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November 23, 2010

Via electronic submittal

California Air Resources Board
Attn: Kevin Kennedy
1001 I Street
Sacramento, CA 95812

Re: Comments on the final draft regulations for California's GHG cap and trade program

Dear Mr. Kennedy and CARB staff:

The Nature Conservancy (TNC) appreciates the opportunity to provide comments on the final cap and trade regulations issued by the California Air Resources Board staff on October 29, 2010. These comments supersede comments we have previously submitted. TNC commends the ongoing leadership of California and the California Air Resources Board (CARB) and staff to address global warming. Overall, we support the cap and trade regulations and believe that CARB has thoughtfully developed a program that will reduce greenhouse gas emissions to help meet the state target in conjunction with the other measures adopted by CARB. We offer the following constructive comments on the final regulations with a particular emphasis on forest offsets, use of allowance value, and treatment of biomass energy and fuels.

Summary of Recommendations:

1) **TNC supports the regulatory cap and greater auction of allowances in the industrial sector**
2) **TNC urges stronger, more explicit language for suggested use of allowance value for ecosystem-based adaptation among other recommendations identified by the Economic and Allocation Advisory Committee**
3) **TNC supports CARB's approval of the Climate Action Reserve Forest Protocol as the basis for domestic forest offset credits issued by CARB and also recommends several edits regarding the conversion of natural forests, conservation easements, and the crediting period, among others**
4) **TNC supports the regulatory language suggesting future inclusion of sub-national credits from reduced emissions from deforestation and degradation (REDD) and proposes explicit language that would also expressly permit crediting of reforestation and improved forest management (REDD+)**
5) **Forest biomass energy and fuels should be included within the cap and mandatory reporting should include upstream impacts to the land base**

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TNC supports the overall declining cap and recommends language that would facilitate greater auction of allowances for the industrial sector over time

TNC supports the cap established in the regulation to reduce emissions by at least 18 MMTCO2e and potentially as much as 27 MMTCO2e. This is consistent with the goals outlined in the Scoping Plan. We are pleased that all the allowances for both the electricity and transportation sectors will be auctioned either directly or through consignment, creating price signals to advance technologies that are less GHG intensive. While we understand that the industrial sector has some uncertainty with respect to trade exposure and potential leakage, we believe that the current regulatory proposal to freely allocate the majority of allowances to the industrial sector through 2020 without a clear process for potentially increasing the auction of allowances could result in an excessive amount of free allowances needed to address leakage and delay progress toward more efficient technologies.

As advised by the Economic and Allocation Advisory Committee (EAAC), the industrial sector should need very little allowance value to address leakage issues.[1] We, therefore, urge CARB to amend its regulations to create benchmarks and a process to facilitate a greater amount of auctioned allowances in the industrial sector over time to ensure that this sector has the proper incentives to transition to more efficient technologies and reduce GHG emissions by 2020. As suggested by our colleagues, the product benchmark for the industrial sector should be adjusted to reflect best practices instead of 90% of industry average. We also agree that a clear adaptive management process should be outlined in the regulations to evaluate and adjust the Industry Assistance Factors in Table 8-1 of the regulations so that the percentages do not necessarily remain static through 2020.

TNC urges stronger, more explicit language for suggested use of allowance value for ecosystem-based adaptation among other recommendations identified by the Economic and Allocation Advisory Committee

TNC supports the deposit of allowance auction proceeds into a common fund such as the Air Pollution Control Fund, as identified in the final regulation (Subarticle 8, § 95870 (f)). While the legislature may ultimately appropriate these funds, TNC urges CARB to amend this section to identify that these funds should be invested in ecosystem-based

[1] *See page 47* , http://www.climatechange.ca.gov/eaac/documents/eaac_reports/2010-03-22_EAAC_Allocation_Report_Final.pdf

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adaptation, land use, transportation and a community benefits fund for use by qualified organizations and local governments, as they were explicitly identified in the final March, 2010 recommendations of the EAAC, *Allocating Emissions Allowances under California's Cap and Trade Program*. [2]

