



# CLIMATE ACTION RESERVE

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December 14, 2010

Chairman Mary Nichols  
Air Resources Board  
1001 I Street  
Sacramento, California 95812

Re: California Cap On Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols, California Code of Regulation §95800 to §96022.

Dear Chairman Nichols and Members of the Air Resources Board,

The Climate Action Reserve (the "Reserve") congratulates the Air Resources Board and its staff on the development of the State of California's cap-and-trade regulation, which will create the first economy-wide cap-and-trade program in the U.S. It is a strong example of California's environmental leadership and will be instrumental in helping the state achieve its greenhouse gas emissions reduction goals under AB32.

As authorized by our Board of Directors, the Reserve would like to submit the following comments on the proposed cap-and-trade regulation, California Code of Regulation §95800 to §96022, issued October 29, 2010 (the "Regulation"). The Reserve strongly supports the adoption of this pioneering Regulation at your meeting on December 16, 2010. The comprehensive and rigorous rules established in the Regulation are critical to ensuring the cap-and-trade program achieves real environmental benefit. For the sake of our health, environment, economy and planet, we cannot afford to delay this monumental program.

The Reserve would also like to bring your attention to several issues that are instrumental for the success of the cap-and-trade program. First, the Reserve is pleased to have four of its protocols, addressing urban forests, U.S. forests, livestock manure and ozone depleting substances, included in the Regulation. We urge you to adopt these protocols on December 16, 2010 as part of the proposed Regulation. Adoption is vital to providing the market with certainty so offset projects may be developed and recognized. Without a solid foundation for the offsets program, the cap-and-trade system will not succeed.

The Reserve also strongly encourages the Air Resources Board to consider additional standardized, performance-based protocols that are comprehensive and rigorous for inclusion in the cap-and-trade program. Adopting additional high-quality protocols will ensure that the cap-and-trade program has an adequate supply of offset credits at a reasonable cost.

Second, we are pleased with and support the accreditation of third-party Offset Project Registries to assist with program implementation. We strongly believe that it is imperative for the Regulation to impose strict competency requirements for such registries. Offset registry services are complex and require specialized knowledge and experience, especially when providing guidance to offset project operators and verifiers on protocol requirements (as contained in §95987(d) “The Offset Project Registry may provide guidance to Offset Project Operators”). In order for this guidance to be accurate, timely, and consistent, Offset Project Registries should be required to demonstrate deep competency in each protocol they seek to administer to avoid programmatic errors and market confusion.

Third, while pricing plays a fundamental role in the market’s operation, the requirement that Offset Project Registries track and report offset prices is likely unworkable as currently drafted and would effectively preclude recognition of any early action credits. Credible offset registries, including the Climate Action Reserve, have intentionally chosen to neither seek nor manage information related to pricing to avoid a real or perceived appearance of a financial interest in offset projects. Further, outside of exchange-based transactions, per unit pricing information is not always readily known or fully discoverable since transactions can be very complex and dependent on external factors. Most importantly, because this information has not been tracked for early action offset projects under the recognized offset quantification methodologies specified in §95990(b)(5), its inclusion as a requirement would alone preclude all previously transacted offset credits under the adopted standards from being recognized as early action offsets, undermining the cap-and-trade program.

Fourth, we agree that Offset Project Registries must carry liability insurance; however, currently, it is not possible for Offset Project Registries to obtain \$50 million in liability insurance, as required under §95986(c)(1)(E). The insurance industry does not typically provide liability insurance in this amount and few entities, if any, could reasonably afford such insurance if offered. Industry standard limits for liability are between \$1 million and \$5 million. Changing the \$50 million requirement to \$5 million is a realistic requirement that is possible for Offset Project Registries to meet. Further, of equal importance to the amount of coverage is the nature of that coverage. Most general or professional liability insurance policies do not specifically cover the improper issuance of offset credits or other similar commodities, yet this is precisely the risk the Air Resources Board is seeking to manage. We would strongly suggest that the Air Resources Board impose requirements that the required liability insurance specifically cover the issuance of offset credits.

Fifth, the Reserve is pleased that the Air Resources Board recognized the importance of addressing reversals. However, invalidation of offset credits every time a reversal occurs as proposed under §95983 and §95985 will create severe unintended consequences and reduce confidence in the overall program, as buyers of credits will be uncertain if their credits will be invalidated at some later date due to actions beyond their control. Reversals, intentional or otherwise, may be effectively remedied by simply retiring compliance instruments, including other offset credits, in proportion to the reversal. This is, in fact, what the Regulation stipulates in the case of unintentional reversals

(§95985(f)). The same requirement should hold for intentional reversals, i.e., the Offset Project Operator or Authorized Project Designee should simply be required to retire compliance instruments, not “replace” invalidated credits. The practical effect from an emissions integrity standpoint would be identical, and retirement would avoid the unnecessary administrative transactions and possible legal disputes associated with invalidating credits (possibly in multiple buyer or end-user accounts) and “replacing” those credits with alternative instruments provided by the Offset Project Operator or Authorized Designee.

Sixth, we fully support the necessity of a clear timeline for submitting project data. Requiring submission of all offset project data on April 1 of each year, as established in §95976(d), however, will create a severe bottleneck and disable the offset program during that period. By requiring annual reporting on a single reporting deadline, the Air Resources Board is setting the verification schedule for all projects to be coincident, which will create undue burden on the verification bodies and board or registry staff reviewing the reported data. This requirement will, in turn, reduce the total number of projects that can be verified in any given year, increase the price of verifications, cause delays in offset credit issuance, and ultimately reduce the available supply of offset credits. A more efficient and effective timeline is to have data covering an approved reporting period submitted regularly, as specified in the Compliance Offset Protocol for that project type or based on the first time a project has been submitted.

Seventh, the Reserve understands the need for the Air Resources Board to require a new verification of all early action credits, as required under AB32 and described at §95990. However, these projects have already once undergone verification by a Reserve accredited verifier and a full conflict of interest assessment. Subjecting such projects to another full re-verification is not only costly but unnecessary. To the extent that Reserve accredited verifiers become accredited by the Air Resources Board, we would request that the re-verification process be streamlined and efficient to reduce transaction costs and uncertainty.

In summary, we urge you to adopt the Regulation at your meeting on December 16, 2010, with the following clarifications and modifications:

1. Along with the Regulation, adopt protocols for urban forests, U.S. forests, livestock manure and ozone depleting substances and establish a process for considering additional standardized, performance based protocols;
2. Modify the Regulation to require that Offset Project Registries demonstrate deep competency in each of the protocols they seek to administer (§95986(h));
3. Modify the Regulation so that price tracking is not required (e.g., 95986(c)(3)(C)), especially with regard to previously registered early action credits;
4. Modify the Regulation to only require that Offset Project Registries carry \$5 million instead of \$50 million in insurance and specify that such insurance must specifically include the issuance of offset credits as a covered activity (§95986(c)(1)(E));
5. Modify the Regulation so that upon any reversal, the equivalent number of credits must be retired instead of “replacement” or “invalidation” of the subject credits;
6. Modify the Regulation to allow for rolling submissions of data rather than all submissions on April 1 of each year (§95976(d)(6));

7. Modify the Regulation to allow for a streamlined and efficient re-verification process for early action credits (§95990).

On behalf of the Board of Directors and all of the Reserve staff, I thank you for this opportunity to share our comments and voice our support for adoption of the cap-and-trade regulation. The Reserve is proud of its close collaboration with the Air Resources Board and looks forward to serving as a strong partner in the years to come.

Sincerely,



Gary Gero  
President