



July 13, 2010

Via Electronic Submission

Kevin M. Kennedy, Ph.D.
Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: ARB's June 22, 2010 Presentation re Offsets & Linkage

Dear Mr. Kennedy:

The COPC (www.carbonoffsetproviders.org) is an alliance of leading companies that provide low-carbon and clean technology investments, representing hundreds of clean infrastructure projects, millions of tons of greenhouse gases reduced, thousands of green jobs, and millions of dollars in economic benefit to local and regional communities at project locations in California, elsewhere in the U.S., and abroad. COPC members finance, produce, generate, provide, aggregate, verify, and/or market greenhouse gas emission reductions for sale as offsets in existing and emerging voluntary and compliance greenhouse gas emission trading markets. Our members include the #1 and #2 project portfolios in North America, the #1 credit aggregator, as well as the largest portfolio of international Clean Development Mechanism offsets in the world.

The COPC is pleased to have this opportunity to comment on the presentation made by the California Air Resources Board ("ARB") at its June 22, 2010 stakeholder workshop on Offsets and Linkage in a California Cap-and-Trade Program. We offer the following comments based upon our members' experience operating within the markets referenced above, including the experience from hundreds of offset projects in many parts of California and nearly all 49 other states that collectively have achieved millions of tons of greenhouse gas emission reductions and sequestration.

A. Introduction.

The COPC welcomes and applauds the progress that ARB is making to develop an offset program as part of the cap-and-trade program being developed under AB 32. We understand the decision taken by ARB in February to withdraw its endorsement of certain voluntary protocols in favor of developing compliance protocols. Unfortunately, many misperceived the decision as a withdrawal of support for offsets. That reality, combined with a period of prolonged uncertainty with regard to which offset projects might eventually be accredited for compliance purposes, has had



a very negative impact on the development of offset projects in California and elsewhere. In short, investment has declined dramatically, to the point that there is a very real question as to whether the needed supply will be available when California's cap-and-trade program is finally launched. For several years we have been calling for greater certainty and guidance with regard to the offset program and compliance protocols in particular. Such guidance is critical to facilitate the kind of capital investment that is needed to develop the projects — and the novel new types of projects — that are necessary to ensure that green house gas emissions are reduced, sequestered, avoided or destroyed in the amounts needed to help California meet AB 32's emission reduction goals without damaging the economy.

Below we provide more detailed comments on a number of issues that were discussed at the June 22 workshop. In sum, we applaud ARB for the progress that it has made, and we strongly encourage ARB to send a critically needed signal to the market in order to spur sufficient investment in offset projects. To that end, we call upon ARB to take four particularly crucial actions:

- *Maintain the schedule of establishing an offset program as part of the cap-and-trade regulation by the end of 2010;*
- *Promptly adopt the four compliance protocols now in the pipeline with minimal change from the Climate Action Reserve originals and expedite the development of more protocols;*
- *Recognize early action (as AB 32 requires) by accepting for compliance purposes offsets generated by projects under rigorous voluntary protocols such as those established by the Climate Action Reserve, and;*
- *Raise the four percent cap on the use of offsets.*

We welcome and applaud California's leadership on climate change. With some adjustments we believe it can become the model for the rest of the nation.

B. The COPC Supports Raising the Cap on the Use of Offsets to Eight Percent.

Though this was addressed during the portion of the June 22 stakeholder workshop devoted to Cost Containment Options (ARB Slide 9), we address it here as it is highly relevant to the discussion of offsets and linkage. We understand that ARB is considering raising the limit on the use of offsets by those under the cap from four percent to eight percent based on a to-be-established trigger price for the cost of allowances on the market. ARB also identified two potential problems with such a cost containment mechanism: first, there may not be an adequate supply of offsets available to meet the demand, and, second, certainty of future access to the (enlarged) California market may be necessary to spur investment in offset projects. These are indeed very real concerns.



Many stakeholders at the June 22 workshop, including the COPC, noted their agreement with ARB's identification of the first problem. Many are greatly concerned, as most of the indications are that there likely will not be an adequate supply of quality offsets when the program is launched. It is striking to note that ARB itself estimates that more than 90% of the offset supply during the first phases is to come from the destruction of ozone depleting substances ("ODS") "only outside California." (ARB Slide 27.) We are not opposed to the ODS protocol, which was just recently promulgated by the Reserve, but we must question any system that would be so reliant upon a single offset project type — and one that is both new and only out-of-state. It certainly offers very little in terms of economic development co-benefits for California.

The second problem identified by ARB is of great concern to the COPC. For there to be sufficient investment in offset projects, the market needs clear signals from regulators that quality offsets will be accredited. Whether correct or not, the signals of late have been widely perceived as entirely negative, and investment in offset project development has fallen-off dramatically. We urge ARB to send a strong signal to the market by raising the four percent cap in addition to other measures discussed below.

