To: California Climate Action Registry
[Policy@climateregistry.org]

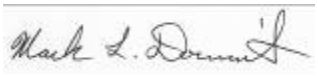
From: National Alliance of Forest Owners
Oregon Forest Industries Council
Washington Forest Protection Association

Subject: Comments on Climate Action Reserve's Forest Project Protocol, Project Implementation Agreement

Date: June 11, 2009

The undersigned organizations appreciate the opportunity to comment on the Climate Action Registry's (CAR) *Project Implementation Agreement*. The members of the undersigned organizations represent more than 100 private owners who collectively provide long-term sustainable management of millions acres of forestlands in California and the rest of the United States.





David P. Tenny	Ray Wilkeson	Mark L. Doumit
National Alliance of Forest Owners	Oregon Forest Industries Council	Washington Forest Protection Association

N **wners** (www.nafoalliance.org) is a national trade association representing 74 million acres of private timberland in 47 states. Our mission is to protect and enhance economic and environmental values of privately-owned forests.

Oregon Forest Industries Council (www.ofic.com) is a trade association representing over 50 large private forest landowners and manufacturing facilities in Oregon State that works to promote a reliable timber supply and a stable business environment while maintaining forest productivity and environmental values. Our members represent roughly 5 million acres of forestland.

Washington Forest Protection Association (www.wfpa.org) is a trade association representing private forest landowners in Washington State. Our members are large and small companies, individuals and families who grow, harvest and re-grow trees on more than 4 million acres.

We are writing in response to the opportunity to comment on the draft *Project Implementation Agreement* (PIA), dated June 2, 2009, and the companion draft

document addressing the *Consequences for Reversals and Early Termination* (CRET), also dated June 2, 2009. Our comments are made from the perspective of industrial and other managed forest landowners.

General Comments:

Lack of Transparency: In making our comments, we wish to note our disappointment that the release of this document is not accompanied by any supporting discussion document publicly setting forth the rationale and justification of the terms that have been fashioned into the PIA's requirements. This lack of transparency precludes a reviewer's ability to understand the intent behind many provisions. It also limits the ability of reviewers to support or challenge the rationales that are the basis for the PIA's content, making it difficult to judge the reasonableness of any given provision. It is imperative that in adopting or rejecting any of the recommendations in the Reserve's process for finalizing this document that the Reserve should publish its intent and rationale in accepting or rejecting all recommendations.

Bias against managed forests: This set of draft documents will likely discourage if not outright preclude most managed forest owners from participating in the offsets program. As we noted in our May 11, 2009, submission: *Comments on Climate Action Reserve's Forest Project Protocol, April 15th final draft*, the language of Section 3.3 – *Project Implementation Agreement* sets forth a general description of the Reserve's and the Land Owner's obligations, and establishes the PIA as a material element of the overall Project Protocol's requirements. Thus, our review and evaluation of the PIA and the CRET have been carried out from the perspective of determining whether these documents contribute to, or undermine the stated objective in the final draft Protocol: to "allow greater landowner participation, particularly…industrial working forests." As you will see from our comments below, in general, we do not believe that this draft document supports the ARB's intent, and CAR's own stated objective in this regard.

Ownership of CRTs: The documents do not adequately set forth who "owns" an issued and registered CRT at the time of issuance or after it is sold. Nor does it clarify the extent to which the Landowner and/or the Reserve have liability to third party buyers of CRTs. Even though the Reserve is not a trading bourse, nor intended to function as a CRT market trading forum, it sets forth various liabilities and responsibilities in the event of reversals and other events. In this context, there needs to be more clarity as to the ownership of a CRT at the time it is issued, when it is purchased by a third party, and when some of the registered tons (CRTs) are held in the Reserve's buffer pool.

The PIA should also clarify the rights to Reserve Buffer Pool CRTs (or the tons registered by a Forest Owner, but held in the Reserves Buffer Pool) at the termination of the PIA. The PIA is also ambiguous as to the right of a Land Owner with respect to withdrawing (retiring without use) a CRT that was registered, but never sold. A Land Owner may wish to reduce his/her exposure to liabilities and obligations by, in effect,

withdrawing previously registered tons and "returning" to the Reserve the unused (unsold) CRT that was awarded.

A Land Owner may also wish to use his/her CRTs to remedy intentional reversals or early termination obligations. The right to do so is not clear. In other words, once a CRT is issued and entered into the Land Owner's account in the Reserve, who owns the title to that CRT, and who has what rights with respect to decisions to sell, hold, or rescind the CRT before it is "used" (sold) as an offset? All of these aspects should be clarified.