While the EAAC report recommends the auction of emissions allowances as the most equitable and efficient way to distribute allowances to capped entities, it also recommends the distribution of allowance revenue to ecosystem-based adaptation, among other important investments. As identified by the California Natural Resources Agency Climate Adaptation Strategy, it is critical to dedicate funding to ecosystem-based adaptation. Proper investment of allowance value will help minimize the negative effects that excessive greenhouse gas (GHG) emissions are having on California's natural systems, and by extension public health and safety, and will simultaneously protect the vital GHG mitigation function these systems naturally provide.

Allowance value investments and compensation should be dedicated to all natural systems in California for adaptation purposes, including its forests, grasslands, working landscapes, coastal areas, watersheds, and deserts to protect and promote their vitality and diversity and the many benefits that they provide to Californians and the economy. These benefits include, clean drinking water, climate regulation and carbon sequestration, air quality protection, flood control, wildlife habitat, crop pollination, recreation, timber, and employment, among other things. The public cannot afford to lose these benefits, and the state has an opportunity to optimize its investment by dedicating a significant portion of allowance value to these resources.

TNC supports CARB's approval of the Climate Action Reserve Forest Protocol as the basis for domestic forest offset credits issued by CARB and recommends several edits regarding the conversion of natural forests, crediting intervals and conservation easements, among others

TNC strongly supports the adoption of the Climate Action Reserve Forest Protocols as the basis for CARB issued offset credits in the United States. The Protocols have gone through numerous public processes over the past ten years with extensive input from experts, stakeholders and the general public. We appreciate that a number of edits were necessary to transition the Protocols from a voluntary framework to CARB's regulatory one. In light of these recent edits and some issues raised in the CEQA analysis, we recommend the following clarifications be added to the Protocol as part of their adoption with the final cap and trade regulation:

[2] *Id*. at p. 50

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Explicitly include language to avoid any risk of conversion of natural forests

While it is unlikely that forest offset projects could convert a diverse, natural forest to more simplified conditions and still create a quantifiable climate benefit, we recommend the inclusion of explicit language that prevents this scenario. CARB should address this issue by adding language to the Forest Protocol that prohibits the award of credit for projects that would lead to or actually convert natural or diverse forest conditions to more simplified ones. Furthermore, CARB should also require additional forest carbon pools to be included in the GHG accounting, such as lying dead wood and soil carbon when activities associated with conversion to more simplified forests are undertaken.

Rather than adjust baselines at renewal of crediting periods, apply additionality discount if necessary

The regulations identify renewable crediting periods for forest projects over 30 year maximum intervals. While it may be beneficial to have regular adjustment intervals to update scientific data for projects, CARB should reconsider the adjustment of forest project baselines over these intervals. Due to the permanence obligation of offsets, the project would have a continued obligation to verify reductions against the initial baseline even if new ones are established based on the 30 year updates. Readjusting a baseline at years 31, 61, etc. would have the effect of creating parallel monitoring and verification obligations against multiple baselines, which could be costly and unnecessary. We, therefore, recommend the forest project baselines to be fixed for the duration of the project life to avoid this problem. If CARB determines that additionality has changed over these 30 year increments, it should consider a discount factor to address this issue, if necessary.

Clarify forest owner definition with respect to conservation easement holders

The revised definition of forest owner needs to be clarified with respect to easement holders. The definition asserts that easement holders are not considered a forest owner, but proceeds to define forest owner to include entities that may hold timber rights. However, easement holders may hold timber rights as part of a conservation easement, which creates an inconsistency in the definition. Therefore, the definition does not need to include an explicit exclusion of easement holders. If there are particular sections of the Protocols that should exclude easement holders from obligations of forest owners, those sections should make this explicit.

