Center for Clean Air Policy
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# MEMORANDUM

Date: July 22, 2010

To: Barbara Bamberger
From: Center for Clean Air Policy
Subject: Recommendations for proposed design of California Reducing Emissions from Deforestation (RED) offsets program

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Thank you for the opportunity to comment on the proposed design elements of the California RED offsets program (see Attachment). CCAP commends the State of California for its cutting edge work and leadership.

We have reviewed the February 2010 paper, "Regulatory Design Options for Subnational RED Mechanisms," and offer our recommendations to ensure the program maintains the highest level of environmental integrity possible and leaves no doubt that RED programs in developing countries should move as expeditiously as possible to the National level. We offer these recommendations recognizing that California may play an important role in setting the bar for other U.S. states and national legislation. We have also attached a summary of the proposed elements of the program as we understand them from reviewing the Options paper and our discussions with you.

***Recommendations:***

CCAP concurs with a number of the design elements currently under consideration by California for the program/linkage agreements. We reference some of these below and offer a few additional comments and recommendations for additional consideration.

<u>Reference Levels, Targets, Trajectories</u>

- The reference level should be based on a minimum 5-year historical average (in line with proposed U.S. climate legislation, which requires a 5-year historical average for the national level). We understand that California is considering a 10-year average; however, a 5-year average may be more realistic given developing countries' differing circumstances and the likely availability of historical data (see next bullet). A 10-year average would limit participation by states to only those with 10 years of historical data, and exclude states with high value forests but low deforestation rates.

- Although California could consider using projected future baselines to accommodate such states, CCAP recommends the program prohibit projected baselines because of the high potential for non-additionality. Also California could mandate that any participating state must enter the program no later than 2012 to discourage skewing the historical reference level with a sudden increase in deforestation.

- The program should require a zero net deforestation trajectory within 20 years of establishing the reference level (currently proposed in U.S. legislation). Crediting baselines should be adjusted downward regularly using updated data in order to facilitate meeting or achieving greater levels of reductions than the 20-year trajectory to net zero.

MRV

- Promote community monitoring and verification procedures in the design of the linkage agreement regulations.

- Discount certain types of projects/activities, perhaps those with low additionality, weak MRV methodologies, or high risk of failure. This could help incentivize the generation of offset projects with the peer-reviewed methodologies, strong additionality, safeguards, or even co-benefits.[1] Similarly, consider identifying a specific set of project types with these attributes which can be "pre-approved" (similar to EPA general permitting).

Leakage

- Ideally, as part of the Linkage Agreement each state/province would establish with the national government a methodology to track potential leakage from the project nationally (this methodology could then be used to help establish a national deforestation baseline, which will take time to develop).

- Fully account for all significant sources of leakage within the state/province and adjust for leakage outside the state/province (proposed in U.S. legislation)

- Only issue credits to state/province registries for emission reductions, and not to projects.

Enforceability/Risk

- Require risk reserve insurance mechanism for all projects to cover both intentional and non-intentional reversals under a state/province approach; utilize a 2:1 reimbursement penalty for intentional reversals and a 1:1 reimbursement for unintentional reversals.

- Consider having the state of California insure against losses through management of a state-run insurance pool for offsets. This could be handled by a discount on offsets (2:1) required for covered entities to meet their cap, with the discount deposited into the insurance pool. The current recommendation for requiring capped entities to carry the liability of offset project failure may prove too much of a disincentive to purchase offsets through the RED program.

Safeguards

- Environmental safeguards: recommend mirroring and expanding upon language currently under consideration in UNFCCC negotiations, but also inclusion of safeguards specific to requiring protection and/or enhancement of biodiversity and other ecosystem services; prohibition against use or introduction of non-native species and noxious or invasive species; ensuring that projects are carried out in accordance with widely accepted SFM practices; ensure safeguards against earlier conversion from native ecosystems by setting a date prior to which conversion occurred (10 years, for example), etc.

- For all safeguards recommend the proposed option of inviting wide participation in their development from third parties and affected parties.

- Limit the total number of internationally-derived forest offsets that can be used to meet caps.

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[1] Kollmus, A., Lazarus, M., and Smith, G., 2010. Discounting offsets: issues and options. Stockholm Environment Institute. 19pp.

Phased Approach

- Propose a tentative list of RED project activities and/or project types that will be accepted as offsets, which either have pre-existing, approved MRV methodologies, or propose MRV criteria around those activities. This could help streamline and expedite the availability of offsets.

- Discount credits that are generated in the absence of national RED frameworks for a specified period of time.

- Similarly, create a pilot phase for subnational offsets beginning in 2013-14 with discounted crediting, and/(or) link this to a crediting baseline of a 50% deviation from BAU for the subnational baseline utilized.

- Establish a sunset clause for offsets generated by subnational programs in absence of a national program.

