The Honorable Mary Nichols
Chairwoman
California Environmental Protection Agency
California Air Resources Board
1001 I Street

Sacramento, CA, 95812

RE: Private Comments on ARB's June 22nd Workshop on Offsets and Linkage in a California Cap-and-Trade Program

July 13th, 2010

Dear Chairwoman Nichols:

We appreciate the openness and sincerity of the California Air Resources Board (CARB) to welcome and evaluate comments provided herein based on their June 22nd public meeting and presentation on offsets and linkage in a California cap-and-trade program. We applaud to the Board for its support of market based mechanisms and specifically its inclusion of high quality carbon offsets as a complementary component of such regulated markets to achieve meaningful and cost effective greenhouse gas emission reductions in a future cap-and-trade system.

We also adhere to the fact that CARB as the regulatory body within California will implement rules and processes that free the way to approve offset protocols, verification requirements and enforceability regulations of offsets pursuant to AB32. These efforts are a critical step to move away from a pre-compliance, unregulated, fragmented and illiquid carbon market into a compliance driven system that provides certainty.

As pioneers in the US and international environmental commodity markets and transactions worth millions of USD, we have been stakeholders in climate change & energy policy developments including early days WCI initiatives, RGGI carbon fund initiatives, first US based VER transactions for European buyers, Gold Standard market introduction, Oregon GHG standard carbon offset funding, post 2012 transactions and other early days activities.

The fundamental value proposition for and creation of market based systems versus command & order programs to reduce exposure of harmful air borne substances and its negative impacts on public health is exemplified by the acid rain program. While CO2e emissions are a global problem and thus have to be dealt with accordingly on a global level, this pioneering program was the first of its kind and has been successful over time to reduce nitrogen oxide and sulfur dioxide emissions effectively and efficiently within and outside of the state of California.

Likewise, California's landmark AB32 legislation has been praised globally for its level of commitment to address the risks and opportunities of climate change. Its cap-and-trade legislative formulation has become a blue print for other states combined under its Western Climate Initiative, other regional programs and pending federal legislation. It has also become a cornerstone for the development of internationally regulated carbon markets inside and outside of North America in a post 2012 environment.

Like no other market, environmental commodity markets are characterized by political willingness to commit to implementing regulations; demand is therefore driven by compliance rather than physical demand driven by typical consumer markets. Like any other market, efficiency is created by competition and innovation through technology advancements to further reduce costs.

1. **Making use of CRTs for compliance under AB32 including early action**

Cost containment can best be accomplished by providing a clear pathway towards rewarding early action especially in the initial stages of enforcement rules under AB32 and by offering a diverse and growing set of project activities located inside and outside of California that are accepted as compliance grade greenhouse gas emission reductions in order to generate sufficient supplies. Carbon offsets are a complementary component of any cap-and-trade system not only for achieving targeted reductions at a low cost, they are a stimulus to invest in future oriented energy & carbon mitigation technologies, natural carbon sinks and other uncapped sectors. Socio-economic benefits of carbon offset programs include creating jobs, protecting natural habitat and securing access of affordable, reliable and abundant environmentally friendly energy resources domestically and abroad in combination of inexpensive greenhouse gas reductions without relying on taxpayers' money to achieve such reductions.

An offset program provides incentives for and added financial value to project activities that reduce greenhouse gas emissions outside regulated sectors and activities. This in turn widens the scope of environmental benefits and lowers the overall costs of compliance for society as a whole. We fully agree with CARB that environmental integrity of carbon markets is a "must"; only offsets that are real, additional, permanent, independently verifiable, enforceable, measurable and transparent should be recognized for early action credit.

The Climate Action Reserve (CAR) created a very robust set of protocols. Reducing artificially their applicability will significantly reduce the intended scope and effectiveness of AB32. Such measures will threaten sufficient continued supply resulting in higher prices without further enhancing the integrity of the system. CAR's robust and at times pain staking, public stakeholder process to approve protocols has created credibility in its issued Carbon Reduction Tons (CRTs). As evidenced, these efforts are rewarded by the market as buyers are willing to pay premiums for such regulatory grade offsets compared to other available carbon commodities within the US pre-compliance marketplace.