Comments on the Draft PIA:

RECITALS, F: This paragraph should be amended by striking the period at the end of the paragraph, adding a comma, and adding the following language: "*or the landowner shall have otherwise replaced any registered and sold CRTs, and withdrawn from the landowners account and withdrawn any unused CRTs.*" This addition allows the PIA to have conformance with the section addressing early termination and remedied intentional reversals.

SECTION 4. Monitoring Rights of the Reserve: This provision should be modified to add language that limits the Forest Owner from any liability for injury or other harm to Reserve employees or the Reserve's agents while on the Forest Owner's property due to the Reserve's or agent's personnel's negligence or failure to adhere to safe practices that should be followed on managed forest lands, particularly to the extent that such personnel are in proximity to harvesting areas. The language should also make it an obligation of the Reserve's personnel or the Reserve's agents to have the proper health and safety training and knowledge and experience for such field activities, and be able to present evidence of such to the Forest Owner. This should include evidence of personal health, injury and casualty insurance, and as applicable, worker's compensation insurance.

The Forest Owner should also have the right to reject any such evidence if it fails to meet the requirements that are usual and customary for third parties employed by the Forest Owner in the management of the Forest Owner's property.

The Forest Owner, at his/her discretion, may also require the Reserve's employees and/or agents to review and agree to the Forest Owner's safety policies and requirements prior to entering onto the Forest Owner's property. The Forest Owner and/or the Forest Owner's agent shall also have the right to accompany the Reserve's employees and/or agents while the latter are on the landowner's property.

The Reserve's employees and/or agents shall make every reasonable effort to inform the Forest Owner of any concerns or other matters, including but not limited to a finding of a Breach or Threat of a Breach, as defined by the PIA, prior to leaving the Forest Owner's property. Such notice should be deemed to only be preliminary and should not

trigger the period of performance required by "Section 6 Remedies," until such notice of a Breach or Threat of a Breach is delivered to the Forest Owner in writing in accord with the procedures set forth in "Section 10. Notices."

SECTION 5. Transfer of this Agreement.

(a) Assignment and Assumption. Subparagraph (4): The time periods should be extended to 15 days.

Subparagraph immediately following Subparagraph (4): This paragraph states that a change to the agreement cannot be made without the Reserve's approval, "…which approval may be withheld at the Reserve's reasonable discretion." This provision, as written is overbroad, particularly in the context of the requirement for "Liberal Construction" set forth in Section 17. This authority should be clarified so as to limit the basis for withholding such approval to matters set forth in the PIA. Further, the Reserve should be obligated to advise the Landowner of its decision to approve or deny any change within 10 days of receipt of notice and request for approval of such changes, and any decision to withhold such approval must be accompanied by a clear statement setting forth the reasons why, and the specific elements of the PIA that the Reserve believes will not be honored.

Subparagraph (c) Notice: The requirement for 30 days advance notice is unnecessary and would seem to be excessive, given the obligations, including the obligation to provide post transaction notice within ten (10) days, that the landowner will have agreed to in executing the PIA at the project initiation. Many business transactions involving land transfers or the rights to use and actively manage forestland are also often comprised of multiple considerations, many of which may have contingencies and rights to extend the transaction date.

In some instances, until certain contingencies are met, the transaction may require confidentiality. This is of particular importance when the land is owned by a publicly held company that is subject to US Federal SEC (and potentially state securities law) disclosure and notice rules. And, in some instances, the transaction may not proceed to completion for matters that can occur within the thirty (30) day period prior to completion. This portends the possibility of the forest owner having to provide continuous notice updates and changes to the Reserve, simply adding to the complexity and costs of the administrative terms of the PIA, while failing to add any material benefit to either party.

Concerns about the integrity of behavior of counter parties with which the Reserve enters into an agreement should be addressed by a proper program of oversight and audit by the Reserve, utilizing its authority to inspect the involved property set out in other clauses of this agreement, rather than creating burdensome reporting requirements.

(e) Subordination. This requirement is overbroad as stated, and should be eliminated for working or managed forests, particularly with respect to mortgages or other forms of financing obligation. Most, if not all, owners of commercial and/or industrial scale managed forestlands utilize debt in their financial structure. It is unlikely that lenders will accept subordination to the Reserves interests, particularly given that the Reserves interests in the forest holding for a managed forest will be marginal compared to the overall asset value. Thus this requirement would effectively preclude such operations from engaging in the program. The requirement also appears to be redundant and unwarranted from a risk management perspective. The PIA provides multiple mechanisms, such as the buffer pool, to ensure the Reserve does not suffer a material loss from reversals of the registered carbon stocks (CRTs).

