cap and trade program and we appreciate the opportunity to weigh in and support ARB's efforts. We would welcome any ongoing opportunity to engage ARB on this important work.

Sincerely,

Sheldon Zakreski
Senior Program Manager
The Climate Trust

65 SW Yamhill Street, Suite 400
Portland, OR 97204

Phone: 503.238.1915
Fax: 503.238.1953

info@climatetrust.org
www.climatetrust.org