That said, we wish to reiterate a basic logical principle that quantitative caps are not appropriate to achieve GHG emission reductions. They do not ensure environmental integrity. The best way to ensure that is to have rigorous protocols, third-party verification, and demanding accreditation processes. However, if quantitative limits are to be required, then they should be set at a reasonable level. As we discussed more fully in our previous comments on ARB's November 24, 2009 Preliminary Draft Regulation for a California Cap-and-Trade Program (copies of which are available here: www.carbonoffsetproviders.org/4.html), the proposed limit of four percent is too low. We therefore welcome ARB's consideration of raising it to eight percent. To ensure adequate investment in offset project development such that there might be an adequate supply, we strongly encourage ARB to establish a trigger price for allowances as soon as possible. Better yet, simply do away with the trigger price altogether. It bears mention that a similar price trigger was adopted by the Regional Greenhouse Gas Initiative ("RGGI"), and it has generated very little investment in offsets for the RGGI market. We urge ARB to consider simply raising the cap to eight percent.¹

C. ARB Should Utilize the Protocols Developed by the Climate Action Reserve and Others (ARB Slides 5 and 19-21).

The COPC strongly supports ARB's consideration of recognizing early action by allowing CRTs (climate reserve tonnes) issued by the Climate Action Reserve (the "Reserve") under

¹ In response to ARB's request for stakeholder input with respect to which of the three cost containment approaches being considered is preferred (a price collar, an allowance reserve, and raising the cap on offsets), we recommend the option of raising the cap on offsets as the method least likely to distort the efficient operation of the markets.

voluntary protocols for compliance purposes. Whether this is achieved under a program of linkage or direct recognition of such offsets is not important. The point is that ARB should take advantage of the years of good work already done by the Reserve in particular to develop rigorous quantification methodologies with broad expert and stakeholder input — including ARB staff engagement at all stages.² Toward that end, as we discuss more fully in our comments on ARB’s June 23 presentation, we encourage ARB to incorporate the Reserve’s work as much as possible both with regard to the four protocols currently at issue as well as others.

1. Recognize Early Action as AB 32 Requires.

The COPC joins with other stakeholders in calling for ARB to recognize all CRTs (climate reserve tonnes) issued under Reserve protocols for compliance purposes, and for ARB to continue to recognize all projects generating such CRTs for the remainder of their credit lives. The Reserve was created by the State to encourage early actions on climate change. ARB should not impose unnecessary limits on the use of issued and future CRTs for compliance purposes from projects meeting the Reserve’s protocols and previously endorsed by ARB.

Doing so will constitute recognition of voluntary early action, as AB 32 mandates. AB 32 provides that ARB “*shall . . . [e]nsure that entities that have voluntarily reduced their greenhouse gas emissions prior to the implementation of this section receive appropriate credit for early voluntary reductions.*” Cal. Health & Safety Code (“H&SC”) § 38562(b)(3) (emphasis added). Many have acted voluntarily to reduce GHG emissions long before ARB will adopt any compliance protocols; indeed, many did so years before the State adopted AB 32. Offsets developed in accordance with rigorous voluntary standards developed by the Reserve and others prior to ARB’s development of compliance protocols must be recognized in accordance with Section 38562(b)(3).

Utilizing the existing rigorous protocols developed by the Reserve and others and recognizing the quality offsets generated in accordance with them will enable ARB to recognize rather than punish those that voluntarily undertook early action to reduce or sequester greenhouse gas emissions. This is consistent with both the spirit of AB 32 and the letter of Section 38562(b)(3). In addition, doing so would help to ensure an adequate supply of quality offsets when the cap-and-trade program is launched in 2012. As it stands now, there is a serious question as to whether the supply will be sufficient due to the lack of regulatory certainty that has dampened investment. A robust supply of offsets, including in particular CRTs from the Reserve, is critical to ensuring adequate liquidity and avoiding the risk of shortages and price spikes.

² We call out the Reserve because it was created by the State and has enjoyed a close working relationship with ARB. However, we also call upon ARB to review and consider utilizing the excellent offset project protocols developed by the Voluntary Carbon Standard (www.v-c-s.org), the American Carbon Registry (www.americancarbonregistry.org), and the Chicago Climate Exchange (www.chicagoclimatex.com).

D. Standardized Approach to Protocols (ARB Slides 8-10).

The COPC supports ARB's adoption of a standards-based approach to offset protocols with established project baselines determining additionality. We also agree with ARB's determination that establishing protocols does not require formal rulemaking; this will help to expedite the process, and as discussed above, it is critical to get compliance protocols on-line as soon as possible. That said, we do encourage ARB to maintain its commendable commitment to participatory democracy by providing for stakeholder input on the development of protocols. There is a rich body of expertise available that ARB can and should draw upon as it develops its compliance protocols.