SECTION 6. The Reserve's Remedies: Forest owners should be given a minimum of (sixty) 60 days to respond to a notice of a breach, or threatened breach. Certain matters may require physical, on the ground actions of a silvicultural management nature to cure the alleged or threatened breach. In such instances, the Forest Owner should only be obligated to provide a plan on the how breach will be remedied within a reasonable time frame that is consistent with state-of-the-art forest practices and forest practice laws that would apply to the land involved. To the extent that a breach or threatened breach involves a reversal, the PIA's reversal provisions should apply.

The language under section *"6. The Reserve's Remedies*," should also be amended to incorporate language that holds the Forest Owner harmless and not in breach of any requirement when any action or condition thought by the Reserve to be a breach or threat of a breach, is the result of, or caused by a need to comply with any other federal, state, or local law or rule for the protection of life, the environment, and or property. For example, certain actions that could be deemed to constitute an intentional reversal may have to be taken to address the risk of, or actual harm from fire. In such instances, the landowner should be allowed to remove from the baseline the quantities of carbon stocks lost from such actions, and be allowed to replace them over time through regeneration. Carbon stock gains from the regeneration would not be deemed additional, but rather would be added back into the baseline until the entire reversal (carbon stock loss) is replaced. This safe harbor approach has been adopted by the US DOE in its 1605 (b) inventory rules as a reasonable means to address force majeure losses and would appear to be a reasonable cure in this instance as well.

SECTION 7. Termination for Breach: This section sets forth requirements related to certain terms of the PIA that have not been completed. (They are addressed in the CRET.) Until such time as these "gaps" are remedied, it is not possible to provide a reasonable critique of this provision.

SECTION 10. Notices: Language should be added to this provision to clarify just what are considered to be normal business days. It is recommended that this term be defined as Monday through Friday, between the hours of 8:00 a.m. and 5:00 p.m.

SECTION 13. Indemnity: Subsection (a) should be modified to clarify the extent of Land Owner indemnity in instances of *Unintentional Reversals*, in which the Reserve, under the draft terms of the CRET, indicates that it will remedy *Unintentional Reversals* through the use of CRTs from the Reserve-administered Buffer Pool. This language can be construed to suggest that the Land Owner is able to rely on that remedy for such losses so as to render the Land Owner free from liability for such losses, whether or not the Reserve can fully cover the exposure in any given case. In effect, in the case of unintentional losses, the Reserve could be assumed to be the liable party to any third party to remedy any CRTs that are alleged to be uncovered by the Reserve's Buffer Pool CRTs.

SECTION 16. Amendments: This section states, "For any CRTs issued in the future, the Term of the Agreement may be extended in accordance with this Section 16." This sentence is confusing. It seems to imply that any CRTs issued after the PIA is executed will require an amendment with respect to the PIA's "Term", as set forth in "Section 2. Term" This should be clarified as to meaning and intent.

Comments on the Draft Consequences for Reversals and Early Termination (CRET)

Contract Termination: Section 7 of the Agreement, *Termination for Breach,* notes that only those reasons for termination cited in the Protocol can entitle either party to terminate the project. Of concern is that the final draft Protocol's provisions only address the right of the Reserve to automatically declare a project terminated when an intentional reversal occurs. The CRET documents set forth the consequences for unintentional and intentional reversals, and for early termination. Thus, the provisions of the Protocol, as drafted, are narrower than the PIA and CRET documents. This lack of alignment should be remedied to ensure consistency and clarity in the Protocol and the PIA. As a contract, removing this ambiguity will be necessary to ensure that that there is a "meeting of the minds" of both parties, which is a fundamental element of any enforceable contractual agreement.

Standard of Reasonableness: A reasonable contract between two parties should have provisions setting forth the terms under which either party may terminate the contract. This is especially important for a contract that is intended to be in force for 100 years. Further, provisions for termination should be fair and equitable, rather than punitive, unless there is a breach of the terms of the contract by one party, for which there is no reasonable remedy, or for which the liable party fails to avail himself of the remedies provided, thereby causing harm to the other party in excess of the nominal harm, to wit, the offsetting of a metric ton of GHG emissions.

In this context, in the event of a reversal, *so long as the landowner replaces any sold offset (CRT) obligations*, there should be no additional penalty for a reversal or early termination, as there

will be no harm with respect to the atmospheric GHG reduction obligation, which is the objective of the Protocol and therefore the PIA. Note that unsold CRTs that reside in the Forest Owner's Reserve Account, if deemed to be unsupported due to the Reversal, should not be subject to replacement, as they have not been "retired" due to their sale and use by a buyer as an offset to GHG emissions. They are in effect unencumbered and therefore should simply be extinguished (unregistered) without cost or liability to the Forest Owner.

