California Air Resources Board
Preliminary Draft Cap and Trade Regulations

Comments Submitted by
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TerraPass, a San Francisco based company with more than 20 voluntary greenhouse gas emission reduction projects under management in the United States supported by more than 200,000 individual and business customers, is pleased to submit comments to the California Air Resources Board (CARB) on the preliminary draft cap and trade regulations released on November 24, 2009.

We commend CARB for moving forward with these regulations to help the state reach the greenhouse gas emission reduction goals contained in California's Global Warming Solutions Act (AB 32). This is especially important in light of continued uncertainty about whether federal climate legislation will pass in 2010. AB 32 stands as the most advanced, economy-wide climate law in the country. Policymakers in Washington, DC and other states are closely following the ongoing implementation of AB 32, which is likely to serve as a model for laws and regulatory structures in other jurisdictions.

TerraPass also praises CARB for affirming that offset projects can reduce costs to comply with the climate law, while spurring innovation in areas of the economy not subject to GHG regulations. The key is to insure that emission reductions from offsets are real, additional, quantifiable, independently verified, and permanent – all criteria reflected in the draft regulations. To maximize the emission reduction and job creation benefits which result from investments in emission reduction projects, the agency needs to clarify issues regarding geographic limits, project types and methodologies, project start dates, credit issuance, and linkages to external offset systems. TerraPass offers its views on these subjects below and welcomes further dialogue with CARB staff this year.

Geographic Limits

In the approved AB 32 scoping plan, CARB states its intent to use the rulemaking process to "…establish an offsets program without geographic restrictions (emphasis added) that includes sufficiently stringent criteria for creating offset credits to ensure the overall environmental integrity of the program."[1] TerraPass supports this goal. To limit offsets to California-only, as some critics have proposed, would be unduly restrictive since the state's comprehensive environmental rules leave relatively few sources of

[1] California Air Resources Board, Climate Change Scoping Plan, December 2008, p. 38.

emissions unregulated. Alternatively, for California to allow offsets from projects anywhere in the world will create challenges in verifying that the international emission reductions meet the requirements of AB 32. Verifying regulatory additionality and difference from common practice in an international context is particularly challenging. Verification is a major reason that to date TerraPass has not included international offsets in its portfolio. To the extent CARB is going to allow some international offsets into the state compliance system, we urge the agency to maintain the strongest possible rigor and diligence during its review of such emission reductions.

TerraPass sees benefits to California emphasizing offset projects within North America with a priority given to those located in the U.S. Offset projects can create jobs, which is important as the U.S. economy recovers from a recession. We also believe there is value in our country demonstrating that a significant part of the greenhouse gas problem can be addressed close to home. Domestic offset projects can reinforce confidence that the U.S. is taking responsibility for its share of GHG emissions.

It is worth noting that the Western Climate Initiative (WCI), the regional consortium of seven U.S. states and four Canadian provinces working to reduce greenhouse gases, has issued guidelines that support offset projects within WCI jurisdictions "…in order to capture collateral health, social, and environmental benefits."[2]

TerraPass opposes the introduction of a policy escape valve that would accept international offsets from the Clean Development Mechanism (CDM) in the event carbon prices in California exceed certain levels. Such a policy change would disrupt the offset market and could greatly diminish the value of existing U.S. projects initiated through early investments. CARB should leave this concept out of the final regulations.

Resolving Uncertainty in Project Types and Methodologies

CARB's current regulatory draft leaves three significant areas of uncertainty which, until resolved, will severely hamper investment in emission reduction projects:

1) Whether external non-governmental emission reduction crediting systems will be approved for use, and if so, which ones;
2) Which project types will be eligible using what quantification methods; and
3) Whether projects located outside California must demonstrate "beyond California" regulatory additionality.