While we strongly support the standardized approach to offset protocols, we encourage ARB not to rely solely on that approach. Innovation should be encouraged by enabling new project types to obtain approval through a case-by-case review process. We recommend that ARB establish a process for promptly adopting new standardized protocols based on project types developed through a case-by-case approach.

E. Additionality (ARB Slide 11).

The COPC welcomes and endorses ARB's conclusion that financial additionality is not required or helpful under a performance-standard approach to offsets.

With respect to regulatory additionality, however, we are very troubled by ARB's proposal to consider requiring offsets generated out-of-state to meet the regulatory additionality requirements of California as if the projects were located in the State. While perhaps initially appealing as a simple way to ensure uniform additionality, it fails to recognize the diversity of regulatory programs outside of California, including those of California's partner jurisdictions in the Western Climate Initiative. If adopted, such a principle would impair the cost containment purpose of the offsets program, and would eliminate an important incentive to reduce GHG emissions in the near term by those not subject to California's cap or other regulatory requirements.

Many sources of GHG emissions that are good candidates for offset projects are in jurisdictions that do not now have emissions control regulations necessitating the use of the most restrictive technology feasible. Market incentives can be harnessed to encourage those emitters to utilize such technology to reduce emissions. By requiring those entities to meet strict requirements not currently mandated in their home jurisdiction *before* counting additional emissions reductions as offsets, ARB will create a disincentive for participation in the offset program. This may well lead to a shortage of offsets, which may slow the rate at which California can transition to a low-carbon economy. Just as importantly, the fundamental purpose of the cap-and-trade program — reducing GHG emissions — will not be served, as there will be neither market incentives nor regulatory requirements to encourage the reduction GHG emissions from such sources. Relatively easily implemented emission reduction projects thus will not be undertaken; in effect, low-hanging fruit be left on the tree.

1. An Example: Additionality and Landfill Methane Capture Projects.

As ARB observes in Slide 28, methane capture projects at landfills have a large offset supply potential, and can only be tapped out-of-state due to California's direct regulation of them. For a variety of reasons other states do not have regulatory requirements as stringent as California, nor are many likely to anytime soon. This is a prime example of a sector that would not be encouraged to install emission reduction technology if ARB were to adopt this additionality proposal.

Landfills currently emit one fifth of all US methane emissions,³ and methane is a powerful GHG with 23 times the global warming potential of CO₂. According to U.S. EPA's Landfill Methane Outreach Program, there are 31 candidate landfills in Nevada, Colorado and Arizona that do not have methane capture equipment installed despite being good candidates for methane-based energy production, and only four other landfills in those three states have actually installed methane capture technology for energy production.⁴ Indeed, only 27% of the 1,754 municipal solid waste landfills in the country had installed methane capture as of 2007.⁵ Installation of methane capture equipment is relatively low in cost and has the potential to greatly reduce anthropogenic methane emissions. Landfills that do not currently employ methane capture for economic reasons might do so if they could sell offsets in a California cap-and-trade program.

California is rather unique in requiring methane capture technology at landfills. This is a logical result of the State's leadership in environmental regulation: emission reduction projects that begin as additional over time will become the norm and thus no longer additional. However, the pace of that development differs from one jurisdiction to another. Imposing California's more restrictive requirements as the baseline "performance standard" on out-of-state landfill offset projects would eliminate the financial incentive to do what the regulations in those jurisdictions do not require. As a result, if this additionality proposal is adopted, landfills in those jurisdictions likely will not install methane capture equipment and easily avoided GHG emissions will continue to go into the atmosphere. And an excellent potential source of offsets for California would be lost.

F. Start Date (ARB Slide 13).

As we discussed previously in our comments on ARB's November 24, 2009 Preliminary Draft Regulation for a California Cap-and-Trade Program (the "PDR") (copies of our earlier

³ See U.S. EPA, Sources and Emissions, Table 1 - U.S. Methane Emissions by Source, available at <http://www.epa.gov/methane/sources.html>.

⁴ See U.S. EPA, Landfill Methane Outreach Program, Energy Projects and Candidate Landfills, available at <http://www.epa.gov/lmop/projects-candidates/index.html#map-area>.