However, appears biased, in that the CRET contains punitive requirements for intentional reversals and early termination without any information that justifies either provision with respect to environmental or financial harm, or any other basis. Thus, the requirements appear to be arbitrary and contrary to the intent of the ARB's decision to develop the Protocol's revisions so as to encourage greater participation of managed forestland owners.

It should be noted that the Reserve is developing the revisions to the Protocol, the PIA and the CRET in response to a request to assist the ARB in addressing the need to encourage greater industrial forest owner participation. In this regard, the Reserve essentially is "standing in the shoes" of the ARB, which is seeking to provide a viable offset program as part of its framework to cost-effectively implement the cap-and-trade elements of it strategy to carry out AB32.

Thus, it should be incumbent on the part of the Reserve to take into consideration these broader aspects of the carbon market and trading process in which the Reserve's offset program will be engaged, and to allow the expected elements of such a larger program to be available to the offset program's participants. In this context, the following paragraphs further amplify the apparent bias that appears to run counter to this future state.

Intentional Reversal Bias: The first bias is the requirement that CRTs lost from an intentional reversal must be replaced by Reserve CRTs, either from the project or from other projects. This provision is not consistent with the intent of Cap and Trade programs, which seek to encourage the use of offsets as a means to reduce program costs. A forest owner should be afforded the option, at the forest owner's discretion, to replace any CRT reversal (loss) with any CRT or other offset or carbon credit registered under a program in which the credits are real, additional, measurable and verifiable.

The CRET, as written, may also leave a forest owner in the situation where the Forest Owner's inventory of registered, but unsold CRTs are not adequate to cover the reversal. Indeed, some of these CRTs would likely be invalidated by the Reversal, reducing the Forest Owner's inventory of banked CRTs. By having to buy only Reserve CRTs, the Forest Owner can be forced to purchase CRTs from other project owners at unreasonable prices. This subjects the forest owner to a captured or restricted market, rather than being able to avail him/herself to potentially lower cost remedies from the larger Cap-and Trade market under AB 32, and potentially under the WCI's or any future federal initiative. Yet the Reserve has not set forth any rationale as to why this restriction should apply. Further, this restriction is contrary to the intent behind cap-and-

trade concepts, and presumes that the forest owner's decision to pursue early termination is a malicious act that deems punishment.

The restriction wherein CRTs must be used is also in conflict with provisions in the Protocol that indicate that other "insurance" measures to address reversal (loss) risk will be allowed as they are developed. As we have commented previously in other submissions, there are many viable reversal risk management options that will involve the direct or indirect purchase of other offsets and credits (allowances). This conflict should be remedied, and the bias of the remedy should be towards encouraging the cost mitigation aspects of cap and trade programs, such as that being developed under AB 32 in California, and by the WCI.

The remedy should also be constructed so as to enhance the ability of managed forest owners to cost-effectively participate in an offset program rather than punish them for doing so. And finally, the breadth of options afforded to a forest owner should be designed to enhance the full fungibility of a forest offset in the larger market. Restricting the replacement requirement to CRTs will have just the opposite effect. This is counter to the many other provisions in the Protocol itself which have been designed to enhance the fungibility of forest offsets, such that a CRT will meet what is often referred to as the "a ton is a ton" test of the market.[1]

Early Termination Bias: The second bias occurs in the situation involving a decision by a landowner to pursue early termination of the project. In this instance, the landowner is obliged to both use only CRTs, and to replace any CRTs that will be lost at a rate greater than 1:1. The bias to use only Reserve CRTs suffers the same deficiency as noted above. The obligation to replace the CRT at a rate greater than 1:1 is simply without any reasonable explanation or justification. So long as any lost CRTs are fully replaced, there is no loss with respect to the level of expected GHG mitigation and therefore no harm to the Reserve or any buyer of a CRT registered with the Reserve. There is also no real cost to the Reserve, as the landowner is charged fees to compensate the Reserve for all program costs. Finally, early termination does not mean immediate loss of the sequestered carbon, if at all.

The imposition of a penalty in the form of an obligation to replace CRTs at a rate greater than 1:1 due to an early termination implies that the early termination has resulted in harm to another party that would go uncompensated. Neither the CRET, the PIA, nor the Protocol set forth any rationale of additional harm to any party that justifies this additional penalty. For this reason, the penalty provision for early termination can only be viewed as being arbitrary in nature and as biased against participation of managed forest landowners. This is not in keeping with the intent of this revision to the Protocol – to encourage greater participation by managed forest landowners – and therefore, as noted above, this element of the early termination requirement should be eliminated.

[1] In the international policy arena, the discussion about the role of offsets in general, and forest offsets in particular, are often framed around the need to be able to ensure an offset buyer that any offset of any type from any program fully offsets a metric ton of CO_2e GHG emissions.