



August 11, 2011

Via Electronic Submission

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: Proposed Modifications to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Chairman Nichols and Members of the Board:

The Carbon Offset Providers Coalition (“COPC”)¹ appreciates this opportunity to provide comments on the California Air Resources Board’s (“ARB’s”) Proposed Modifications to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (the “Regulation”). COPC commends the ongoing leadership of CARB and its staff to address global warming. In general, we strongly support the State’s development of a cap-and-trade program and believe that ARB has thoughtfully developed a program that will reduce greenhouse gas (“GHG”) emissions and help the State to meet its mandated emission reduction targets under AB 32. That said, there are a number of important provisions in the Regulation and the Proposed Modifications relating to offsets that require further change if the cap-and-trade program is to be workable and thereby meet AB 32’s mandated GHG emission reductions. We offer the following comments in an effort to improve the Regulation and enable California to meet these goals.

1. COPC Supports the Inclusion of a Cap-and-Trade Program in the AB 32 Scoping Plan.

While these comments are addressed to the Proposed Modifications to the Regulation, we wish to comment briefly on the Board’s consideration of ARB’s recent Supplement to the Functional Equivalent Document (“FED”) prepared for the AB 32 Scoping Plan in accordance with the California Environmental Quality Act (“CEQA”). We encourage the Board to approve the FED with the Supplement and to approve the Scoping Plan itself. ARB’s use of cap-and-trade as but one of its tools to implement AB 32 is well-supported in the FED Supplement’s expanded alternatives

¹ COPC is a coalition of leading companies in low-carbon and clean technology investments, representing hundreds of clean infrastructure projects, millions of tons of greenhouse gases (“GHGs”) reduced, hundreds of green jobs, and millions of dollars in economic benefit for local and regional communities at project locations in the U.S. and abroad. COPC regularly comments on federal, state and regional regulatory efforts to address climate change, and particularly those that may affect the markets for carbon emission reductions — also known as offsets. More information on COPC and its members is available at www.carbonoffsetproviders.org.

analysis. We note that under the Scoping Plan, only approximately 20% of the State’s GHG emission reductions are to come from market-based mechanisms, yet these mechanisms are critical to the Plan’s strategy to meet AB 32’s emission reductions mandate.

More specifically, a viable and robust offsets program is critical to the success of ARB’s cap-and-trade program. Offsets deliver necessary cost containment and early investment in clean technology, carbon-reduction infrastructure, and green jobs. A robust supply of offsets is essential to delivering these, particularly the cost containment element. In the context of what ARB has recognized is a “severe and prolonged economic downturn” (ARB’s Status of Scoping Plan Recommended Measures, July 22, 2011), it is imperative that there be a robust supply of quality offsets to mitigate the cost of complying with the many requirements of AB 32.

ARB’s own March 24, 2010 economic analysis confirms this. ARB modeled the regulations under a scenario in which no offsets could be utilized and compared the results with the baseline case in which offsets are utilized to the full 8% limit. ARB’s modeling concluded that the “no offsets” scenario would yield allowance prices in 2020 that would be \$108 higher (\$148/ton instead of \$30/ton) — resulting in \$18 billion more in costs in that year alone.² Such costs would cripple the launch of California’s cap-and-trade program.

In addition to serving as a critical cost containment mechanism, offset projects achieve GHG emission reductions *now*. Millions of tons of GHGs have been reduced over the last 15 years in the U.S. through the voluntary offsets market. This practical, on-the-ground experience from thousands of projects has resulted in the development of clean technology and carbon-reduction infrastructure — not to mention green jobs. This experience can be deployed quickly to create a pool of low-cost GHG emissions reductions for covered facilities under the Regulation, thereby promoting many of the goals of AB 32.

2. “Buyer Liability” is not a Workable Approach to Address Post-Issuance Problems with Offsets.

We have strong concerns about ARB’s “buyer liability” approach to addressing situations in which problems are identified with offset credits at some point after issuance. (See generally § 95985.) The risk of such post-issuance problems is very small due to the rigor of the ARB offset regulations. However, *any* policy under which already-issued offset credits carry the risk that they may be invalidated will prevent the development of a market in offsets.

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² “Updated Economic Analysis of California’s Climate Change Plan,” Staff Report to the Air Resources Board (March 24, 2010) at ES-7 (Table ES-2).

a. The Buyer Liability Approach is Neither Fair Nor Efficient.

