



restore the balance

December 15, 2010

Ms. Mary D. Nichols, Chairman
California Air Resources Board
Via web submission

RE: TerraPass comments regarding offset reporting, verification, and registry requirements

Dear Chairman Nichols and Members of the Board:

TerraPass is a San Francisco-based company whose mission is to combat climate change by enabling consumers and businesses to understand and take responsibility for their greenhouse gas emissions. TerraPass has the most projects listed on the Climate Action Reserve, and has had more projects issue credits than anyone else. We have served well over 350,000 individual and business customers, about 25% of whom live in California. We also count some of the world's largest financial institutions and multi-national corporations among our customers and partners.

We are pleased to offer the following comments of a detailed and specific nature on proposed offset reporting, verification, and registry requirements. Highlights of our recommendations include:

- Imposing a timing test for project additionality in favor of the January 1, 2007 cut-off date;
- Requiring the basic tenets of offset credit quality for offsets issued by other programs;
- Removing the January-December reporting and verification cycle for offset projects;
- Allowing two-year verification cycles in some cases;
- Clarifying the application of the 8% limit;
- Deleting the replacement ton provision in favor of using ARB's enforcement authority;
- Changing document retention timelines for verification materials to five years post-verification;
- Simplifying and clarifying the Early Action credit regulatory verification process.

Thank you for your ongoing work on the critical issue of addressing climate change, and the opportunity to comment here.

Sincerely,

Erin Craig
Chief Executive Officer
TerraPass Inc.

TerraPass Inc.

TerraPass Detailed Comments: Draft Regulation

Subarticle 4: Compliance Instruments

The following sections should refer to section 95854, not the more limited section 95995:

- Section 95820(b)(2): Surrender of offset credits shall be subject to the quantitative usage limit set forth in section 95995.
- Section 95821(e): Compliance instruments specified ...usage limit set forth in section 95995.

Subarticle 7: Compliance Requirements for Covered Entities

Quantitative Limit on Offsets – Clarity. The following two provisions concerning the offset limit are difficult to interpret taken together. We recommend that they be clarified to state that the total triennial **compliance obligation** is subject to the quantitative usage limit but that the annual and triennial **surrender obligations** are not. In other words, a compliance entity may submit, in its triennial surrender (say, 2015), a quantity of offsets equal to 8% of its total three-year compliance obligation, even if it has submitted no offsets as part of its annual compliance obligations in 2013 and 2014.

- Section 95854: The number of offset credits that each covered entity may surrender to meet its annual or triennial compliance obligation...
- Section 95856(f)(2): The total number of allowances and offset credits submitted to fulfill the combined Annual and Triennial Surrender obligations is subject to the quantitative use limit on offset credits...

Consistent with the cost-reduction purpose of offsets, **we recommend that compliance entities be permitted to surrender an unlimited number of offsets in the annual compliance surrender events, understanding that when the triennial compliance obligation is calculated, the total number of offsets credited for the three-year period will be subject to the 8% limit.** In this way, a company can minimize its economic outlay in the first two years, providing capital for investment in onsite emission reductions. Should a company's offset submittals in the first two years exceed the 8% limit over the whole period as thereafter calculated for the triennial obligation, the excess quantity of offsets would simply remain retired and the allowance surrender obligation adjusted upwards accordingly to equal 92% of the entire triennial obligation. (In such a case, the total number of offsets and allowances submitted would exceed the triennial obligation, which is a benefit to the environment; if a company chooses this route, there is no harm to the cap nor to the offset limit policy.)

Subarticle 13: Offset Credits Issued by ARB

Section 95970(b) should refer to the quantitative usage limit in **section 95854.**

Timing Test for Additionality. Section 95973(a)(2)(B) limits ARB-issued offset credits to projects with a commencement date later than December 31, 2006. The Initial Statement of Reasons notes that this

date is consistent with AB32's passage, and projects allowed as a result are more likely to have been inspired by California's global warming legislation. However, the regulation's definitions of "additionality" and "business-as-usual" specify that the project should not have occurred but for the possibility of carbon revenue, NOT that such carbon revenue must have been a result of California's actions. Indeed, such a definition would limit potential offset projects to a very small pool as the revenue from California markets is still uncertain and until about a month ago was assumed to be zero due to various legal and political threats.

We agree that a timing test should be applied to offset projects to assure additionality, but consistent with the stated definitions of additionality and business-as-usual, **we recommend that this test take the form of a time limit instead of a cut-off date.**

A time limit test examines the length of time between the project's commencement and its commitment to a carbon revenue regime. Most voluntary registries use this type of test. It has the distinct advantage of always being "current," which is to say, it provides a moving time window instead of a fixed date in time that quickly become ineffective as an additionality screen as years go by. Our earlier comments on the Early Action Projects describe how this type of test works, and makes a specific recommendation for the test language. We echo those recommendations here, and suggest that this test is a superior means of assuring additionality for all projects over time than imposing an arbitrary cut-off date.