Understanding of National Government for State/Province Level Linkage Agreements

Regardless of the crediting pathway, whether it is state/province level or nested projects reconciled with state/province accounting, a mutual understanding between the state or provincial government and the national government should be a prerequisite for a linkage agreement. In this understanding, the state/province should advise the relevant national authorities of the program, obtain and incorporate their feedback, establish ways of future cooperation, and agree to benchmark and adapt its elements to the national plan over time should the national government decide to implement national RED. The national government would then agree to work to recognize the state level efforts in its national plan and MRV system.

Along these lines, participating states and provinces should have a statewide forest sector/land use management plan that is compatible with a national plan, or have all necessary authority over in-state decisions on land use management under a national plan in order to undertake development and implementation of a statewide RED framework. We recommend adoption of language in HR-2454.[2]

State-to-state GHG transactions and agreements ultimately will have national implications. For example, if a national government develops a national inventory and RED program it will be necessary to integrate sub-national actions into the national plan. Therefore, there should be an understanding that state programs will support the development of such national actions and inventories.

If there is not at least a mutual understanding between the state or province and the national government, credits or projects could be canceled or otherwise de-legitimized down the road. This could occur for a number of reasons. For example, in the short run, national government resistance to a state or province level program could lead to legal actions against or passive opposition to such programs. State or province level projects could also be excluded from an eventual national program for methodological or technical reasons, while the development of the international compliance market could reduce the demand or price for subnational reductions, causing sub-national projects to be discontinued. Any of these outcomes could render the state or province level credits worthless to the entities seeking to carry those credits to meet their regulatory obligations.

In addition, without a mutual understanding a state-to-state international RED crediting program in some instances could unintentionally generate internal discord between states or provinces and the

[2] One issue with this approach is that it would require California to develop regulatory criteria which specify the components of a statewide REDD strategy and require California to oversee compliance with these criteria in multiple foreign states.

respective national government, an outcome that should be steadfastly avoided. A state-state program could also create diplomatic problems for the U.S., particularly if it is not aligned with positions on RED held by the U.S. State Department or consistent with the parameters of bilateral agreements with the national governments of these states. California should choose subnational entities carefully, and ensure that there is consistency and alignment on these issues through careful coordination with the State Department.

Finally, some countries have committed to NAMAs (National Appropriate Mitigation Actions) under the Copenhagen Accord. If states sell offsets for forestry and other sectoral projects, this may undermine those NAMA goals either outright or by double counting.

Project-based offsets without state or national RED framework

Because it is so difficult to demonstrate and verify that projects result in a real, net emission reductions, without at least a state level (and ideally a national level) accounting system, we strongly discourage project-based reductions outside of an organized, government-led RED framework. Without state or national accounting, project reductions run a risk of undermining California's cap and trade program, a program poised to be the gold standard. In terms of the project-based "nested approach", whereby credits may be issued by a state/province directly to a project developer, this option should be discouraged unless it is limited to a pilot phase with controls that include discounting, risk reserves, and other safeguards.

Attachment

***Summary of Program Design Elements Currently Proposed by the State of California***

- Focus initially on deforestation only (RED)

- Intention is that RED be the first test case for a sector-based approach to offsets

- Goal is to kick-start RED at subnational level because of little or no movement at national level. Objective is to utilize state-level actions to drive national RED

- GCF began in 2008 as a collaboration between U.S. states and states in Amazona and Indonesia. Current state-to-state partnerships includes 13-14 states with the likes of Aceh; Acre; Amapá; Amazonas; East Kalimantan; Mato Grosso; Papua; Pará; West Kalimantan. Proposal is to establish a mini-RED program with states through "linkage agreements" to generate offsets.

<u>Timeframe</u>

2011: Rules will be promulgated for linkages agreements
2012: Program Implementation begins
2013-2014: First offsets are generated (at the earliest); pilot phase possible
2012-2020: Cap and Trade Compliance Periods (3yrs each)

(One state – Acre – is expected to be ready to generate some supply earlier than the 2$^{nd}$ compliance period in CA (which begins in 2015) – but no credits are expected before 2013/2014)

Following are key aspects of the conceptual program with the corresponding options being considered:

<u>Crediting Pathways:</u>

- RED credits generated as part of a "jurisdiction-wide" approach at the state or provincial level

- RED credits issued by a regulator to "nested" projects that meet specified eligibility criteria and are reconciled with the state/provincial accounting (essentially project-based crediting with consent of state/provincial government)

<u>Crediting Entity:</u>

- Regulatory agency such as ARB
- "board-approved external program" such as a credit-issuing standards body - would require an MOU between ARB and such entities
- State/province RED programs

<u>Preference:</u>

Preference is first for California-based forest offsets, then international offsets, but no quantities are specified