In the case of offset discrepancies, it almost certainly will be the offset project operator, verifier, or offset project registry that is at fault. All of these parties are subject to ARB enforcement, as each must affirmatively submit to ARB's jurisdiction in order to participate in the program. Yet, under ARB's proposed buyer liability rules, it is the holder or user of a credit that is presumptively liable for any discrepancy. This arrangement turns fairness on its head.

The approach also is highly inefficient. To be efficient, a liability system should impose liability on the party that has the most information and ability to control performance. Most covered entities do not have any special insight into methane digesters, ozone-depleting substances, or forestry, and it will be costly for them to double-check the quality of the offset credits. In an offsets program, covered entities should be able to will rely on the work of verifiers — and on ARB itself as credit issuer. For this reason, making covered entity buyers liable for problems not detected through the regulatory system will impose substantial new costs on buyers without materially reducing the risk that such problems will occur.

ARB has suggested that buyers can easily manage their liability risk through contracts. This is simply not consistent with marketplace realities. A viable offsets program will involve the participation of many buyers and sellers — including aggregators that mediate between smaller covered entities and offset project operators. A buyer liability rule would unleash a chain of potential contractual claims involving every party that ever held custody of the credit. Aggregators and small businesses will avoid such a market — leaving a stunted offsets program involving only bilateral arrangements between the largest covered entities and the largest offset projects. Small businesses and small projects will fall out of the equation.

b. The Buffer Account Approach Should be Applied to All Offsets.

The Regulation includes a buffer account to address post-issuance problems associated with forest offset projects. We strongly urge ARB to apply the approach of this Forest Buffer Account to all offset projects. This approach would be just as effective at ensuring the integrity of the program as the buyer liability system, as it would ensure that the system would be made whole in the event of invalid credits. It would be easier for ARB to manage, as it would need only to withdraw credits from the buffer account in order to make the system whole. There would be no need to make demands upon an unlucky (and unhappy) user of credits that have been invalidated after issuance. It also would be far more fair, as it would hold “bad actors” liable where possible rather than unlucky purchasers of credits. The buffer account's approach of a system-wide backstop would enable the market as a whole to manage the risk of post-issuance invalidation in an efficient manner that also would be more effective and more fair.

Applying this buffer account approach to all offset projects would not impose unreasonable administrative or risk burdens on ARB. The primary role of ARB would be to determine the portion of offset credits to set aside in the account. As the risk of invalidation is extremely low due to the

rigor of ARB’s program leading up to issuance, we believe the set-aside would be quite conservative. However, ARB would have the ability to increase the amount of the set-aside if the buffer account runs low. Finally, as noted above, in the event of invalidation, ARB need only withdraw credits from the account to make the program whole. The account requires no active management — and no need to make demands on the unlucky holders of invalidated credits, demands that may well be contested.

3. **Specific Modifications Should be Made to the Invalidation Rules to Improve Fairness and Efficiency.**

Regardless of the liability approach ARB adopts, it is important to ensure that the process for offset credit invalidation are well designed. We appreciate many of the modifications that ARB has proposed to the invalidation procedures. However, we urge ARB to consider the further modifications outlined below.

- ***Modify the “Statute of Limitations.”*** ARB has proposed to shorten the period of time during which an offset credit is subject to invalidation from eight years to five. See Section 95985(a). We urge ARB simply to allow the invalidation period to expire upon the date of ARB’s acceptance of the second verification, regardless of when that occurs. It is that second verification that will provide the final measure of assurance regarding the credit’s validity. There is not need to require a credit be subject to a further arbitrary period of five years during it which would be subject to invalidation — and thus unmarketable.
- ***Modify the Conditions for Invalidating Credits.*** We appreciate ARB’s proposal to modify section 95985(b) to specify the conditions under which offset credits may be invalidated. As now proposed, subsections 95985(b)(1)-(4) establish four conditions under which offset credits may be invalidated: (1) the project information is not “true, accurate, or complete”; (2) the project documentation contains errors such that emission reductions achieved by the project are overstated by 5% or more; (3) the project did not meet all applicable legal requirements; and (4) a finding that credits already have been issued for the project in another program.
 - ***Eliminate the Catch-All Condition.*** We respectfully suggest that ARB eliminate subsection 95985(b)(1). Given the myriad requirements of the offset regulations, any number of projects will have documentation that has inadvertent inaccuracies or omissions. Yet, under this new provision, a minor paperwork problem could result in invalidation of 100% of the offset credits already issued for a project — even if there was no impact on the reductions or removals actually achieve by the project. Any discrepancies that do have material effects on the environmental integrity of the project are addressed by subsections (b)(2), (3), and (4).