Offset Project Designee. Section 95974 enables Offsets Project Operators to designate other entities to perform certain required duties. The capabilities and desires of an Offset Project Operator may change over time, especially the very long periods of time involved in crediting offset projects. **Therefore we recommend that an Offset Project Operator be able to designate an Authorized Project Designee at any time during the crediting period,** not only at the time of project listing.

Crediting Period Renewal. The italicized language below is unclear. Is this meant to provide a total time window of 9 months or of 27 months?

- Section 95975 (g) Timing for Offset Project Listing in a Renewed Crediting Period. The Offset Project Operator or Authorized Project Designee must submit the information in section 95975(c) for a renewed crediting period to ARB or an Offset Project Registry *no earlier than 18 months and no later than 9 months from conclusion of the initial crediting period or a previous renewed crediting period.*

Calendar-Year Offset Reporting Cycles. **Forcing offset projects into calendar-year reporting cycles places extraordinary pressure on all actors in the segment due to workload cyclicity without providing any commensurate environmental or marketplace benefit.** Section 95976(d) is the first reference to calendar date requirements for submittal of offset project data reports and verifications, so we will elaborate here.

We agree in general that frequent reporting and verification, usually annual but with some exceptions, is appropriate. And, there are numerous requirements throughout the regulation which ensure that offset project data is reported on a frequent, uninterrupted basis. We do not believe there is any further benefit to forcing reporting and verification tasks into an identical January-to-December cycle. For example, the ARB and Covered Entities will have identical information regarding the availability of offset credits whether they are verified on a calendar year basis or on an annual basis with arbitrary start and end dates. Registries can still submit annual audit documents.

Therefore, we recommend that all references to calendar dates be removed, in favor of relative dates pegged to the last day of the monitoring period. Using this framework, section 95976(d)(6) would read: “All Offset Project Data Reports are due 91 calendar days after the last day of the project’s monitoring period.” Similar changes would be required to several other sections. Here are some examples: 95977(b) – simply end the section after the word “annually” in the first sentence; 95977(c) – eliminate reference to calendar year; 95977(d) – change dates to relative timeframes; 959857(b)(2)(E) – use the phrase “monitoring period” instead of “year.”

Document retention Section 95976(e)(2) sets document retention limits relative to a project’s crediting period. This creates a long and uneven, variable document retention policy. For example, much of a project’s documentation results from verification and monitoring work. A project with a 10-year crediting period would be required to retain some documents for 15 years, and other documents of exactly the same type, sensitivity and implication, for only five. Variable retention policies are very difficult and relatively expensive to implement. Since the standard makes clear that five years is a sufficient timeframe to retain verification documents, **we recommend that retention of all monitoring and verification records be limited to five years after the issuance of the relevant verification opinion.**

Interim data collection methods. Section 95976(f)(1)(A) allows Offset Project Operators to apply to ARB for interim data collection method approvals in the case of unexpected equipment failure. However, this approval mechanism is limited to incidents which may result in the loss of at least 20% of a project’s annual emission reduction volume; another way to think about this, is that projects must be at risk of losing at least 73 days of data to be able to apply to ARB for a substitute/interim data collection procedure.

We recommend that this loss threshold be lowered to 8%, or about 30 days of data. It does not seem equitable that projects with major equipment problems have special procedures available to them while projects with lesser but still material data loss challenges do not have such rights. We believe this lower threshold better balances the workload implications for ARB with the capability of project operators to address equipment failures in a timely manner.

Annual verification exceptions. Section 95977(b) specifies that non-sequestration offset projects be verified annually. In general, we support imposing annual verifications. However, certain projects – indeed certain project *types* – result in offset projects which produce very few offset credits each year, and for these projects annual verifications are a significant cost burden. For example, TerraPass works with many agricultural methane projects which produce fewer than 7500 credits per year; annual verifications impose a project cost of \$1-2 per ton, just for the verifier, for a 7500 ton project. These projects have many co-benefits – for example, they tend to be run by small business concerns or be publicly owned. **For these small projects TerraPass recommends that the regulation provide flexibility to allow less-frequent verifications** while maintaining annual monitoring report submissions. This flexibility could be provided in a several different ways:

A sentence could be added to 95977(b) which carves out an exception if such exception is written into the Compliance Offset Protocol – *“The verification of GHG emission reductions... must be performed annually unless otherwise allowed by the Compliance Offset Protocol.”*

A blanket exception for small projects could be written into the regulation: *“The verification of GHG emission reductions... must be performed annually unless the Project’s submitted*

Monitoring Report shows that the project produced fewer than 10,000 metric tons of emission reductions during the relevant Monitoring Period. In such cases, the Project Operator may choose to forego one verification and complete a two-year verification the following year. In no case shall a Project which opted for a two-year verification be awarded more credits for its first year than its Monitoring Report estimated.”

