



ENVIRONMENTAL DEFENSE FUND

finding the ways that work

July 6, 2009

Brienne Aguila
Offsets and Cap-and-Trade Project Manager
California Air Resources Board
1001 "I" Street
Sacramento, CA 95812

Re: Comment on carbon offsets approval within AB 32 cap-and-trade program

Dear Ms. Aguila,

Please accept this letter related to approving offset projects and protocols for use in the California AB 32 cap-and-trade program. The discussion in this letter answers questions posed to the public at a meeting hosted by the California Air Resources Board on May 21, 2009. Environmental Defense Fund submitted a similar letter to CARB on April 18, 2008 (attached) to address similar questions posed by the agency to the public, at that time, for consideration in the development of the AB 32 Scoping Plan. As you will see from the two letters, our views on offsets remain consistent.

This letter begins with a general outline summarizing our major points, followed by a more in-depth discussion of individual topics. Please feel free to contact me using the information provided at the end of the document if you have any questions or concerns.

Summary:

- **Project pre-validation** - CARB should reconsider the need for a mandatory project pre-validation.
- **Hybrid approach** - A hybrid project protocol process is likely most beneficial route for the state, though additional thought should be given to only allowing unique projects within the project by project review.
- **Project protocol development guidance** - CARB should develop guidance documents and perform additional public outreach and education for project and protocol developers.
- **Streamlining project protocol development** - CARB should look for ways to streamline protocol development without sacrificing integrity.
- **Staff resources** - CARB should consider increasing staff in the near term to facilitate offset project development.
- **Project prioritization** - CARB should use a framework that maximizes the resources of the agency, facilitates the development of new emissions reduction projects, and doesn't slow the progress that is gained when fostering the development of a wide variety of project types.
- **Enforcement** - CARB should adopt the general rule that all regulated entities in the cap-and-trade market are liable for submitting emissions allowances equal to the amount of their emissions, and also create mechanisms to ensure replacement credits are quickly delivered to purchasers.

1. **General view of Environmental Defense Fund on greenhouse gas offsets**

In the challenge to reduce quickly GHG emissions from all areas of the economy, Environmental Defense Fund is a vocal advocate for market based solutions. Within the rubric of our advocacy is a broad recognition and general support for offsets as a mechanism that enables economy-wide emissions reductions in the most efficient manner. This mechanism drives reductions outside of the cap in cap-and-trade programs and encourages development of new and innovative solutions to reduce GHGs. Furthermore, some offsets, such as those generated by the agricultural and waste sector, can facilitate reductions of criteria and air toxic pollutants in over-burdened communities and can lay the groundwork for including sectors within the cap-and-trade program that currently are treated as offsets due to challenge of accounting, monitoring and enforcement.

2. **Environmental Defense Fund generally supports the potential elements of the compliance offset system, but CARB should reconsider the need for a mandatory project pre-validation.**

On May 21, 2009, staff presented a slide titled “Compliance Offset System Potential Elements.” This list of elements, with the supporting documentation provided in the presentation, outlines a multi-step process for bringing offset credits into the California cap-and-trade program, ensuring accuracy and enforcement of quality.

Environmental Defense Fund believes that quality standards for offset protocols and projects are needed to ensure offset credits represent actual emissions reductions achieved. However, while the development and layering of quality control mechanisms can ensure offset quality, such a system can also alienate high quality offsets from the program if those controls and layers increase the costs and time required for obtaining regulatory approval without having a corresponding benefit.

In general, most if not all of the mechanisms listed and described by CARB (i.e. protocol adoption; validation; registration; monitoring and reporting; verification; certification; issuance and enforcement) are valuable additions, ensuring offsets achieve the highest quality standards. **However, the CARB proposal may be setting too high a hurdle for project developers by requiring project developers to undergo a project validation step prior to developing the offset project.** Since project validation is an up-front assessment of the offset project rather than a traditional assessment using project verification documents, measurement data and detailed additional analysis, some project developers who are projecting small profit margins may be shut out of the market because their projects become too costly or delayed. As an alternative to mandatory project validation, CARB should offer a voluntary project validation service for project developers. Such a program would afford project proponents the option of an up-front assessment of their proposed project’s applicability and allow more diverse, innovative project developers to compete without compromising the integrity of credits ultimately approved for use in the compliance market.

