The ClimateTrust®

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Clerk of the Board
Air Resources Board
1001 I Street
Sacramento, CA 95814

Comments to the California Air Resources Board re: Cap and Trade Program Rules

Thank you for providing The Climate Trust with the opportunity to submit comments regarding the California Air Resources Board's cap and trade program rules. We sincerely commend the Air Resources Board (ARB) for its pioneering leadership in greenhouse gas emission reduction policy.

The Climate Trust is a 501(c) (3) nonprofit organization headquartered in Portland, Oregon. Our mission is to provide expertise, financing, and inspiration to accelerate innovative climate solutions that endure. The Climate Trust was created in 1997 in response to the United States' first regulation of greenhouse gases (GHG) under the Oregon Carbon Dioxide Standard. The Trust solicits, negotiates, and contracts to purchase carbon credits on behalf of regulated utilities, businesses, and governments. We have over 10 years of experience, investing more than $16 million into numerous high quality GHG reduction projects in nine states and nine sectors.

As a pioneer in the carbon market, The Climate Trust offers a unique perspective to comment on ARB's proposed rules. These comments focus on the use of offsets and early action credits under the proposed cap and trade program to support a fluid, market based mechanism to move the Western region towards a low carbon future.

1. Invalidation of issued offsets and the current designation of liability will interfere with the development of an efficient and cost effective offset market

The primary focus of the ARB rules related to offsets should be on rigorous verification and certification standards to ensure that only quality credits enter the market. If stringent requirements are established, the need to invalidate credits would be rare. The Trust believes that ARB has set up strict rules to ensure that only high quality credits are used to meet compliance obligations. In unusual situations where offset credits must be invalidated, a straight forward, efficient method of replacing the credits should be made available.

One of the driving forces for the rise of standards and certifications was to take the risk out of purchasing credits by creating accepted protocols and verification standards. As stated above, ARB should establish appropriate verification and subsequent certification standards to ensure that only quality credits enter the market. Once credits are certified by ARB, invalidation of the credits should be an extraordinary occurrence. However, if ARB finds it necessary to retain the option of invalidation, a buffer account should be established for all credit categories, similar to the buffer account for forestry projects. For example, ARB could implement an insurance pool where a small part of allowances and/or credits are banked and set aside only to be drawn upon in the event that an extraordinary reversal cannot be otherwise resolved.

The buyer liability approach set out in the draft rules does not efficiently address the problem of invalidated credits. Under ARB's proposed rules, the holder or user of a credit is presumptively liable. If that party is no longer in business, ARB will require the Offset Project Operator or Authorized Project Designee to replace the invalidated ARB credits. The Trust recommends that the Authorized Project Designee be removed from this requirement. The Authorized Project Designee is defined in section 95802(a)(21) as "an entity authorized by an Offset Project Operator to act on behalf of the Offset Project Operator". There are many situations where the Authorized Project Designee has no connection with the actions that lead to invalidation. One obvious example is where the discrepancy is due to intentional acts of the verifier, or project registry.

While ARB has asserted that the various entities can manage their risk through appropriate contracts, the reality is that the credits frequently go through a chain of ownership that would have to be unraveled in order to determine contractual liability upon invalidation. Many small businesses would avoid this situation and the offsets market would be composed of contracts between large corporations able to bear such liability, thus creating inequity in the market and limiting credit supply.

2. The process for invalidation of credits should be carefully constructed with a limited horizon

The Trust recommends that ARB limit the time frame for invalidation of credits to the earlier of the eight year statute of limitations, or the second verification of credits, whichever comes first. According to the proposed rules, ARB considers the validity of credits to be convincingly established after five years if a second verifier has not identified any grounds for invalidation as set forth in section 95985(b)(6). The Trust believes there is no reason to wait five years; ARB should accept a second verification as the final point for any potential invalidation.

In addition, The Trust urges ARB to modify the provisions under which offset credits may be invalidated. Currently, these include four conditions:

- information that is not "true, accurate, or complete" (Section 95985(b)(1))
- documentation that contains errors whereby emission reductions are overstated by 5% or more (Section 95985(b)(2))
- the project did not meet applicable legal requirements (Section 95985(b)(3))
- the credits have been issued in another program (Section 95985(b)(4))

The Trust respectfully requests that ARB eliminate the first condition ((b) (1)). In the Trust's experience, given the breadth of requirements of the regulations, it is foreseeable that some projects will have documentation with unintended inaccuracies or omissions. Furthermore, under the rule as written, it appears ARB could invalidate all of the credits from the project rather than just the credits affected by the inaccuracies. This is an overly broad and punitive solution. ARB should limit the liability from "overstatement" to the extent of the overage.

3. Quantitative limits on the use of offsets may prevent cost effective greenhouse gas reductions

As long as ARB has rules in place to ensure that offset credits are high quality, there is no reason to implement artificial limits on their usage. ARB should be encouraging investment in projects and should understand the long time horizon required for planning and investing in projects. Limits on the use of offsets will serve to inhibit investment and create uncertainty regarding the monetization of the carbon reduction portion of the projects. If ARB believes that a limit is needed on the use of offsets, the Trust recommends that ARB extend the time period for the quantitative limit to the full length of the program (from 2013-2020). This allows a maximum number of years for a compliance entity to invest in projects, or purchase offset credits in the market, in an efficient and cost effective manner.

4. The procedures for transitioning Early Action Offset Credits need tightening and clarification

The process set out in the rules for transitioning early action credits to ARB verified offsets remains burdensome and clunky. A few particular comments follow:

- Section 95990(d) should be modified to allow holders or owners of early action credits to register with ARB in addition to Offset Project Operators and Authorized Project Designee.

- Sections 95990(h) (5) (A), (B) and (C) should be tailored more narrowly to the statements each of these entities would be competent to make about the status of projects and credits. For example, an Authorized Project Designee may not be able to attest to how the credits were measured since this is the responsibility of the verifier.

In general, the Trust has concerns that the process for accrediting early action credits and transitioning them to ARB certified credits remains burdensome and confusing. A smoothly functioning system that takes into account the realities of the state of the carbon market, and the fact that the credits have already been verified, will reduce the uncertainty around the transfer of Climate Action Reserve Tonnes. This is necessary to ensure that more projects seek credit for early action and to enhance liquidity early in the compliance periods, thereby reducing the costs of the program.