Baker & McKenzie LLP

300 East Randolph Street, Suite 5000
Chicago, IL 60601
United States

Tel: +1 312 861 8000
Fax: +1 312 861 2899
www.bakermckenzie.com

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California Air Resources Board
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Comments on April 5, 2016 Public Workshop

We are pleased to submit these comments on behalf of our client, Encourage Capital, in support of California's continued leadership on addressing the challenge of climate change, and in particular, its April 5, 2016 Public Workshop on Sector-Based Offsets.

I. Overview of Encourage Capital

The impacts from climate change are already having far-reaching effects on natural ecosystems and human well-being. Encourage Capital believes that the private sector must play a critical role in providing financial resources for both reducing greenhouse gas emissions and sequestering carbon in biological systems such as forests, grasslands, wetlands, and agricultural systems.

Encourage Capital invests in and is designing ecosystem-based investment strategies to address global climate change. The firm believes that investing in projects focused on the conservation, restoration and improved management of biological systems — such as forests — is one of the most reliable and most cost-effective ways to address climate change. Such projects also provide co-benefits such as healthier ecosystems that support biodiversity, sustainable wildlife habitat, fresh water and livelihoods of forest communities.

Encourage Capital has become a leader in financing ecosystem-based carbon offset projects that develop carbon credits for the California carbon market. The firm's EKO Green Carbon Fund invests in projects that rely on improvements in forest management practices designed to sequester more carbon. We are also developing investment strategies to support REDD+.

II. Inclusion of a REDD+ Sectoral Offset Mechanism is Critically Important and California's Actions Have Worldwide Relevance

Emissions associated with forest loss, agricultural expansion, and other land-use change account for roughly one third of global carbon dioxide output worldwide. Without solving the crisis of global deforestation, we cannot solve the climate change challenge. Encourage Capital applauds California's leadership in addressing the urgent need to develop a world-class model for incorporating REDD+ into a functioning compliance regime. California's efforts in this regard will directly benefit the California program by creating an expanded pool of eligible and high-quality compliance offsets while also benefitting tropical forest conservation, biodiversity and forest-dependent community livelihoods. Importantly, the whole world is carefully watching how California moves forward in its efforts to include REDD+, because, if done right, this is likely to become a model that will be replicated in other jurisdictions around the world thereby achieving large scale benefits.

III. ARB Should Allow For Multiple Approaches to Address Reversal

Encourage agrees that reversal risk of REDD+ credits must be mitigated to ensure environmental integrity of sector-based credits under the cap-and-trade program. As a design element, existing standards have addressed permanence through the collective buffer approach, which the evidence suggests has worked well to date. ARB has asked for comment on four potential options to address reversals and leakage: 1) using only the jurisdictional approach; 2) insurance; 3) a buffer pool; and 4) discounting future credit issuances. Encourage supports flexibility in the design and use of a combination of the four approaches ARB has set forth. For example, coupling the jurisdictional approach with nested projects along with a requirement to retain credits in a buffer and requiring future year issuances to first replenish the buffer after any reversals would be a robust approach to ensure overall sectoral permanence of the reductions.

As noted in our prior comments on the March 22, 2016 technical workshop, Encourage believes that myriad benefits result from recognizing REDD+ credits from a jurisdictional accounting system that is able to include nested projects. With respect to reversals, where projects are nested within a jurisdictional accounting framework, maintaining a buffer for the jurisdiction in which both the nested projects and the jurisdiction fairly contribute into the buffer is important. In the event of a reversal, the buffer would be drawn to make the jurisdiction "whole" but the responsibility for replenishing the buffer should fall on the culpable party (e.g., the project or jurisdiction). This approach would ensure that projects are held responsible for reversals within their project boundaries even if the jurisdiction is performing better than its reference level. Conversely, performing projects would not be impacted due to an unrelated jurisdictional reversal, as the jurisdictional buffer would account for such non-project-related reversal.

Encourage also supports the flexibility of allowing the procurement of insurance to mitigate reversal risk. One of the key features of the insurance approach to consider is from where the insurance pool of credits would be sourced. From a risk management standpoint, there is virtue in expanding the geographic area beyond the underlying jurisdiction to source such credits, as that reduces the risk to the insurance pool from any geographic, political or other jurisdiction-specific threats.

ARB also seeks comment on the use of future year discounting to address reversals. This approach is most effective as an ancillary, yet important component of an overall means to address reversals. For example, coupled with the establishment of buffer accounts as described above, future year issuances could first be used to fully replenish a buffer account in the event of a drawn down due to a reversal. In that sense, the future crediting is "discounted" in that the jurisdiction and/or projects would not receive as many credits that would be eligible to be sold into the market.

As a separate, but related point, where projects are nested within a jurisdictional accounting framework, to the extent a project performs and the jurisdiction as a whole does not (unrelated to reversals), the system design in the host jurisdiction should ensure that the performing project would continue to be entitled to credits from a buffer, additional credit issuance in the future and/or some other compensation mechanism. In this scenario, the jurisdiction as a whole would not be entitled to additional credit issuance until such time as the jurisdiction returned to a state of performance to warrant such issuance, thereby ensuring environmental integrity at the jurisdictional level. However, the host jurisdiction should develop a mechanisms for performing projects to receive appropriate credits and/or compensation to ensure fairness, provide proper incentives to continue to develop and maintain high quality projects and reduce a major risk that the private sector struggles to overcome (i.e., projects that perform being subject to the risk of jurisdictional non-performance). This crediting or compensation mechanism could be achieved by utilizing the same types of mitigation measures used for reversal risk, but applied to performance risk.

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We applaud and strongly support ARB's continuing efforts to develop its international sector-based offset program and welcome the opportunity to engage further on developing the critically important sectoral REDD+ crediting mechanism.

Regards,

Richard M. Saines

Richard Saines
Partner
312 861 2835
richard.saines@bakermckenzie.com

Cc: Eron Bloomgarden
Encourage Capital