3. **CARB’s development of a hybrid project protocol development process is the most beneficial route for project developers and for the state.**

In general, EDF recommends CARB utilize a project protocol development and approval process that grants the state considerable authority to recognize valid emissions reductions projects, maximizes emissions reduction opportunities, minimizes regulatory costs incurred by project developers, and makes the most efficient use of agency staff time and resources. A hybrid approach is the most efficient and

effective direction because it allows CARB to utilize the most beneficial features of both the project-by-project and standards-based approaches.

a. **Discussion of project-by-project review**

As evidenced by the Clean Development Mechanism (CDM) program, the project-by-project review process is both time and resource intensive, requiring the regulator to develop specialized knowledge about each project type proposed. Such a process may also lead to similar project types having different quantification methods, leading to a mistaken, albeit potentially warranted, perception of a miscalculation of emissions reduction credits. Further, due to the resource intensive nature of this process, a case-by-case analysis can slow down the overall development of emissions reduction projects if the approval pipeline is unwieldy or if waiting periods for project qualification are too long.

On the other hand, and as characterized by CARB staff, a project-by-project assessment can facilitate the development of a large number of smaller scale projects that might not otherwise be recognized due to their smaller total tonnage reduction. Project developers with specialized experience of an area or emissions source can step forward and apply for project crediting, increasing investment and emissions reductions throughout the state. As individual quantification methods are adapted to meet larger statewide needs, project-by-project analyses can lead to the development of more comprehensive protocols. Furthermore, by engaging in a project-by-project approach, CARB effectively outsources some of the protocol development work to the community of project developers rather than keeping it solely in-house (within the agency). By engaging in this type of outsourcing, CARB may be able to counteract the slow nature of the individual project approval process by increasing the general rate that new project protocols are submitted to the agency.

i. **CARB should develop guidance documents for project and protocol developers**

In general, the most effective project-by-project program will engage potential project developers to participate and deliver a clear understanding of the required elements of emissions reduction project protocols. **To accomplish this Environmental Defense Fund recommends CARB develop and distribute a detailed project protocol submission guidance document, and engage in significant public outreach and education to inform project developers and regulated parties about the details of offset project development and use in California.** This document and outreach should, at a minimum, allow project developers (and support staff) to ascertain how project details should be characterized in an application to the agency and what aspects of protocol development are most important. Further, CARB could develop guidance on allowable monitoring methods, permanence assurance and additionality. Finally, in the development of a guidance document for project developers, CARB should utilize plain wording that will allow inexperienced project developers to comprehend the program's requirements.

ii. **While CARB should look to other project-by-project offset programs for guidance, their efforts to streamline protocol development cannot sacrifice the integrity of the credits or diminish confidence in the overall program.**

In developing an offset program that uses, in part, project-by-project review, it will be important for CARB to balance the need to have enough information to prove that proposed projects meet identified threshold criteria, (i.e. permanence, additionality, verifiability, enforceability, realness) but not become so cumbersome as to barricade valid project development. For example, while the some offset protocol approval bodies utilize step-wise processes that include generating an issue paper, running technical

workgroups, and submitting protocols for public review, such steps can create a cumbersome (albeit transparent and thorough) process that leads to significant delays in protocol development and approval. Therefore, CARB should look to truncate or simplify steps where doing so would not sacrifice project accuracy, transparency, or public acceptance of the finalized protocol (and would still meet the requirements of AB32).

b. Discussion of a standards-based approach to project development

Environmental Defense Fund also supports the use of a generally applicable standards-based approach to project protocol approval to increase the speed that certain projects will be credited while decreasing the risk of similar projects being credited under different quantification methods. These beneficial qualities, however, must be counterbalanced by the propensity of such an approach to decrease the diversity of project types that are able to be credited since it is likely that only a few project types will end up with a standards-based protocol. This decrease in diversity is likely driven by the fact that standards are most likely developed in-house (rather than being outsourced to project developers).

One added benefit of the standards-based approach is that staff can set their own protocol development schedule and priorities for project approval (since the agency controls the protocol development process). This desire for time management, however, does not necessarily need to sacrifice the ability of the agency to kick-start the project development process (and facilitate important GHG reductions) because a standards-based approach can also be outsourced, to some degree, to the project development community. CARB could increase the potential that generally applicable project protocols are developed and submitted to the agency by offering clearly written guidance to project developers, similar to that recommended above. Such efforts by the agency up front could help to ensure maximum efficacy of staff time and reduce the overall resource constraints placed on the agency.

c. The value of a hybrid protocol approval process

As explained by CARB staff at the recent public meeting on offset protocol development, a hybrid approach to offset protocol development and approval allows the agency to benefit from the positive attributes of the project-by-project process and standards-based approach. However, to afford the agency benefits without the potential burdens, some initial work will be required to give clear guidance to project developers and environmental advocates. Such guidance must clearly state what criteria each project (and project protocol) needs to meet to be able to achieve credit under an AB32 framework.