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- ***Tailor the “Overstatement” Condition to the Actual Invalidity.*** We respectfully suggest that ARB modify subsection 95985(b)(2) relating to “overstatement” to tailor it to those credits actually impacted by the overstatement. In the event that an offset data report overstates emission reductions achieved by a project, ARB should invalidate only an amount of credits that corresponds to the overstatement. As currently proposed, ARB would invalidate *all* credits associated with the report, even the credits that correspond to real emission reductions.

4. **Improve the Process for Accrediting Early Action Offsets.**

ARB has proposed to modify the rules for creating early action offset credits to now include the process for converting early action credits into ARB-issued offsets. We welcome the intent of this proposed modification, though we are concerned that the process for accrediting early action credits and transitioning them to ARB-certified offsets is still too administratively burdensome. We propose a number of specific additional modifications to help ensure a smooth transition mechanism, and thus encourage more projects to seek credit for early action. This will help to ensure that more valid emission reductions are transferred from the voluntary market to California’s compliance market, which is important given that ARB and most analysts currently predict that there will be a shortage of offsets in the early period. Our proposed minor modifications are listed below.

- ***Expand the Scope of those that can Register the Early Action Credits.*** Section 95990(d) requires an Offset Project Operator or Authorized Project Designee for an early action offset project to register with ARB in order for compliance offset credits to be issued. We recommend that this be modified to allow holders of early action offset credits to register with ARB in case the project operators or authorized designees do not do so.
- ***Eliminate the Burdensome Attestation Requirements.*** Sections 95990(h)(5)(A), (B), and (C), require the Offset Project Operator, Authorized Project Designee, or each holder of the early action credit seeking issuance of ARB offset credits to attest in writing that (A) the reductions/removals have been measured in accordance with the appropriate early action offset protocol and that all information submitted to ARB is true, accurate and complete; (B) its participation in the Program is voluntary and subject to ARB’s regulatory requirements and subject to ARB’s exclusive jurisdiction to resolve any and all disputes; and (C) it acknowledges the need to fulfill all applicable local, regional, and national regulatory requirements that apply to the offset project — in essence, attesting to the offset project’s regulatory additionality. We have no objection to the second of these, subsection (h)(5)(B), provided that it can be extended to any holder a credit that may seek to register it per our first proposed modification. However, the other two attestations, subsections (h)(5)(A) and (C), are properly within the purview of the verifiers. We respectfully recommend that these attestations not be required of the project operator, designee, or holder of the early action offset credit seeking to register them with ARB as compliance offset credits.



5. Expand the Eligible Domestic Offset Credits.

As noted above, ARB and most analysts have predicted that there will be an insufficient supply of offsets, particularly during the first compliance phase. A shortage of offsets threatens the viability of the entire program. Just as ARB's "no offset" model showed a huge increase in the cost of the program, a program with an anemic supply of offsets also will increase the costs to levels that would threaten the viability of the entire program. Yet ARB has not proposed to add any new compliance offset protocols nor added to the list of projects eligible for early action credit. We strongly recommend that ARB explore additional paths for generating offset credits.

Of course, the best way to expedite the development of compliance offset protocols is to adapt the high quality ones that exist today in the voluntary market. We strongly encourage ARB to consider the protocols developed by such carbon project standards organizations as the Climate Action Reserve ("CAR"), the Verified Carbon Standard, the American Carbon Registry, and the Gold Standard. For new compliance protocols developed in this way, the projects developed in accordance with the forerunner voluntary protocols ought to be made eligible for early action credit — as is now the case with ARB's four existing compliance protocols. Not to do so would violate AB 32's mandate that "appropriate credit" be given to voluntary early actions. Cal. Health & Safety Code § 38562(b)(3).

We thank ARB for this opportunity to submit these comments, and we'd be happy to provide additional information. To that end, please feel free to contact COPC's California representative at Beveridge & Diamond, PC, Nico van Aelstyn, at nvanaelstyn@bdlaw.com and (415) 262-4008.

Sincerely,

A handwritten signature in black ink that reads "Roger Williams" followed by a stylized flourish.

Roger Williams, Chairman
CARBON OFFSET PROVIDERS COALITION

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COPC Members

