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SUBJECT
Comments on Sector-Based Crediting and Subnational Reducing Emissions from Deforestation and Degradation (REDD) as part of California's Cap-and-Trade Program

Dear Air Resources Board,

It is very encouraging to see California taking a leadership role in developing rules on sector-based and sub-national crediting of emission reductions from REDD programs.

At a time of general uncertainty in the outlook for mandatory market-based mechanisms to reduce greenhouse gas emissions at the US-federal, Australia, and UNFCCC level, California's future cap-and-trade system mandated by AB32 represents one of the bright prospects for new sources of compliance demand for robust emissions reductions from well-designed and efficient REDD mechanisms. As such, AB32 has the real potential to actively shape the design of long-term sustainable and scalable REDD mechanisms and associated projects by driving demand for REDD credits. Although we recognize that the overall scope for offsets and internationally-linked measures under AB32 will necessarily and understandably be limited compared to in-State measures, we cannot overemphasize the importance of even modest movement of high quality REDD credits into AB32 as part of broader global greenhouse gas mitigation efforts. The signal sent by high-quality REDD tons being used for compliance purposes in AB32, even if in the years after 2015, would lend a significant boost for global efforts in developing a REDD market and financing mechanism. In this sense, California/AB32 can help seed a robust REDD market ahead of long-term adoption of a REDD mechanism by future US-federal and/or UNFCCC/international climate mitigation frameworks.

While acknowledging this potential represented by AB32, the ultimate effectiveness of any carbon financing mechanism rests in the details of design, and we thus offer the following observations and recommendations to ARB's thinking on rule design for REDD and sectoral offsets. We thank you for the opportunity to submit these comments for consideration. We were unable to attend the recent workshop on July 30, 2010, so these comments are based on the ARB presentation available online along with informal conversations. We apologize in advance if any of the comments are based on an incorrect interpretation of ARB's current thinking.

General Comments

We note that REDD is currently being discussed in the context of sector-based crediting. We agree that affectively addressing deforestation and degradation in developing countries at scale will require transformational changes in the forest sector. This will require improvements in policy, capacity and governance in many countries. The UNFCCC REDD+ negotiations are progressing with the need for sector wide reductions in developing countries in the long term. However, the effective design and implementation of sector wide REDD policies and measures combined with the accompanied capacity building and governance reform will be time consuming and costly. As a stepping stone towards achieving these sector wide reductions it is possible to design and implement regional and project based REDD activities that are environmentally and socially credible.

We would like to highlight that significant amounts of work have been done by a number of organizations on how to credibly estimate emission reductions from project based REDD.[1] This includes how to take leakage, permanence and other technical considerations into account in a credible and robust manner to ensure environmental integrity. These methodologies do not extend to all types of REDD projects. Experts acknowledge that in some situations leakage is an insurmountable obstacle that cannot be accurately monitored and tracked on a project level, which prevents the development of credible projects in these circumstances. In many other project scenarios it is possible to create credible stand-alone REDD projects that have the potential to generate real and verifiable emission reductions. Efforts are also underway to develop regional monitoring and accounting rules that will credit projects that are nested within regional reference scenarios. The region may cover various subnational jurisdictions such as a state or province within a country.

We encourage California to consider these types of stand-alone REDD projects outside the context of sectoral or subnational crediting. That said, the remaining comments will focus on REDD in the context of sector-based crediting and subnational reductions.

Phase in

Observation

It is unclear what is meant by "meeting requirements of REDD-Readiness". This could be a potentially onerous and wide ranging set of criteria – only some of which may be required to demonstrate environmental and social integrity of any project level emission reductions nested within a sectoral accounting scheme.

Recommendation

The concept of allowing projects as a step towards regional or subnational crediting systems should be considered in the phase in. As noted above, project level emission reductions can be generated to a high social and environmental standard, and can act as a learning and capacity building exercise for regional and national governments.

Crediting Baseline

Observations

In the current UNFCCC REDD negotiations the implicit assumption of many countries is that the crediting baseline will be the same as the historic and/or business as usual baseline. The concept of setting a crediting baseline below the historical or business as usual baseline is found in some academic studies and submissions to the UNFCCC negotiations. This notion is often accompanied by detailed discussion of existing or planned policies and measures to be undertaken in the developing country that could reduce emissions to the crediting baseline if implemented. Implementation of these policies and measures is in turn often supported (financially and technically) by industrialized countries, though

[1] For example, the Voluntary Carbon Standard has developed rules and procedures for developing and registering REDD projects. Climate Focus has also been involved in an initiative to develop REDD methodologies. See http://www.adpartners.org/initiatives_redd.html

some countries are willing to self-finance some of these policies and measures. In the absence of this support, there is no incentive for developing country governments to assume the costs of these policies and measures, which will likely include the opportunity costs involved.