As discussed above, with the desire to facilitate widespread emissions reductions through offsets is the need to ensure the agency both 1) effectively uses staff resources in the protocol development process and 2) creates confidence that project accounting is fair and accurate. By allowing similar project types to use project-specific accounting protocols, CARB could run the risk of both overburdening agency resources as well as potentially approving two identical protocols with different emissions calculation methods.

CARB should therefore consider allowing project-by-project review only for truly unique project types and avoid developing independent protocols for broad swaths of similarly situated projects.

d. CARB carefully evaluate and monitor it's capacity to provide necessarily detailed and speedy review of project protocols, and increase staff where necessary

The Intergovernmental Panel on Climate Change has recognized that near term GHG reductions are critical for preventing catastrophic climate change. Offset projects are a necessary part of the solution and

have the added benefit of controlling the costs of switching to a low-carbon economy. By deploying more staff resources over the next 2 years to 1) develop standards based project protocols, 2) work with project developers to develop and approve case-by-case project protocols, and 3) develop and disperse guidance documents for project submission, CARB can positively impact the development of valuable emissions reduction projects (and facilitate co-pollution reduction) throughout the state. Furthermore, since project development and qualification is new to the California regulatory environment, an upswing in staff does not necessarily need to continue in perpetuity once the general body of information available to regulators, the public, and policy makers is increased and streamlined project development and approval pathways are created and matured.

4. Use of project protocol prioritization

Environmental Defense Fund recommends CARB use a process that maximizes the resources of the agency, facilitates the development of new emissions reduction projects, and fosters the development of a wide variety of project types. However, we understand that in some cases the agency must decide what types of projects to proceed with first in development. Such a decision is assisted by a clear prioritization of goals and objectives, but this prioritization should not be used as a perpetual justification to limit the development of valid offset projects. Further, by strategically outsourcing protocol development to project developers, CARB can reduce the risk that project prioritization will be needed for a lengthy period of time.

Under the case-by-case portion of the hybrid protocol development approach, a prioritization framework would assist CARB in choosing which projects to review and approve first. Under the standards-based approach portion, the prioritization criteria would assist CARB in deciding which general protocol to develop first. Note that if CARB provides sufficient protocol development guidance and efficiently utilizes staff resources to review projects and protocols, project prioritization criteria may be needed only during the early years of the program when the need to review project protocols exceeds the capacity of the agency to do so in a timely manner. Consequently, Environmental Defense Fund recommends CARB use prioritization metrics as a tool to choose which project protocols to develop first in the comprehensive offset protocol portfolio and we do not support using prioritization criteria as a tool to justify limiting the amount of offset projects that can be recognized in perpetuity.

In general, Environmental Defense Fund supports the list of prioritization criteria distributed by CARB at the recent public workshop of offsets. However, it is our recommendation that certain criteria be weighted higher than others as follows:

a. Highest priority projects

In general, Environmental Defense Fund supports CARB prioritizing project protocols and the projects that meet certain criteria. **Whatever the process for prioritizing, developing and approving new protocols, CARB should continue to quickly adopt protocols for quantification of the most common project types where such protocols exist and under which a significant amount of credits are likely to be generated – such as afforestation or methane digesters.**

Project prioritization screening guidelines Environmental Defense Fund recommends as most important include:

- Emissions reduction projects where a large body of scientific evidence exists and a high quality project protocol can be developed in a short time,¹
- Emissions reduction projects that achieve co-pollutant reductions or ecological benefits both within the state and outside of California,
- Emissions reduction projects that are replicable and where the project protocol is able to be utilized at a broad number of sites and generate a significant amount of emissions reductions, both in state and outside California.

5. Enforcement

In general, Environmental Defense Fund recommends that CARB adopt the general rule that all regulated entities in the cap-and-trade market are responsible for submitting emissions allowances equal to the amount of their emissions. Adopting this proposition would mean that regulated entities would be liable for obtaining replacement credits in the event that offsets purchased or surrendered become invalid or an over-calculation is discovered. Although we discuss potential tools both CARB and the regulated community can utilize to acquire replacement credits, we recommend these as methods for obtaining new credits rather than as a way to obviate or circumvent liability. Environmental Defense Fund recommends CARB adopt or approve the use of these mechanisms (or similar instruments) to maintain the integrity of the cap in the event of credit invalidity.

Although credit invalidity can occur in a number of ways, perhaps the three most common will be 1) reversal of sequestered carbon, 2) an after-the-fact determination of mistake or malfeasance in the credit quantification, 3) an after-the-fact finding of a fatal conflict of interest between the project developer and the project verifier.² In the event of these situations, an entity that purchased credits from a project developer would suddenly find it had less credits than previously thought. Such an effect could have significant consequences no matter whether the finding of invalidity occurred before or after the credit was submitted for retirement to meet compliance obligations.