⁵ See Congressional Research Service, "Methane Capture: Options of Greenhouse Gas Emissions Reductions," September 17, 2009, available at <http://fpc.state.gov/documents/organization/130799.pdf> (citations omitted).



comments on the PDR are available here: www.carbonoffsetproviders.org/4.html), the COPC is deeply troubled by ARB's proposed start date of December 31, 2006. We strongly encourage ARB to expand upon its proposal to recognize earlier start dates in the context of linkage, recognizing the differing requirements of the offset programs under which those projects were registered. Such recognition can and should be made a part of an expedited independent evaluation of those programs by ARB. (See Section C above.)

G. Geographic Scope (ARB Slides 14 and 22-23).

The COPC supports ARB's decision not to limit offsets to those generated by projects in California. As a first step, we support ARB's decision to issue credits for offset projects located in the U.S., Canada or Mexico. We also support ARB's decision to consider linking with other offset programs in the medium-term. Climate change is inherently a global problem, and it does not matter where on earth a ton of greenhouse gases is prevented from entering the atmosphere.

H. Verification (ARB Slide 17).

The COPC supports ARB's decision to require verification of offset projects by ARB-approved third-party verifiers. This is a reliable way to ensure environmental integrity.

I. Buyer Liability and Enforcement (ARB Slide 24).

The COPC endorses the idea of requiring offset project developers to contribute to a buffer pool that may be drawn from to compensate for reversals. We support the use and development of appropriate buffer pools on a program-wide basis. We are less confident that establishing buffer pools for specific project types such as forestry projects is a good idea. We are concerned that this may lead to differentiation among offsets generated by different project types, as offsets should be as fungible as possible. We recognize that the permanence risks associated with different project types vary, but that can be addressed by requiring different levels of contribution to the program-wide buffer pool by different project types. The buffer pool tool, if managed effectively, should be sufficient to manage the risks associated with unintentional reversals of offsets. It will serve as something of an insurance policy for the offset program. As with all insurance policies, it must be actively managed to ensure that it provides sufficient protection at an appropriate cost.

How to handle reversals due to intentional actions is more problematic. We understand that ARB must retain the power to revoke the credit granted for an offset that is submitted for compliance purposes that later turns out to be ineligible. We also understand the need to require that the revoked credit be replaced with a valid one. The critical question is who must bear responsibility for the revoked credit and its replacement.

In the immediate wake of a reversal due to an intentional act, the ineligible offsets can and should be replaced out of the buffer pool rather than requiring the regulated entity that submitted them to do so. By drawing first upon the buffer pool, ARB can ensure the integrity of the program



in the near term while providing time to pursue enforcement action against the responsible party. While we understand that a “buyer liability” principle may be attractive from an administrative standpoint, it would undermine the cost containment purpose of the offset program by imposing significant costs upon the buyers of offsets. They would have to independently determine and/or insure the integrity of the offsets they purchase rather than being able to rely upon the program that certifies the offsets. This would be very difficult and costly in those instances when purchases are made from intermediaries such as brokers or aggregators and not from the project developers directly. In addition, a “buyer liability” approach also would undermine the liquidity of offsets, as those generated by different project types may bear different risk profiles and thus different costs. Fungibility of the instruments traded is essential to the efficient functioning of a carbon market.

Moreover, the enforcement objectives can be met just as effectively by placing liability where it belongs — be it with the project developer, the independent verifier, or the program that certified the project. As the accrediting agency in addition to the enforcement agency, ARB will have the best knowledge of the players and should be able to pursue the responsible party efficiently. This is far better both in terms of allocating liability to those most likely to be responsible, and in terms of ensuring the cost containment purpose of the offset program (as well as, at a broader policy level, the use of a market-based compliance mechanism in accordance with H&SC § 38562(c)).

J. Conclusion.

Once again, we thank ARB for this opportunity to submit these comments. We’d be happy to provide additional information. Please feel free to contact the COPC’s California representative at Beveridge & Diamond, PC, Nico van Aelstyn, at nvanaelstyn@bdlaw.com and (415) 262-4008.

Sincerely,

A handwritten signature in black ink that reads "Roger Williams" with a stylized flourish at the end.

Roger Williams, Chairman
CARBON OFFSET PROVIDERS COALITION

cc: Governor Arnold Schwarzenegger (www.govmail.ca.gov)
Mary D. Nichols, Chair, ARB (mnichols@arb.ca.gov)
James N. Goldstene, Executive Officer, ARB (jgoldste@arb.ca.gov)
Lucille Van Ommering, Manager, ARB (lvanomme@arb.ca.gov)
Brienne Aguila, Cap-and-Trade Regulatory Offsets Program, ARB (baguila@arb.ca.gov)
Raymond G. Olsson, Ph.D., Market Operations & Oversight, ARB (rolsson@arb.ca.gov)
Sam Wade, Caps, Allowances & Revenue Use, ARB (swade@arb.ca.gov)

Attachment

COPC Members