The CAR program is the most advanced of its kind in the US. The combination and integration of best practices into CAR specific protocols makes it unique in the US and any artificial reduction or disapproval of CAR approved protocols should be cautiously considered before decisions are made to reject, exclude or change any of them.

We therefore recommend that early action for CAR approved protocols and inclusion of already issued CRTs should be granted for both inside and outside of California activities for its entire crediting period and it is important that CARB's determined starting date will also be consistent for states that are members of the Western Climate Initiative.

Any distinction between CARB and CAR protocols for consideration of compliance will result in further confusion for any investor in an already down market ever since the voluntary market collapsed due to the recessive economy. At the same time, investments might shift towards those activities that CARB approves and penalizes early action investments in otherwise CAR approved activities.

Reversing or altering the process would come in late and is not in the best interest of market participants, it would champion the flow of investments into CARB approved activities, while discounting not to say potentially nullify previous investments in CAR approved activities. CARB risks further complicating support for and undermining public approval of AB32 and its impacts it might have on federal climate change legislation. We rather recommend that CARB will be prioritizing its limited time and resources on providing market signals that allow all market participants to account for early action reductions already made and to leverage on the advancements already created by CAR without further increasing redundancy and duplications. **We therefore anticipate that CARB will approve CAR protocols in its entirety.**

If indeed any changes to existing and market wide accepted CAR protocols are intended nevertheless, we expect at a minimum that CARB will be providing clear language on processes to be executed as to any of the protocols that CARB defines differently than CAR. In particular in regard to enforceability and verification processes, also related to linkage timing, its impacts on eligibility of CAR approved protocols including clear language on criteria set for project type, starting date, vintage and transferability of otherwise approved CAR issued CRTs to meet ARB standards for being accepted as compliance worthy credits.

2. **Linking with other programs and standards**

The discussion about offsets has been a lengthy, thoughtful and meaningful process. Lessons learned from the European Trading Scheme have largely been incorporated in domestic state and regional programs. While the EU and the UNFCCC are contributing to adjust, reform, improve and address certain approval processes and eligibility concerns of Certified Emission Reductions (CERs), it is crucial to acknowledge the benefit of high quality offsets as a cost containment measure in compliance markets ***and*** as a globally recognized carbon currency.

The greater the availability of eligible project activities to make use of based on approved project protocols, the greater the benefit to create economy wide investment opportunities in un-capped sectors to reduce greenhouse gas emissions at the lowest cost. While CARB currently reviews ODS, urban forestry, methane digesters and forestry, CARB should accelerate approving new protocols under its own authority as soon as possible. Every eligible project activity fulfills and describes a certain additional revenue generating opportunity, although not each of them creates the same volumes of carbon offsets at the same cost. It should be left to the market to decide which activity should be prioritized; additional regulatory interferences will result in sub-optimal outcomes and potentially increase prices unnecessarily.

Certainty, credibility and robustness of carbon markets in its totality are based on longevity, accountability and applicability of governmental programs. Voluntary markets are simply insufficient. Taking advantage of compatible standards and linking regional programs globally will further result in more cost efficient mitigation solutions by creating global trading opportunities. As mentioned in the first section of this paper, greenhouse gases are global pollutants and thus have to be dealt with on a global level. Fungibility of carbon offsets is thus a crucial component of the implementation of AB32 as well as any federal legislation. This fact has already been acknowledged and incorporated in federal climate bills.

For the reasons mentioned above, we recommend CARB to review and create a pathway to linking to CAR and already existing additional offset protocols created under the Voluntary Carbon Standard, American Carbon Registry, Gold Standard and the Clean Development Mechanism.

It is important to highlight the fact that high quality offsets if applied prudently indeed reduce greenhouse gas emissions from uncapped sectors effectively, while allowances on the other hand per se do not. Thus, the configuration of a truly well adjusted cap-and-trade system depends not only on offsets; its success heavily depends on simplicity and fairness for regulated entities by providing economic sensible solutions to achieve projected reductions.

