DATE: June 4, 2015

Via Email
Mary Nichols
California Air Resources Board
1001 I Street, P.O. Box 2815
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Subject: Comments on the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms – U.S. Forestry Projects Offset Protocol, Dated May 20, 2015

Dear Chairman Nichols:

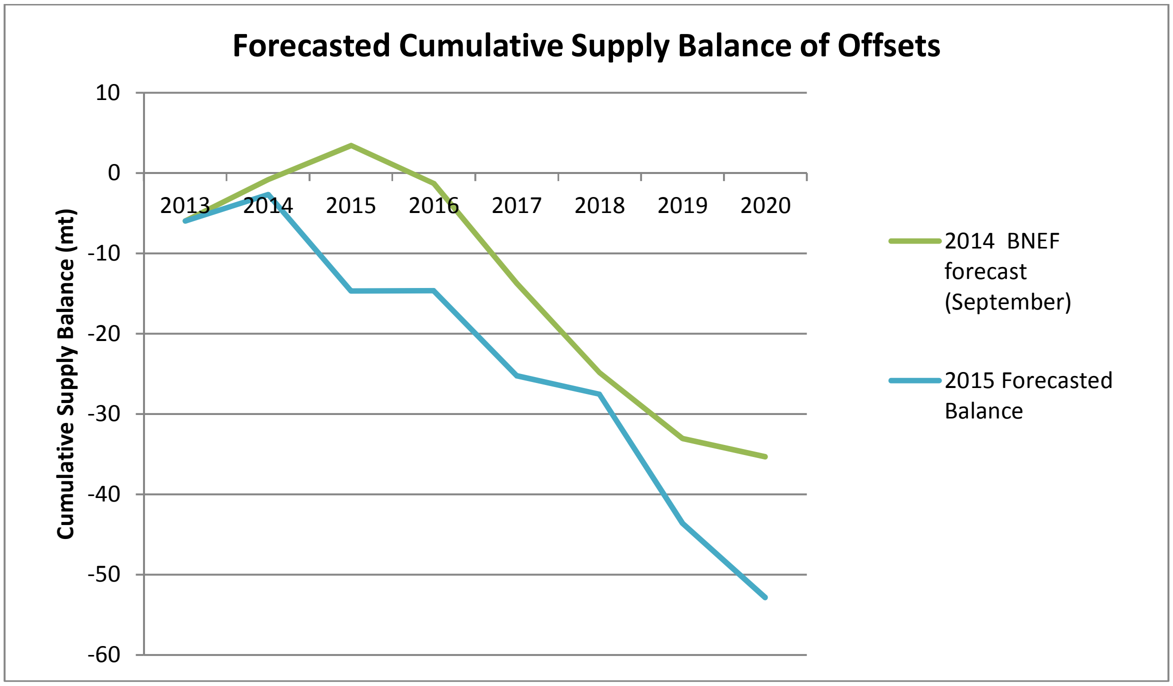
The undersigned strongly support the California Air Resources Board's (CARB's) commitment to include features within the Cap-and-Trade Program that promote cost-effective emissions reductions. A robust and liquid offset market is a critical cost containment feature within the Cap-and-Trade Program. As we look towards linkage with additional jurisdictions and the possibility of a post-2020 program, additional offset supply will prove ever more crucial. In acting to ensure that offsets provide their intended cost containment benefits, we echo staff's concerns that there will not be enough offsets to meet 2013-2020 offset demand and that there are challenges with identifying additional compliance offset protocols to fulfil demand. Accordingly, the importance of increasing offset supply by approving new protocols and by ensuring that existing protocols can meet their full potential while providing for continued environmental integrity is paramount.

While we share the goal of achieving a robust and liquid offset market, we write to express our serious concern that the process to amend the Compliance Offset Protocol for U.S. Forestry Projects did not adequately evaluate the impact to the offset market, nor were the implications fully acknowledged by staff, discussed with stakeholders, or communicated to the Board. As a result, these changes could unintentionally reduce the already short supply of offsets. We strongly support efforts to ensure the integrity of offsets and believe modifications to the protocols can be conducted without introducing additional regulatory uncertainty. A more robust understanding of the impact of even minor changes should be a priority of protocol revisions.

Projected impact on total offset supply

Since 2014, the outlook for the projected supply of offsets has declined significantly. While new protocols have been implemented, the fallout in ODS destruction capacity from the recent Clean Harbors investigation and the proposed changes to the US Forest Protocol risk further contributing to a reduction in the projected supply of high quality emissions reductions from the existing pipeline of projects. The introduction of additional regulatory uncertainty risks further inhibiting the development of future projects.

In attempting to assess the impact of these events on offset supply, we utilized Bloomberg New Energy Finances' (BNEF's) most recent September 2014 offset supply analysis to conservatively estimate the impact on the cumulative supply balance.



Source: Derived from BNEF (2014) and BP (2015) analysis

First we assumed that compliance entities on average use only 75% of the offset quota allowed over this period (i.e. 6% average utilization versus the full 8%) increasing to 90% utilization by 2020. We then updated estimates on ODS and U.S. Forestry offset supply going forward – adjusted conservatively to take into account the impact from the Clean Harbors investigation and the estimated impact from the proposed revisions to the US Forestry Protocol and the actual issuance data from 2014 and so far in 2015. When coupled with BNEF's 2014 total compliance demand forecast, the cumulative supply balance shows the projected offset supply excess or shortfall relative to the market's needs. While in the original BNEF September 2014 forecast, the market was predicted to be short, our updated forecasts show an even more significant shortfall of offset supply.