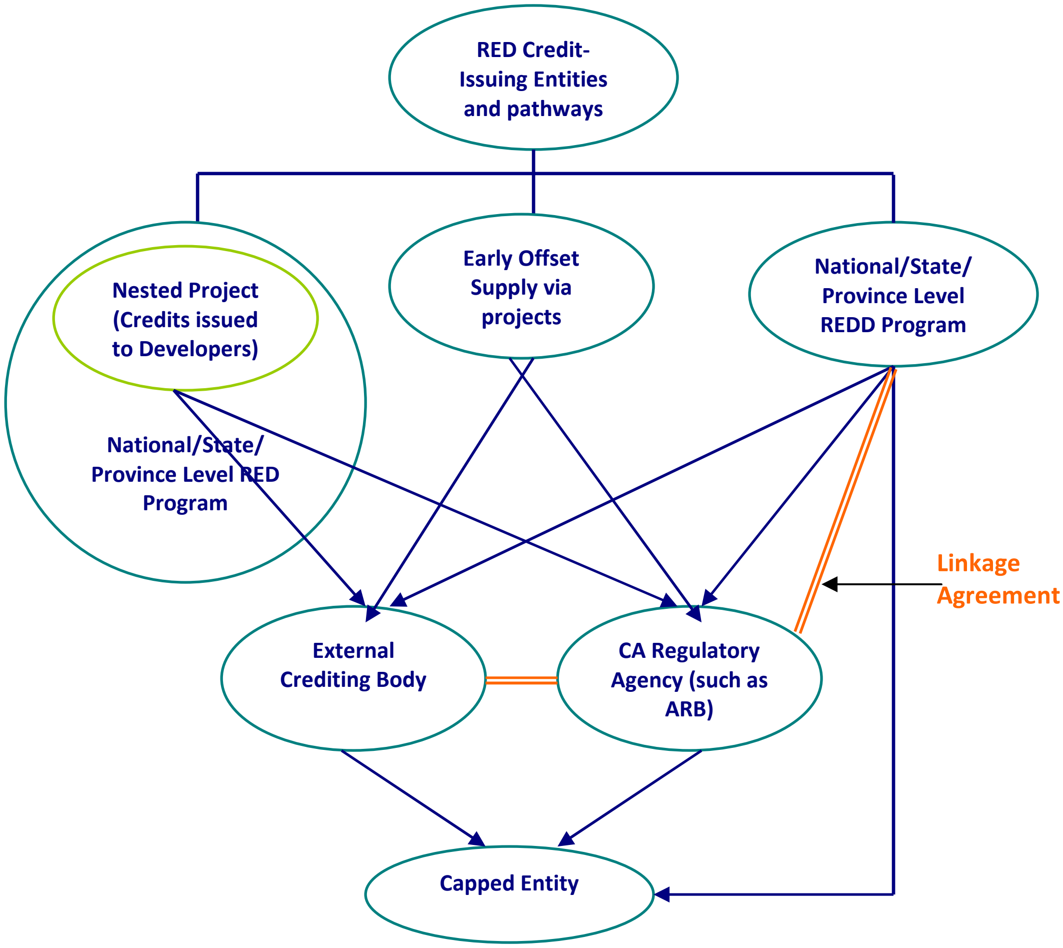
<u>Limits:</u>

The new law specifies that only 4% of an entity's cap can be met with offsets of any kind. Under sector-based crediting, RED forest offset credits would be limited within the 4%, but discussions are still evolving on what the limit would be. 1-2% is currently being considered.

Volume

122 MMT total from 2012 to 2020. If forest offsets are only eligible to meet 50% of this, then the total number of tons for this period would be 61 MMT. Demand in the first compliance period (2012-2014) would be 4MMT/year, but expected availability from international forests would be low or non-existent during this period, in which case, offsets would have to come from other sources or from in-state forest activities.

All crediting will be ex post.




Linkage Agreements- Minimum requirements (still in formulation) for establishing a link at the subnational level:

Two Potential Types

1. Bilateral
2. Unilateral

State/Province-Level accounting that can be compatible with future national level accounting with respect to:

1. baselines and Targets
2. State/Province RED planning

3. GHG Inventory/Registry Requirements

MRV of Performance could consist of:

1. MRV of state/province performance

    MRV could either be a hybrid of IPCC and California designed criteria (spelled out in a set of guidances following regulation), or could defer to one or more external standards (approved by ARB or EPA). The former would be more time consuming and could delay the program.

2. MRV of Nested Project Performance

    Potentially additional rigor for leakage and additionality, beyond what is required for state/province approach

Safeguards:

Law only specifies "no net harm." In terms of proposed regulations, only very preliminary thinking has been set forth on environmental safeguards. More detail is explored for rights/interests and benefit-sharing. Comparable or more rigorous to language in current legislation or UNFCCC language.

Enforceability:

Proposes liability rest with covered entity for any offset project failures in foreign state/province programs

Early Action/Phased Approach:

Proposes early offsets supply be enabled through a limited-window pilot phase, or for states that lack state RED programs, setting specific requirements that demonstrate state's intent and commitment toward a RED program. However, the latter option does not seem to be any more rigorous than the requirements for selling under an existing state RED program, suggesting that the door is open to all states without a state-level RED program to sell project-based offsets in an early-supply phase.