

September 27, 2011

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

Submitted electronically

Re: Comments on the second notice of modified California cap and trade regulations

The Verified Carbon Standard Association (VCSA) welcomes the opportunity to offer a second round of comments on the modified text of ARB's Proposed Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation. We appreciate the continued effort demonstrated by the Board and its staff to develop and refine a market-based set of rules to cost-effectively reduce greenhouse gas emissions.

Founded in 2005 by The Climate Group, the International Emissions Trading Association, and the World Business Council for Sustainable Development and the World Economic Forum, VCS is one of the world's leading voluntary greenhouse gas (GHG) emission reduction programs with over 60 million Verified Carbon Units (VCUs) issued from more than 500 projects registered worldwide. VCSA is eager to assist in the development of a robust and efficient California cap and trade program. We have many years of experience in building a strong, coherent and well-respected global GHG emission reduction program and would like to share our experiences and insights. More information about VCSA and the VCS Program can be found on our website at www.v-c-s.org.

VCSA offers the following comments and recommendations recognizing the considerable work and leadership taken by ARB staff in crafting a complex and comprehensive rule. Furthermore, we offer the following in the spirit of support for and a desire to contribute to a program that is fair, transparent and administratively efficient.

VCSA notes that, despite our earlier recommendations and similar recommendations provided by other parties, the proposed rule makes no provision for a defined mechanism by which ARB will receive and consider offset methodologies developed and/or presented by third parties for approval as compliance offset protocols and/or early action offset project protocols. We believe that the absence of a defined mechanism is not in the public interest as it enables a closed non-transparent process that can result in unequal treatment being given to project and methodology developers seeking consideration by the Board. By limiting the opportunity for third parties to submit protocols for consideration, the absence of a defined submission mechanism does not serve ARB's own interest in executing the most administratively efficient program. Moreover, failing to provide clear guidance regarding the parameters that offset protocols must follow risks establishing a system that is inconsistent across project types. Accordingly, we urge staff to reconsider our earlier recommendations as follows.

1) Recognition of early action offset credits

VCSA is pleased to see that the criteria for approval of early action offset credits issued by early action offset programs (Section 95990 (c)) now includes a place holder for GHG reductions or enhancements that result from the use of "additional early action offset project protocols" (i.e., protocols other than the four protocols already approved by ARB) (95990(c) (5) (E)). Expanding the list of eligible protocols will encourage more projects to seek credit for early action and, as a consequence, will enhance liquidity and help contain the cost

of compliance early in the program. This is especially important given the possibility that the supply of offset credits issued under the four approved protocols may not meet demand.

The modified draft rule, however, does not identify a mechanism for how additional protocols will be considered and added to the list of existing eligible early action methodologies. To truly facilitate the development of an adequate pool of early action credits, more clarity must be provided for how early action protocols can be brought forward for consideration and approval.

- **RECOMMENDATION:** Amend Section 95990 to include a provision that describes a transparent process that ARB will employ to receive, evaluate and approve additional early action offset protocols.

2) Approval of new compliance offset protocols

The modified draft rule provides no formal path for submitting methodologies for review, evaluation and approval by ARB. An open, transparent process for receiving, reviewing, evaluating and approving offset methodologies provided and/or developed by third parties is a necessary signal for the market to continue developing protocols (and projects) that will provide the offsets necessary for effective cost-abatement.

- **RECOMMENDATION:** ARB should establish an open and defined mechanism through which offset project developers can submit new project types and methodologies for consideration. VCSA suggests that ARB consider adopting a process similar to that employed by the Australian Department of Climate Change and Energy Efficiency for inviting parties to submit methodologies for review and approval under that country's forthcoming Carbon Farming Initiative. Details about that submission process can be found at <http://www.climatechange.gov.au/government/initiatives/carbon-farming-initiative/methodology-development/methodology-guidelines.aspx>

3) Eligible offset project types

VCSA notes that, with the exception of the placeholder language in Section 95990 regarding early action offsets, the modified draft rule still limits the number of offset protocols eligible for use in the California cap and trade program to the four project types already approved. Such a limitation places an unnecessary constraint on the market, stifling innovation, creating uncertainty among project developers and investors, and ultimately limiting the cost containment benefits that offsets offer to a cap and trade system. There exist a number of established carbon offset standards that have significant standing in the domestic and international carbon markets that stand as ready sources of protocols for ARB's consideration.

- **RECOMMENDATION:** ARB should initiate an open, transparent process for evaluating and approving protocols from established, high quality carbon offset standards prior to the 2013 implementation of the cap and trade program.