Offset verification time limit. Section 95977(d) sets a nine-month time limit for the submission of verification statements after the monitoring period’s completion. While we agree that in general this should allow sufficient time to complete a verification, there can be incidents which significantly derail the verification process and which are beyond the control of the Offset Project Operator or even the verifier. Examples include: loss of critical Verification Body staff due to turnover, illness, or untimely death; lengthy delays in obtaining documentation or opinions required from a regulatory agency, product manufacturer, previous project owner, or anyone else without a material interest in the project’s timely verification; process bottlenecks including, especially, internal review processes at verification bodies if there is a calendar-year verification cycle for all projects.

To accommodate these unusual circumstances, **we request that the ARB allow one-time extension requests to accommodate situations where the Offset Project Operator has acted diligently and in a timely manner yet cannot meet the deadline.**

Verification site visits. To accommodate the possibility of two-year verification cycles as requested above for small projects, we recommend modifying the language of Section 95977(e)(2)(C)(iv) to require a site visit with every verification, though not to be interpreted as a requirement for site visits more frequently than once per year.

Process for Issuance of Offsets. Generally, section 95981 lays out two different processes and two different timelines for issuance of offsets, depending on whether the project was submitted to the ARB or submitted to an offset registry approved by the ARB. We question why the process has different timelines if the approved offset registry’s processes have already been approved by the ARB. Second, the timelines seem unreasonably long. For example, taking more than six weeks to review a submitted verification statement; more than two weeks to notify an offset project operator that a credit has been issued (we would expect this to be instantaneous with issuance, by software); and three weeks to issue a credit once a determination has been made that an issuance is appropriate. We would expect the administrative process of issuance to take at most 5 calendar days.

Note also, subsection (f) switches to “working days” when all other date references in the section are “calendar days.” Finally, the language in this section and in section 95982 use the words “transfer,” “issue” and “register” seemingly interchangeably so it is not clear whether there is a meaningful distinction which we are missing.

Invalidation of voluntary offset credits. Section 95985 (d) makes reference to the actions ARB will take if a retired or surrendered offset credit is found to be invalid, including actions ARB will take if such credit has been retired under a *voluntary* program. The ARB has no authority over voluntary programs (with the possible limited exception of opt-in participants to the ARB regulatory program), so the requirements and enforcement provisions listed here as pertaining to voluntary program retirements should be deleted. Instead, the ARB should commit to notifying the retiree of the voluntary program credit’s invalidation so that the retiree may take appropriate private action with the voluntary program

authority. Of course, the ARB's general enforcement authority, which is separate from the obligations imposed here related to replacement tons, remains in force as allowed by statute.

Invalidation and replacement of compliance credits. We have serious concerns with the offset credit replacement provisions included in this section. As a point of background, we believe that **the economic burden imposed by a replacement ton provision greatly exceeds – by more than an order of magnitude – the economic burden imposed by typical ARB enforcement proceedings.** For example, if a project's verification is reversed because the verification data was found to be wrong or inaccurate (e.g., using incorrect weather data on a dairy project), the economic burden of replacing those tons will be in the hundreds of thousands of dollars. Furthermore, it is unlikely that any individual entity within the chain of responsible parties received economic benefit at a level anywhere close to the cost of replacement tons. Also, we note that the replacement provision is in addition to ARB's ordinary enforcement authority and ability to levy penalties.

When addressing non-sequestration projects where credits cannot be physically reversed, we have two categories of conduct which might result in credit invalidation. First, we have human error – by the ARB, the verifier, the Offset Project Operator, the Offset Project Designee, or other parties; second we have intentional misrepresentations or fraud. The replacement provision, which as noted above is far more punitive than ARB's enforcement practice from an economic standpoint, treats these behaviors as equal. We believe that **human error should be treated as error, and if the ARB chooses to conduct an enforcement action against the responsible party they should do so, but without imposing a replacement ton provision.** If they choose to do so, the ARB's enforcement division could establish fines based on the cost of replacement tons. Alternatively, the ARB could establish a small non-sequestration buffer pool to cover non-fraudulent actions while maintaining the integrity of the cap, and use its enforcement authority to deter such error.

In cases of fraud or other intentional misconduct, we recommend that the ARB use its full enforcement authority and levy fines which are at least sufficient to replace the invalidated credits.

In neither of these cases is a provision in the regulation that requires replacement of the tons necessary. We recommend deletion of all reference to this requirement.

Requirements of Offset Project Registries.