With regard to forestry offsets, these forecasts have been cross-checked with the leading forest project developers under the Californian Cap-and-Trade program, accounting for over 60% of the total forest carbon credits under the program to date. Across their portfolios, **a 40-**

60% aggregate reduction in supply is expected out to 2020 as a result of the proposed protocol changes. If these proposed revisions are implemented, we believe it is quite possible we will see an initial rush of forestry project registrations wishing to qualify under the current protocol. However, over the longer term, we would expect to see significant and ongoing reductions in development of forestry projects owing to these proposed changes. Given the brief three-year tenure of the current forestry protocol, the long lead times involved in forestry project development, and the uncertainty of post-2020 offsets policy, the introduction of such major changes is premature and would further exacerbate offset supply limitations.

While the market is in a significant supply shortfall, we expect the spread between offsets and allowances will diminish to the point where the transaction costs of sourcing offsets and associated invalidation risks will outweigh the cost advantage to be had from the use of offsets. Should such a dynamic persist, liquidity and investment will halt, and the intended cost containment benefits of offsets will be lost.

Understanding the forestry sector implications

If the updated forestry protocol fails to be amended in a manner that is regionally-specific, scientifically-based, commercially-viable, and suited to the forests most at risk of harvest, forest managers may be deterred from sustainably conserving their forests through forestry offset projects – the very program that is intended to engage them. A forecasted 40-60% reduction in leading forestry offset developer's supply pipelines serves as stark warning.

Our specific concerns with the proposed revisions are as follows:

1. The general eligibility requirements outlined in *S 3.1(a)(4)(A) and (B)* are not appropriate forestry management standards for many forests in the eastern U.S., nor do they provide adequate flexibility for proper forest health and environmental management outside of California - deterring participation outside of California.

2. The strict and onerous provisions surrounding both the definition of 'even-aged management' and associated buffers places unnecessary constraints on a forest owner's ability to maintain economically productive forests - a necessary co-requirement to support participation in the program.

3. The proposed changes to the process for calculating Minimum Baseline Level for projects with starting stocks above Common Practice is a barrier to large landowners placing portions of their property into a carbon project in order to protect old-growth and other well-stocked stands and will have a negative impact on utilizing carbon as a conservation tool for subsections of a large property.

Moreover, the process and provisions for updating the assessment area data file and site classification groupings within the protocol is opaque. Justification is needed as to why the new Common Practice values are based exclusively on Forest Inventory and Analysis (FIA) data collected over a very brief window of time (~2007-2012). If baselines are set artificially high based on periodic market fluctuations, and demand for timber is strong, landholders will be less incentivized relative to the current protocol to lock forest stocks in for greater than one hundred years and instead look to harvest.

Instilling confidence in the program

Periodic review and update of the protocols is essential to ensuring the continued environmental integrity of the offset program. We urge CARB to carry out these activities in a predictable, planned and transparent manner that is clearly communicated to stakeholders well in advance and that takes into account the input of experts, regulated parties and other stakeholders. To limit the regulatory uncertainty inherent in such activities, CARB should establish a clear process and timeline for such activities. As part of the process, we also ask that CARB thoroughly evaluate the impacts of proposed changes to avoid unintentionally and unnecessarily jeopardizing offset supply. Changes without sufficient notice or within compliance periods should be avoided in order to allow supply and demand balances within phases to be predicted with reasonable confidence.

Since the start of the program only seven forestry projects have received credits using the current protocol. Scoping, feasibility assessments, and building a pipeline of projects under a particular protocol requires significant resources and time. Should the current amendments move forward, efforts by the sector to build a promising pipeline of supply based on the current protocol will be reduced, resulting in not only lost offset supply but also lost opportunities to conserve or more sustainably manage ecologically valuable forest lands throughout the U.S.

In addition, more transparency to what constitutes invalidation would help to instil confidence in the program, reduce risk and minimize verification costs. To this end, development of a regularly updated Frequently Asked Questions document would help to develop a clear and common understanding of regulatory language. Minimizing the possibility for different interpretations of regulatory language and establishing a sound balance between a protocol's rigor and the commercial viability of project development and verification are both key to supporting offset development.

Conclusion

In acknowledging the shortfall in offset supply and on-going challenges resulting from a preference for in-state offset protocols and additionality requirements, priority should be placed on safeguarding and maximizing the offset generation potential of existing CARB approved protocols. Before considering any proposed amendments to the US Forestry Protocol, we strongly urge the Board to require staff to provide:

1. A detailed analysis of the impact on offset supply from the proposed changes to the US Forestry Protocol.

2. More opportunities for stakeholder engagement so that staff can explain and receive expert feedback on the objectives of these significant changes – and whether alternatives exist that would meet these objectives without a large impact on offset supply.

3. A proposal to provide fairness, clarity, certainty, transparency and predictability to investors in offset projects such that significant changes to protocols will occur only after a sufficient period of time has passed so that investors can recoup investments made under the rules in play at the time the investment was made. In no cases should these changes be implemented within a compliance period, with less than 2 years

notice to stakeholders from board approval, or within a minimum time period since the previous change. Specific to these contemplated revisions to the US Forestry Protocol, if significant changes are to be made after the additional process and analysis requested by this letter, such revisions should not go into effect before 1/1/18.

4. A process to enable staff to release minor public clarifications (where no impact on offset supply is expected) on matters related to protocols in a timely and more frequent manner. This is likely to reduce the need for regular, more significant, changes to protocols while providing needed clarity to market participants.

The undersigned appreciate the board's and staff's consideration of these recommendations on this important matter.

Sincerely,

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