OTHER RECOMMENDATIONS

4) Financial standing requirements for Offset Project Registries

Given the central role that registries play in ensuring the environmental and financial integrity of an emissions reduction and trading program, it is important that the providers of registry services are themselves technically capable, financially sound, and managerially competent entities. VCSA believes that the requirements for Offset Project Registries outlined in the proposed rule are not robust enough for purposes of establishing the sound, long-term functioning of the offsets program. For its own program, the VCSA requires its registry service providers to meet strict financial standing requirements (including, for example, more extensive insurance coverage than required by ARB and minimum net asset requirements), and have in place insolvency protections and conflict of interest policies (including prohibitions on proprietary trading of carbon instruments) that go beyond the requirements indicated in the modified draft rule. We suggest that ARB establish similar standards.

→ **RECOMMENDATION:** Amend Section 95986(c) to include requirements that Offset Project Registry applicants meet more robust financial standing standards similar to those established by VCSA for its registry service providers. Annex 1 to this letter provides a summary list of the requirements set out by the VCSA as part of the RFP issued for VCS registries.

5) Standardized methods

VCSA notes that Section 95972(a)(9) of the modified draft regulation text has been redrafted to clarify “standardized methods.” VCSA has recently issued for public comment draft requirements for two specific approaches for standardizing the determination of baselines and additionality. The two methods are performance methods and activity methods. Performance methods set performance benchmarks, or metrics, for determining additionality and/or the crediting baseline. Project activities that meet or exceed a pre-determined level of the performance metric (e.g., a given level of CO₂e emissions per unit of output) may be considered additional, provided they also meet other qualifying criteria). A performance benchmark can also serve as a baseline for crediting GHG emission reductions and removals. Activity methods use a positive list to pre-determine additionality for given classes of activities. Project activities may qualify for a positive list if they are not financially viable without carbon finance, have no revenue streams other than carbon finance, or have low rates of adoption in the marketplace. An activity that qualifies for a positive list is automatically deemed to be additional.

The draft requirements are the product of a VCS-convened expert committee comprised of individuals representing a broad range of stakeholders knowledgeable in the effective functioning of GHG programs including methodology and project developers, environmental non-profit organizations, GHG program regulators, validation and verification bodies, and businesses.

→ **RECOMMENDATION:** VCSA would be happy to schedule a briefing specifically for ARB staff to discuss the relevance and applicability of its work on standardized approaches to the California offset program design.

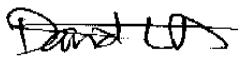
6) Offset project location requirements

The four compliance offset protocols included in this rulemaking specify, in general, that all eligible projects must be located within the United States. This requirement appears to be in conflict with the principle of reciprocity announced by the Western Climate Initiative (WCI), of which the State of California is a partner. Under that principle, offsets issued by one WCI Partner Jurisdiction will be recognized and accepted for compliance in all other Partner Jurisdictions. As the ARB protocols are currently written, it appears that a project following one of the ARB protocols, but undertaken in a Canadian Partner Jurisdiction, could not be issued compliance offset credits in California.

→ **RECOMMENDATION:** Clarify the ARB offset protocol requirements to ensure that projects following those protocols but undertaken in jurisdictions with which California has linkages will be eligible for recognition in California.

Thank you again for the opportunity to provide input to this important regulation. Should you have any questions, please do not hesitate to contact me by telephone (+1 202 296 1427) or email (dantonioli@v-c-s.org).

Sincerely,



David Antonioli
Chief Executive Officer

ANNEX 1

REGISTRY REQUIREMENTS OUTLINED IN VCS REGISTRY RFP

1. Ability to Deliver Services – VCS registries must have the ability to deliver registry services at all times, including the capacity to connect/communicate with other VCS registries and the VCS database as well as maintaining disaster recovery and security systems.
2. Accessibility – VCS registries will ensure that VCS accountholders are able to easily access the system and are not impeded from doing so because of barriers associated with fees and/or other costs.
3. Insurance – VCS registries must maintain specified minimum insurance levels, as follows:
 - Directors and officers liability – minimum \$14 million;
 - Employees liability – minimum \$3 million;
 - Operational failure – minimum \$14 million;
 - Fraud and theft – minimum \$7 million; and
 - Public liability – minimum \$14 million
4. Financial Standing - VCS registries must have a minimum financial rating of BBB by Standard & Poor's (S&P) or an equivalent rating by a comparable rating agency, or have net assets of \$16 million and sufficient cash/near cash assets to cover operating overheads for the following 12 months.
5. Transfer of terms – VCS registries must ensure that the terms and conditions of their agreement with VCS will be treated as a condition of any sale or merger of the registry.
6. Insolvency Protection – in the event of a registry's insolvency, the registry must ensure that VCS documents and VCUs held in the registry will not be available to other creditors.
7. Conflicts of Interest – VCS registries shall maintain internal policies for the management of potential conflicts of interest between registry accountholders, participants in any carbon market, other VCS Registries, other standards or itself, as a registry for other environmental products.
8. Non-VCS Credits – VCS registries shall provide a clear separation of their activities on behalf of VCS from any other registry activities.

David Antonioli 9/26/11 3:23 PM

Comment [1]: You will have to change these to USD.