In the event of credit invalidity prior to submission to the regulatory agency for compliance purposes, the harm occurred is purely financial because the entity that purchased the offset credit paid money for something that didn't actually equal what it represented. In such an event, since the regulated party would not yet have been required to submit the credit to meet emissions regulation, the atmosphere has not felt the credit shortfall. On the other hand, if the credit is invalid (or reversed) after being surrendered for compliance purposes, both the party buying the credit and the atmosphere would be aggrieved. In either situation however, the remedy for the planet (and emissions market) must be the same - a valid allowance credit must be surrendered for each unit of emissions.

a. Sequestration credit buffer pools and penalties

One method to ensure regulated entities surrender valid offsets is to require that any offsets credit based on terrestrial carbon sequestration be linked to a buffer pool of emissions credits. Such a pool serves as an insurance mechanism for regulated parties because the pool automatically delivers replacement offsets

¹ Existence of protocol that has already been developed for a particular project type and adopted in a comprehensive and transparent regulatory processes could fit within this category.

² A conflict of interest finding may trigger a project review rather than an invalidation of project credits – such penalties are to be determined by the Board.

equal to the amount reversed. Environmental Defense Fund recommends that CARB require all offset credits based on terrestrial carbon sequestration to be linked to a buffer pool. An example of a system like this can be seen within the current draft of the Climate Action Reserve's Forest Project Protocol.

In addition to buffer pools, Environmental Defense Fund recommends CARB establish additional tools to discourage project developers from voluntarily reversing sequestered carbon sold for credit. Such tools could be imposed on project developers who want to sell credits for use in the California cap-and-trade program and could include requirements to deliver additional carbon credits or money to the state. By establishing an extra level of enforcement for sequestration credits, (and discouraging willful carbon reversal), CARB will help preserve buffer pools for events where unforeseen events lead to carbon release rather than situations where developers change their mind about preserving carbon in soils and trees. In creating this tool, CARB should attempt to discourage voluntary reversals that occur closer to the project origination date (as opposed to older projects where carbon sequestration has occurred for a number of years). An example of a penalty can be a requirement on the project developer to acquire and surrender to the state an amount of offset credits greater than that reversed (at a ratio of greater than 1:1).

b. Insurance pools, policies and contract rights

Similar to buffer pools for terrestrial carbon credits, insurance pools, insurance policies and contract rights can be used to ensure valid credits are surrendered by regulated entities in the event that a credit they either retired or planned to retire is deemed invalid.

Insurance pools of offsets credits, either held at the project developer, project registry or statewide regulatory level operate nearly the same as sequestration buffer pools - they release credits to replace any credits found to be invalid. Insurance pools can be created by 1) taking some small amount of credits from every offset project registered, 2) applying a surcharge fee on registered projects and purchasing credits on the open market with the collected money, or 3) some other method.

Insurance policies for offsets are similar to insurance policies for other types of items - where the regulated entity or offset provider contracts with a third party provider to provide a remedy in the event that the pre-stated condition occurs. In this situation, an insurer would acquire and deliver valid offset credits to an insured who found out the credits they had previously purchased or retired were invalid. While insurance policies for offsets may not exist yet, similar insurance instruments have been used in other situations where one party faces potential liability based on the actions of another.

Contract rights are based on an agreement between two parties where those parties agree to a particular remedy in the event of some occurrence or non-performance. For offsets, purchasers and sellers can agree that a seller either provide a replacement credit or a refund in the event that a previously sold credit becomes invalid or overturned. Also, such a contract can require the seller to step into the shoes of the buyer / regulated party (subrogate) in the event that the regulatory agency requires a replacement credit be surrendered.

Environmental Defense Fund recommends that while CARB should assess the ability of the agency to require buyers and sellers establish the tools discussed above, such tools should not be used to remove liability from the offset purchaser / obligate party to surrender valid credits. However, by creating easy to use mechanisms that can secure replacement credits in short order, project developers can significantly reduce the chance that regulated entities will face enforcement action and can create added value for projects that carry the highest assurances that credits will be replaced if found to be invalid.

6. Conclusion

Thank you for the opportunity to comment on the wide ranging issue of bringing valid, high quality offset projects to market for use in the California cap-and-trade program. Ensuring offsets meet the highest quality standards and credits found to be invalid are replaced with ones that are valid are key objectives of Environmental Defense Fund. In addition to this letter we have attached a letter we submitted during the Scoping Plan development process. Please feel free to contact me with any concerns or questions you have.

Sincerely,



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