With such looming uncertainties, investors (especially providers of moderately priced capital such as commercial and investment banks) are adopting a "wait and see" approach. Without access to up-front capital, many emission reduction projects are being delayed and the initial supply of offsets into the cap and trade system may be very

[2] Western Climate Initiative, Design Recommendations for the WCI Regional Cap-and-Trade Program, September 23, 2008, p. 10.

limited, raising the cost of compliance and creating undue pressure on decision makers to loosen bounds on offset supply or quality, and raising questions about the efficacy of the market as a whole. TerraPass urges CARB to resolve these uncertainties in the following ways:

Crediting Systems and Project Types: Since there are already several offset crediting systems with a variety of project types in use across the United States, TerraPass advocates that CARB use the current regulatory process (as opposed to a later rulemaking or proceeding) to name an initial group of crediting systems and project types with calculation methods acceptable for projects located in the U.S. and Canada. Specifically, we recommend that CARB accept:

1) the Climate Action Reserve (CAR) crediting system along with all CAR protocols already adopted by its board; and
2) the Voluntary Carbon Standard (VCS) crediting system along with the methodologies for landfills (ACM 0001) and livestock (ACM 0010).

In both cases, we expect that CARB may restrict project eligibility within these protocols by imposing a uniform standard for project start dates.

TerraPass has extensive experience with the development and use of CAR and VCS protocols. We believe that these protocols result in projects which meet CARB's stated requirements for offset project eligibility and result in emission reductions which are more reliably documented and more heavily scrutinized than projects subject to other kinds of regulatory requirements in California or elsewhere.

These protocols required years of work to develop and drew upon many experts in public consultation. Lengthy development processes are inherent with such methodologies, similar to creating a Best Available Control Technology (BACT) standard or other technical regulation. By adopting existing programs and protocols now, CARB will foster near-term emission reductions funded voluntarily by investors rather than taxpayers or energy consumers.

California-specific Additionality: The suggestion that emission reduction projects located outside California might have to meet a California-specific additionality benchmark for certain emitting activities would open a true Pandora's box. Among the thorny issues would be the need to determine whether a project has met a California regulatory threshold where no such regulation exists and hence neither monitoring nor recordkeeping consistent with California regulatory compliance would be available.

More importantly, environmental regulation results from a convergence of geographical particulars (e.g., air basins, habitats, and surface water patterns), human activity patterns, and economic conditions. Applying a "California level" of environmental stringency uniformly across other states presumes that other jurisdictions have misjudged these factors and must first apply a similar level of control before an emission reduction project

could be considered "beyond business as usual." TerraPass' experience working with emission reduction projects across the country, however, leads us to conclude that other states have different geographical, anthropogenic, and economic conditions which are mirrored by their regulatory regimes. They are not broadly "less stringent;" rather they are different. Landfills provide an instructive example:

As an AB 32 early action measure, California chose to implement strict controls on landfill methane emissions. The state made this decision after examining the gas control status of all landfills in California and performing relevant economic and environmental analyses. CARB moved ahead because the policy affected a small number of sources and because it was one of the most cost effective measures available. However, we expect such an analysis would have looked quite different elsewhere in the country.

Prior to AB 32, California's landfills were already subject to more stringent groundwater protection standards than landfills in many other states. In addition, many California landfills had methane collection requirements because they did not meet air quality standards for ozone. Also, due to California's energy mix and renewable portfolio standard, electricity prices are relatively high in the state, so the ability of landfill gas-to-energy projects to help fund landfill gas collection systems is commonplace. Finally, California's population densities in the major cities and the resulting concentrations of solid waste produced, have virtually eliminated active small, local landfills over time in favor of very large (and hence federally regulated) landfills serving these urban centers.

By contrast, many other states are largely rural and thus have less demanding air and water quality control challenges. Electricity prices in these states are relatively low and there are no incentives for renewable energy such as what can be produced from landfill gas. The states tend to be served by small, local landfills. In these cases, the same equations California examined would result in a very different analysis of the cost effectiveness of gas control. Assuming that such systems somehow "should be" in place before an emission reduction is beyond business as usual, is overly reaching, administratively complex, and unnecessary to achieve the emission reductions which are the goal of AB 32.

Timing for Regulating Emission Sectors: The AB32 scoping plan described an initial group of emission sectors (electricity generators and large industrial sources) that will be regulated in 2012 and a second phase of emissions (transportation-related fuel combustion, natural gas deliverers, and smaller industrial sources) for which rules would take effect in 2015. In the draft regulations, CARB has proposed that the second phase be moved up to the same 2012 date as the first group of sectors. We support the acceleration of the rules since it would lead to faster emission reductions. However, if this proposed change does not make it into the final regulations, we encourage CARB to quickly review and approve offset protocols for the second group. Approving protocols in these categories will create incentives for early action and result in carbon reductions that would not otherwise occur.