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TNC supports the regulatory language suggesting the future inclusion of sub-national credits from reduced emissions from deforestation and degradation (REDD) and proposes explicit language that would also permit crediting of reforestation and improved forest management (REDD+)

TNC strongly supports and commends CARB's explicit inclusion of a regulatory pathway to credit reduced emissions from international deforestation and degradation (REDD). Forest loss and degradation are responsible for roughly 12% of global anthropogenic emissions, so we are pleased that California recognizes the critical importance of addressing this problem and providing this leadership. We also commend CARB's jurisdictional approach to this issue, as it is important to engage governments to effectively and comprehensively address REDD.

In addition to the inclusion of deforestation and forest degradation, it is also critical to include forest restoration and improved forest management. These activities not only remove additional carbon dioxide from the atmosphere through sequestration, they also help reduce deforestation and degradation by ultimately providing restored forested areas that can meet demand for forest products instead of continued depletion of remaining forests. With this in mind, we recommend that CARB include explicit language in this section to acknowledge that subnational REDD approaches can also include additional forest activities such as reforestation and improved forest management. Crediting for these activities, however, should be conditioned on maintaining or decreasing historic emissions from deforestation and degradation. This comprehensive approach to jurisdictional accounting and crediting, or "REDD+", would also be more consistent with CARB's overall approach to forest offset projects from North America, as it includes avoided deforestation, improved forest management and reforestation activities.

Forest biomass energy and fuels should be included within the cap and mandatory reporting should include upstream impacts to the land base

While TNC supports the development of biomass energy and fuels from forests, careful consideration should be given to the GHG and environmental impacts that could result upstream from the production of the feedstock. The final proposed cap and trade regulations exempt forest biomass energy and fuels from the cap and only require the *reporting* of GHG emissions associated with the combustion of biomass without inclusion of upstream impacts. Yet, biomass energy and fuels, depending on the land use and management impacts upstream, can result in increased biological GHG emissions from the landscape as well as additional indirect emissions from energy use.[3]

[3] *See* Timothy D. Searchinger, Steven P. Hamburg, et al., *Fixing a Critical Climate Accounting Error*, Science, Vol 326, October 23, 2009 <www.sciencemag.org> accessed October 23, 2009.

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The potential upstream land use impacts of biomass energy and fuels for a cap and trade program are comparable to those associated with the production of biofuels for California's Low Carbon Fuel Standard (LCFS). CARB has been and continues to invest considerable time and effort to account for indirect land use impacts, GHG emissions and sustainability for forest biofuels in its LCFS. Given the similarity in upstream accounting issues and potential environmental impacts with respect to biomass energy and fuels in the cap and trade program, the GHG treatment and sustainability considerations should be consistent across programs. TNC recommends that ARB amend § 95852.2 (a)(4)(A) of the cap and trade regulations and § 95852.2 et al. of the Mandatory Reporting Regulation to include upstream biological emissions associated with the land use impacts and management of feedstock. The accounting and reporting guidance should be developed in 2011 prior to the regulations taking effect in 2012 and should require biomass fuel suppliers to report biological emissions associated with the feedstock. In the near term, CARB should require fuel users to report the origins of biomass for fuel. The sustainability standard developed pursuant to the LCFS should also apply to the biomass used for energy within the cap and trade program.

Also, TNC recommends the inclusion of biomass energy and fuels in the cap. The combustion of biomass results in greenhouse gas emissions and may not be offset by regrowth or maintenance of feedstock (e.g., forests) upstream. To maintain an incentive for biomass energy and fuels, compliance obligations may be freely allocated. However, this free allocation should be contingent upon proper evaluation and accounting of upstream biological emissions and sustainability criteria, as well as benchmarking based on best practices for the industry, as discussed earlier in our recommendations.

Once again, TNC appreciates the tremendous work and leadership of CARB and California. We offer our assistance to work on the adjustments we recommend above and look forward to the successful implementation of the cap and trade program. If you have any questions, please contact Michelle Passero at MPassero@tnc.org.