In this context making use of private sector financed project activities will channel funds into the right direction; the same cannot be said if the vast majority of tradable commodities are channeled through governmental bodies, which essentially imposes a tax in the form of auctionable allowances, leading to less efficient outcomes and potentially higher costs for the consumer and the economy as a whole.

3. Regulatory Additionality

The principles of offsets are clear and have reached levels of mutual understanding and consistency: As such, any greenhouse gas offsetting activity has to be permanent, additional (real), quantifiable, enforceable and third party verifiable. California has some of the most stringent environmental regulations in the entire US. Superimposing California regulations on projects outside of the state will forcefully exclude project activities that based on applicable state regulations are evidently additional.

Thus, we recommend that regulatory additionality should be defined by the applicable baselines according to the relevant environmental laws and regulations consistent with individual project locations and their jurisdiction.

In some cases, such as for landfills, a national benchmark exists also referred to as The New Source Performance Standard (NSPS). This is an example of how regulatory additionality can be accounted for. Imposing such benchmarks for all eligible carbon offset activities is cumbersome.

As mentioned previously, one major attribute for investing in uncapped sectors is to spur investments in innovative projects for which sufficient data to create national benchmarks is not always available, for this reason, regulatory additionality should apply based on project location in context of applicable state or province specific laws and regulations and their respective jurisdictions.

Over time, protocols evolve and as in any market, information and knowledge increases. We thus, believe as long as offset principles apply, trading offsets generated from projects inside and outside of California as well as from around the globe are enforceable and contribute to the integrity of the system as a whole.

We believe that the definition of the "precautionary principle" applies as defined by the Rio declaration in 1992, "In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation".

Thus, while CARB has to impose regulatory certainty around AB32, the lack of experience or the lack of scientific certainty should not artificially constrain the development of a market based system. Sufficient work has been done over the recent decade to safeguard that offset principles are applicable and for the sake of minimizing environmental degradation and its impacts on public health, creating incentives and a pathway towards a low carbon economy outweigh the potential risks that comes along with establishing an entirely new market based system that addresses climate change. Delaying implementation of AB32 will ultimately be more costly to society and nature, and, in the longer term, selfish and unfair to future generations.

4. Buyers liability

As a result of early market inefficiencies, we have witnessed due to the need for more reliable and more objective processes, a global standardization of market interactions creating exchanges, registries, and project documentation requirements related to ownership transfers and retirement of carbon offsets resulting in increased transparency, enhanced price discovery and traceability of supply and demand from its source to its use.

We recommend abandoning the concept of "buyer liability" in its entirety. Such a measure would restrict, limit and constrain private investments and hamper trade of environmental attributes, such as carbon offsets.

Such a modus operandi ultimately delays investments, increases costs – as i.e. insurances have to be applied - and reduces the willingness to purchase carbon offsets. Effectively, CARB could discredit offset transactions – the effect would be a blow to the market. Such a concept is not evident anywhere else in the world – a better concept is to outline a robust certification process. As outlined above, much has been done already to standardize such processes. In case a credit has already been issued, it should not be possible to revoke it. Following a strict and rigorous certification process will be needed to minimize potential fraud and misuse to keep the environmental and market integrity intact.

Related to forestry projects, suppliers of offset credits should have the responsibility to create "buffer pools" which would make up for any discrepancies in volumes. The purchase experience should be made as easy as possible and thus the buyer should be exempted from carrying any responsibility as long as offsets are approved and verified according to CARB protocols. Similarly contracts, such as Emission Reduction Purchase Agreements, already have in most instances a clause included that mentions if for any reason the delivered volumes are lower compared to contracted volumes, that seller will provide credits of the same quality sourced from similar projects without increasing the price for the buyer to balance out any discrepancies.

We wish to thank you for considering our comments and recommendations. We fully acknowledge the challenge CARB faces to balance market interests with environmental integrity. At the same time, we believe that California agencies such as CAR and CARB itself have mastered to overcome such challenges in the past and will continue to do so in the future. If you have any questions, please feel free to contact Erik Hansen at 202.510.2204 or myself at 202.758.6060.

Yours sincerely,

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