Other Offset Project Eligibility and Additionality Issues

Grant funding: CARB's draft regulations suggest that offset projects (or any quantity of emission reductions) that have benefited from government or public grants could be excluded from the California system. This exclusion would be ill advised since even with carbon revenues, many projects are barely economically viable. As a case in point, every dairy digester project TerraPass has ever worked with has received public funds in one form or another, and none of them is a commercially attractive investment even with this funding. Urban forestry projects, which are public by definition, represent another category where grants and carbon revenue together help make the projects more attractive, but still do not create a financial return for anyone involved.

We recommend that the final regulations allow additionality to be evaluated on the merits as specified in the relevant protocols and not face an automatic exclusion because a grant was received. As a practical matter, we would expect grant funders to accomplish this goal without a CARB requirement, since grantmakers will not favor projects which can support themselves with other revenue streams.

Project Start Date: The draft regulations propose that for an offset project to qualify for use in the California system it must have begun operations after December 31, 2006. We believe that a more accurate appraisal would place the online start date one year earlier. The legislative history shows that AB 32 was gaining momentum for passage during 2005, even though it was not finally approved and signed until 2006. During 2005, offset project developers had increasingly good reasons to believe that greenhouse gas regulation in California was imminent.

In other parts of the country, the Regional Greenhouse Gas Initiative (RGGI) approved rules that allow offset projects to be used for compliance purposes if they started after December 20, 2005. At the federal level, the proposed McCain-Lieberman Climate Security Act (a cap-and-trade system with offset provisions) came to the Senate floor for votes in 2003 and 2005.

These policymaking signals gave developers growing confidence that GHG emission reduction projects could provide a financial return. From TerraPass' experience reviewing over 200 domestic offset projects, we believe that a project online date of January 1, 2006 appropriately distinguishes between projects which were implemented to generate saleable GHG credits, and those which were implemented for other reasons and would have happened in any case. The January 1, 2006 date would match the RGGI eligibility date.

Carbon Credit Issuance

In the draft regulations, CARB proposes to issue its own carbon offset credits. We can see the benefits to such an approach, especially given the strong reputation of the state's air pollution regulatory system and the credibility a CARB stamp could give to an offset

credit. However, carbon credit issuance would be an entirely new administrative undertaking for the agency. New expertise, personnel and travel – along with a lengthy review process – would be required to fulfill this function properly.

We are uncertain as to whether CARB's expertise is best applied here. We recommend that the agency consider alternatives, including delegating the issuance task to an outside contractor with experience in financial and carbon markets. Engaging an independent entity that implements the rules on credit issuance and reports to CARB may be the most sensible approach.

Both CAR and VCS have spent years developing their respective systems complete with approved methodologies and procedures for registering and retiring credits. The registries employed by CAR and VCS already take care to serialize their credits, so as to avoid double-counting. At a minimum, CARB should draw upon this collective experience to insure that high quality offset credits are issued in an efficient manner.

Approved External GHG Systems

TerraPass supports the notion of California accepting offset credits from other greenhouse gas systems, provided they can demonstrate that these emission reductions are real, additional, quantifiable, permanent, verifiable, and enforceable. Offset supplies from other systems will be essential if businesses are going to have options to lower the costs of complying with AB 32. However, in requiring the approved external GHG systems to meet certain offset criteria, it would be a mistake to insist that other systems have the exact same limits on offset use as those in California. CARB's intention to limit offsets to 49% of emission reductions or 4% of compliance obligations may make sense for California, but other states and regions have different regulatory frameworks and different air quality and energy profiles. These states and regions may have legitimate reasons to allow more offsets in their GHG systems. California should not exclude these offsets, as the draft regulations currently suggest.

We recommend that CARB move quickly to establish the MOUs with approved external GHG systems. These relationships will be vital to insuring that an adequate supply of offsets is available for regulated emitters that need them.

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Thank you for considering our comments. We would welcome the chance to answer any questions you may have.