The current ARB thinking does not seem to include any financial or technical support for developing countries to help them reduce emissions from the historic and/or business as usual baseline to the crediting baseline. In the absence of UNFCCC agreement on REDD and post-2012 finance, or US federal legislation that includes financial and other support to help developing countries reduce emissions in the forest sector to a crediting baseline, it is highly unlikely that this will spontaneously occur through unilateral action of developing country governments. This is true if the crediting baseline is set at 50%, 25%, or a lesser percentage compared to the historic or business as usual baseline.

This creates a significant risk that the mechanism currently proposed by ARB will (i) not incentivize any developing country or region in a developing country to participate in the California system; and/or (ii) if a country or region does participate, it will likely not be able to unilaterally reduce emissions by 25% or 50%, thereby removing the chance of generating any REDD offsets that could be used by Californian companies to help reduce the cost of complying with California's climate legislation.

Recommendations

We recommend setting the crediting baseline to equal the reference level as the default position, but allowing participating regional or national governments to set a lower crediting baseline if they choose to do so or this is required under a future UNFCCC REDD mechanism. If the reference level set in a conservative and credible manner this will help ensure emission reductions below the baseline are additional – particularly if project level additionality is also required for project level crediting.

However, if ARB wants to require developing country contributions to emission reductions, rather than setting a strict crediting baseline whereby no credits are issued until the sectors emissions equal the crediting baseline, *ARB could consider issuing credits for a certain percentage of emission reductions below the reference level on an incremental scale until 100% of emission reductions are recognized as credits*. For example, assume a particular region's reference level for the sector was 1,000,000 tCO_2e emissions per year. If emissions were reduced to 900,000 tCO_2e in a given year, 80% of the emission reductions (i.e. 80,000 tCO_2e) would be issued as offsets, and the remainder would be attributed to the developing countries "own efforts". For emission reductions between 900,000 and 800,000 tCO_2e in a given year, 90% of the emission reductions would be issued as offsets. So in this instance, if a region reduced emissions to 800,000 tCO_2e, a total of 170,000 tCO_2e (80,000 + 90,000) would be issued as offsets. This could continue until 100% of emission reductions are issued as offsets.

We recommend California provide financial, technical or other support to regions in developing countries that want to participate in a regional crediting mechanism. Meeting the eligibility criteria will be costly, and support for this could be found from e.g. auction proceeds from an auction of allowances. If funding is limited, this could be structured as loans repaid to California by some of the "own effort" emission reductions discussed above, with options for converting the loan to a grant if emission reductions are not generated.

We recommend crediting sector wide emission reductions to the regional government that has in place a sectoral crediting mechanism and infrastructure (less any project level credits, as discussed below).

The ability for regional governments to generate and sell credits into the Californian system will help stimulate government level action.

It should also be noted that a crediting baseline that is set below the business as usual baseline is not needed to demonstrate additionality of emission reductions. Additionality is necessarily achieved if the baseline is set conservatively and emission reductions occur below the baseline.

Private Investment and Crediting Nested Projects

Observations

The nested concept was developed in part to stimulate private sector investment in REDD and reduce investment risk. It attempts to address some of the public policy risk associated with sectoral crediting options. The public policy risk exists because based on simple sectoral crediting, if a sector as a whole does not reduce emissions, individual projects may not generate credits even when those projects perform well. This is because the emission reductions of a successful project could be offset by increased emissions in other parts of the region that are attributed to poor government policies or enforcement completely unrelated to the successful project (i.e. not associated with leakage). This penalizes successful projects and essentially means the ability of a project to generate a return on investment is dependent on good governance and effective regional policy implementation rather than project performance. Good governance and policy implementation across an entire region or country is outside the control of most (if not all) local communities and investors engaged in REDD projects. Setting a sector's crediting baseline for project level activities 25% or 50% below the regions reference level significantly increases public policy risk. *This will likely be an insurmountable risk for any local community or investor interested in developing a REDD project with the expectation that they will finance the project or generate a return from the sale of credits in the Californian system.*

It should be noted that this risk exists even if the crediting baseline is set at the reference level. A number of options to reduce this risk exist. Possible solutions are discussed below.

It is unclear who will pay for the development of regional reference levels and infrastructure needed for nesting projects in developing countries. This may represent a substantial cost.

Recommendations

We recommend direct crediting of project level reductions and the use of buffer accounts that can be drawn upon to reward successful projects if there is a sector wide underperformance. For a more detailed discussion of this please see O'Sullivan, R., Streck, C., Pearson, T., Brown, S. and Gilbert, A. (2010) *Engaging the Private Sector in the Potential Generation of Carbon Credits from REDD+; An Analysis of Issues*, Report to the UK Department for International Development (DFID), available at: http://www.climatefocus.com/documents/engaging_the_private_sector

Proceeds from the auctioning of allowances could be used to support the costs of developing regional reference scenarios and accounting infrastructure. The above discussion on structuring this as loans remains applicable.

Please do not hesitate to contact us if you would like to discuss any of the above observations or recommendations further.

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