- Section 95986 uses the term “registration” and “registered” in a context that does not refer to offset credits (See for example (c), (c)(3)(A). Given the specific use of this term to refer to offset credits in other parts of this Section, as well as other parts of the regulation, we suggest that a different term be adopted for the approval of offset project registries.
- Section 95986(c)(3)(C) requires that a registry possess a repository of ownership information of all offset credits it issues, including prices and counterparties. While it may be important for the ARB to understand the transaction prices of compliance instruments, it is not important or relevant for the ARB to understand or require a registry to track prices of credits which are being sold for voluntary retirement; which do not meet the ARB's requirements for compliance credits; or which otherwise are unrelated to the ARB program but are nonetheless registered on a registry which has been approved by the ARB.

It is unclear whether the ARB expects approved offset registries to shut down their voluntary programs; expects them to run parallel but separate registries; or expects them to treat all credits and recordkeeping as if they were compliance instruments even if they do not qualify or are not being transferred. **Imposing regulatory recordkeeping and disclosure requirements on the voluntary market will significantly dampen this market's contribution to mitigating climate change and should be avoided.**

- Concerning transaction prices, we have concerns with the simplicity of this requirement when compared to the types of transactions common in the secondary compliance instrument marketplace. Forward sales, partial pre-pays, derivative such as options, the associated transaction credit and insurance requirements and other factors make determination of “price” less than straightforward. At the same time, these transactions create the capital to originate projects, increase liquidity and help limit market volatility. Also, many buyers keep prices confidential as sensitive business information; it is not clear how the ARB would handle this sensitivity. Limiting price discovery to instruments already registered on the ARB registry may alleviate the complexity somewhat.
- 95987(b)(1)(F) requires an offset project registry to publish a project's Commencement Date at the time of the project's listing. We have found that the Commencement Date identified at project Verification can differ from the Commencement Date submitted at listing – in either direction. This usually results from the unearthing of superior documentation of project commencement than was available at listing. There is no conflict or issue with including the date at listing, provided that the ARB recognizes that this date may change with the first verification.
- We recommend changing the record retention time for section 95988 to five years after the verification statement is issued, as noted above.

Subarticle 14: Recognition of Compliance Instruments from Other Programs

Requirements for compliance instruments. **This subarticle fails to require fundamental tenets of quality for offset credits: real, additional, quantifiable, permanent, verifiable and enforceable. This oversight should be corrected.** Please see our earlier comments regarding a timing test for additionality, including a test applied to all projects which commenced prior to 1/1/2007 if not all projects without exception.

Use of the CAR Protocols for Early Action. Under Section 95990(b), it is not clear as to whether a project must simply use the CAR “offset quantification method” or whether the project must also successfully list and register credits as CRTs on the CAR Registry. Given that the CAR Registry does not currently have the capabilities listed in 95990(c) nor the capabilities listed in 95986(d), it is not obvious how projects using these protocols qualify under this section. Clarifying language should be added.

Registry requirements for price tracking. Please see comments regarding price tracking above. Note also that no current voluntary registries have the capability to track price.

Re-registration of Early Action projects with ARB. As currently constructed, projects which commenced after December 31, 2006 but before January 1, 2012 have several choices: they may use CAR protocols

and processes to receive credits, subject to regulatory verification on top of CAR verification; they may register with the ARB instead; or they may switch from CAR to ARB at some point in the next two years. Several questions arise for these cases:

- If a project chooses to register directly with the ARB and forego any CAR processes, how will the ARB handle credits which are created prior to finalized processes for listing, verification, and issuance? For example, if a project commenced in 2009 and the ARB's registry is not available until the end of 2011, what are the implications for the 2009 and 2010 credits? Are they unavailable because the ARB requires annual verifications?
- If a project chooses to switch its registration to ARB from CAR, does its crediting period re-set at that time, and if so does that re-set count as one of its allowable renewals?

A guidance document or other process guide which clarifies these issues is needed.

Regulatory verification of offset credits for early action. We urge the ARB to provide a simple process for this requirement. As currently proposed, the process is unwieldy; for example, offset credits from a single project's historic vintages are now likely to be owned by many unrelated parties who therefore separately bear the responsibility of reverification. This situation is likely to result in a great deal of duplicate and wasted effort. Similarly, operating projects have ongoing verifier site visits associated with current-vintage verifications. Can these visits, indeed the entire verifications, be combined with current CAR verifications so as to prevent site visits which are duplicative and hence add no value to the regulatory level of assurance? Can a centralized opt-in process for reverification of historic vintages be arranged?

How will the timing requirements and restrictions discussed in sections 95976 and 95977 be applied to reverifications, and to ongoing CAR and/or regulatory verifications of Early Action projects, if at all?
