

**Comments to the California Air Resources Board Staff on Compliance Offset Criteria**

**Submitted May 29, 2009**

The Nature Conservancy (TNC) appreciates the opportunity to provide comments on the California Air Resources Board (ARB) preliminary proposals regarding offset compliance criteria in a cap and trade program. With over fifteen years of experience developing forest offset projects and policy internationally and domestically, TNC supports the inclusion of forest-based offsets in California's proposed greenhouse gas (GHG) cap and trade program and believes forest-based offsets would provide cost-effective and meaningful greenhouse gas emission reductions that would also achieve many important and much-needed complementary public benefits. These co-benefits include the protection and enhancement of water quality, fish and wildlife habitat, air quality, recreation and sustainable local economies.

As outlined by the California Health and Safety Code, section 38562(d)(1)and(2), forest offsets, as well as offsets in general, can and should be real, permanent, quantifiable, verifiable, enforceable and additional. With these criteria in mind and based on TNC's experience, we offer the following comments and recommendations in response to the criteria offered by ARB staff during the April 28<sup>th</sup> public workshop.

**Definition Criteria:**

*TNC supports the initial proposed offset definition with additional explanation regarding the function and legal nature of the offset*

ARB staff indicated that is considering defining a compliance offset based on a tradable offset unit, indicating that it is fungible and equivalent to I metric ton of CO<sub>2</sub>e and identifying the offset criteria in the regulations. TNC supports this approach, as it is important to acknowledge that the offset may be traded with other reductions on an equivalent basis and to create consistency in the unit of the reduction.

Additionally, TNC recommends that the offset definition indicate the function that the offset serves – i.e., offsets are greenhouse gas reductions that compensate for GHG emissions that occur elsewhere. This additional description will help clarify the purpose of the offset in the compliance program. Another critical aspect of the definition is to clarify that the offset is an allowance, so the legal nature of this tradable unit is clear. Presumably, the term “greenhouse gas reduction” will also be defined somewhere in the regulations to further explain reductions as they relate to both offsets and emissions allowances.

## **Types of Emissions Reductions:**

*Greater clarity is needed to distinguish direct and indirect emissions reductions to avoid confusion*

The ARB staff presentation makes a distinction between direct and indirect emissions reductions as those that occur where the reduction activity is implemented versus those that occur at a location other than where the activity is located. In several other GHG programs, Climate Action Reserve and World Resources Institute, these distinctions are defined by ownership and control. As a consequence, the use of this terminology is confusing. Therefore, TNC recommends identifying this issue with different terminology.

## **Geographic eligibility:**

*TNC supports ARB staff preliminary recommendation to issue compliance offsets for projects in California and outside California in jurisdictions that have an agreement with California*

TNC supports the issuance of compliance forest offsets within California as well as outside of the state, both domestically and internationally. Within California, ARB will have the authority to enforce obligations related to offset project development and GHG reductions. For jurisdictions outside of California, the state will need to establish agreements that will provide for or enable the enforcement of compliance offsets to meet the requirements of the Global Warming Solutions Act. It is also reasonable to disallow offsets from other jurisdictions that are capped under California's program so capped industries are not competitively disadvantaged.

## **Start date of compliance offsets:**

*TNC supports the reward of early actions that were undertaken through the California Climate Action Registry*

The cap and trade program in should reward GHG reductions that were registered and verified by the California Climate Action Registry (CCAR) as early as 2001. For reductions that accrued prior to the adoption of GWSA, this may be done through set aside allowances. The CCAR legislation, which expired with the adoption of the Global Warming Solutions Act, explicitly stated that the state would commit its best efforts to recognize early action GHG reductions that were certified by CCAR. Many companies and organizations relied on this commitment and undertook early actions and significant investments to reduce emissions, achieving CCAR's statutory goal. As a matter of public policy, these GHG reductions should be acknowledged and rewarded by the state so that entities will continue to undertake early actions with confidence that these efforts will be acknowledged and rewarded.

Furthermore, projects that were initiated as early as 2001 pursuant to CCAR should also be eligible to produce compliance offsets for the cap and trade program starting with vintage years 2006 and later. The fact that a project started as early as 2001 should not prohibit a project from providing more recent offsets for the compliance program. These offsets will need to meet the offset criteria approved by ARB and should be accruing now so that capped entities will have an available pool of offsets to purchase once the cap and trade regulations are approved. Offset projects, and forest projects in particular, can require a significant amount of lead time to not only set up the project, but to grow the trees. Therefore, a decision to only recognize offsets starting in 2012 could result in a lack of offsets available for capped entities in the first compliance period.

### **Ownership rights:**

*Ownership rights may vary by sector and also depend on the legal nature of the offset*

The issue of ownership rights is directly connected to defining the legal nature of an offsets and allowance. As mentioned earlier in the definition section, it is critical for ARB to specify the legal nature of an offset. For instance, is it a permit or a commodity? Personal property or real property? The federal Clean Air Act defines allowances as a permit, which allows the government to limit the rights and recourse associated with allowances and provide flexibility to the agencies to change the criteria of an allowance. Defining allowances as a permit also helps address public policy concerns that trading in emissions reductions could create a private property right in a public resource, the air. Permits limit this right. For fungibility, offset allowances should be defined in the same manner as the emissions allowances of the program, which should be defined as a permit for the reasons stated above. Defining the legal nature of the offsets and emissions allowances are also critical from a tax perspective.

In the case of forest offset projects, the ownership of the offset permit should originate with the landowner as the reductions initially accrue as part of real property, the trees and soil. However, these offsets should be freely transferrable to allow project developers to obtain the permit and rights associated with it. TNC advises ARB to also consider the legal establishment of a forest carbon right that may support and complement the development of offset projects and related offset permits.

### **Criteria:**

*TNC supports the criteria of real, quantifiable, permanent, verifiable, additional and enforceable for offset projects. The Climate Action Reserve provides a strong foundation for forest offset rules that meet these criteria.*

**Real:** *TNC supports the elements identified for ensuring that offsets are real.* Projects and associated GHG reductions should account for uncertainty in estimates and err on the conservative side. Double counting should be avoided and this should be addressed through

clarity of ownership, serialization and transparent registration of all GHG reductions, whether they are offsets or direct emission reductions.

Leakage is an issue that is related to offset projects, but the GHG program more broadly. While individual offset projects can and should account for leakage, TNC recommends that ARB look at this issue more broadly and determine if there are programmatic ways to help address this issue through complementary policies and greenhouse gas reduction insurance pools.

*Quantifiable: TNC supports initial staff thinking on quantification.* Calculation methodologies should be measurable, replicable, peer-reviewed and updated periodically as the science improves. There should be comprehensive accounting of emissions sources and sinks. However, consideration should be given to forest projects and particular live carbon pools that may not need to be counted if it is not an emitting pool, resulting in more conservative GHG reduction estimates.

*Permanent: TNC strongly supports the permanence of GHG reductions.* Forest offset projects may be managed and protected to maintain reductions for long periods of time. However, natural disturbances may occur that could result in the release of some GHG reductions. Subsequent changes in landownership or management decisions could also result in the release of GHG reductions. These issues may be addressed through legal instruments, such as conservation easements and contracts, that address human activity and through the development of insurance and buffer pools to address natural disturbances. GHG programs like the Climate Action Reserve draft forest protocols and the Voluntary Carbon Standard offer examples of these instruments. ARB and the state should explore the development of a state-backed buffer pool/insurance mechanism that would support GHG reduction risks associated with offset projects as well as risk more broadly.

*Verifiable: TNC supports staff outline of verifiability.* Third party verification is critical to the integrity of offset projects. Offset project should have clear and standardized monitoring and reporting obligations, which are verified. Only GHG reductions that have occurred should be verified to maintain the integrity of the cap and trade system. While ARB could undertake some of the verification obligations, ARB should seek to accredit/license other third parties to verify offsets as the workload would be substantial and likely exceed ARB's current capacity.

*Additional: TNC supports a standardized approach to determine additionality.* In general TNC agrees with ARB staff thinking to use standardized baseline methodologies to determine and assess additionality of offset projects. A standardized approach provides greater certainty to project developers, investors and verifiers in terms of what would likely qualify as an offset. The approach can also provide greater upfront transparency to the public, as they would have the advantage of vetting the standardized protocol early in the process versus a case by case basis when offset projects are proposed. A standardized approach should already incorporate regulations. However, to the extent a protocol does not incorporate a regulatory test, this should be included to ensure that offsets are not granted to projects that are required by law. With a

standardized baseline test, a financial additionality test should not be necessary. In many cases such a test requires subjective judgment that is difficult to verify, which has led to the support of a standardized approach to obviate this need. In addition, many projects will need multiple revenue streams to be implemented, so funding for carbon may only represent a small portion of an investment in an offset project at initiation.

The funding source should be viewed as an ownership consideration versus an additionality assessment, particularly with a standardized baseline/additionality approach. Where sources of revenue other than those for carbon are used to develop a project, a project may still be additional as it exceeds the standardized baseline and produces measurable GHG reductions. The other funding sources, to the extent it can be shown that they led to offsets that are additional, could receive some value or offsets as a result.

*Enforceable: TNC supports ARB staff thinking that offset must be backed by regulations and tracking systems.* We agree that proper and transparent ownership and tracking must be established to enable enforcement and avoid double counting. ARB should have the authority to investigate and take action for violations by offset providers, project developers, third party verifiers and any registries that ARB may rely upon for offset project development, registration and verification.

*Co-benefits: TNC supports the inclusion of co-benefits criteria in offset requirements.* Offset projects, and forest projects in particular, can provide a host of public benefits. In urban and rural areas, forest projects can help protect water and air quality. They may provide indirect greenhouse gas benefits by providing shade to housing and biomass energy. Forest offset projects, through improved management, protection and restoration, can also protect and foster fish and wildlife habitat. When managed and protected for biodiversity (i.e., a mixture of ages and native species), they can produce climate benefits while simultaneously building greater resistance to fire, insect infestation and disease – the very things the state will seek to protect from the negative effects of climate change. Thus, TNC encourages ARB to adopt guidelines that seek to maximize these important and integral co-benefits and avoid environmental harm.

TNC commends the great work of ARB staff as they develop proposals and regulations for offsets and cap and trade system, as well as the other aspects of the GWSA. We look forward to working with you on these issues and please feel free to contact us with any questions or comments.

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