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August 11, 2011

The Honorable Mary Nichols
Chairman, Air Resources Board
1001 I Street
Sacramento, California 95812

Re: California Cap On Greenhouse Gas Emissions and Market-Based Compliance
Mechanisms Regulation, Including Compliance Offset Protocols

Dear Chairman Nichols and Members of the Air Resources Board,

The Climate Action Reserve (the “Reserve”) congratulates the Air Resources Board (the “Board” or “ARB”) and its staff on the development of and revisions to the State of California’s cap-and-trade regulation, which will create the first economy-wide cap-and-trade program in the U.S. It is a strong example of California’s environmental leadership and will be instrumental in helping the state achieve its greenhouse gas emission reduction goals under AB32.

As authorized by our Board of Directors, the Reserve would like to submit the following comments on the revised cap-and-trade regulation, California Code of Regulation §95800 to §96023, issued July 25, 2011 (the “Regulation”). The Reserve strongly supports this pioneering Regulation and is encouraged by the continued progress toward implementation of this critical program.

The Reserve developed and implemented its offsets program to encourage actions to reduce greenhouse gas emissions and to demonstrate that, with the right set of rigorous rules and robust processes and oversight, offsets could, in fact, have true environmental integrity. To that end, our comments on the revised Regulation are focused on changes that we believe will, based on our experience operating the largest offsets program in North America, improve the function and integrity of the Air Resources Board’s cap-and-trade program.

We support the Board's reliance on existing registry infrastructure and experience to manage the offset registration process, rather than having the Board attempt to duplicate this infrastructure itself. However, we are concerned that the Board has not set the bar sufficiently high to ensure that an offsets program administered by third-party registries would maintain the highest standards for quality and credibility. The offsets program is not only complex, but any failure to deliver the highest quality offsets could jeopardize the credibility of the entire cap-and-trade program. For that reason, we strongly believe the Board must set the threshold for approval of third-party registries as high as possible; must ensure that such registries are experienced, knowledgeable, competent, and free of conflict of interest; and must exercise very stringent oversight of registry activities. Our comments that follow are meant to support the Board in this endeavor.

First, having pioneered the real-world application of standardized offset protocols, the Reserve strongly supports the revised Regulation's inclusion of language requiring that Compliance Offset Protocols use standardized methods (§95972(a)(9)). The use of such methods helps to reduce uncertainty, inconsistency, and subjectivity in the assessment and quantification of offset projects. We would, however, recommend that this language be clarified to specifically state that Compliance Offset Protocols must determine the eligibility and additionality of projects using standard criteria rather than project-specific assessments, and that they quantify emission reductions using standard baseline assumptions, emission factors, and monitoring methods. This will ensure that the Board's Compliance Offset Protocols do not suffer from the issues that have occurred in the United Nations Clean Development Mechanism program and other offset efforts that rely on more subjective, less consistent project-specific approaches.

Second, we would also encourage the Board to consider and adopt additional standardized, performance-based protocols that have been developed with broad stakeholder input and support as soon as possible. Doing so will allow sufficient time for offset projects to be built and operate so that they may begin providing a flow of offset credits into the program well before it launches. We would specifically recommend that the Board consider and adopt each of the Reserve's other high-quality offset protocols: Organic Waste Composting, Organic Waste Diversion, Nitric Acid Production, Landfill Methane Capture and Destruction, Coal Mine Methane, Destruction of Ozone Depleting Substances from Article 5 Countries, and Livestock and Landfill Methane Capture and Destruction for Mexico. The Reserve will shortly complete two additional protocols for the agricultural sector – Rice Cultivation and Nutrient Management – that we would also encourage the Board to consider and adopt as soon as they are completed.

Third, we continue to believe that the primary liability for replacing offset credits that have been invalidated by the Board should be imposed on the underlying project (the Offset Project Operator or Authorized Project Designee) as they are responsible for errors leading to invalidation (§95985). Such an approach has been used successfully in the Reserve's offset program and provides assurances that once a credit has been issued, it remains valid, while protecting the environmental integrity of the overall offset system. The draft regulation adopts

this approach for forest projects (§95985(g)); we would recommend that it be extended to all project types. It is only if ARB is unable to obtain compensation from the project that other mechanisms should be considered.

Fourth, if the Board does ultimately decide to enact the buyer liability approach that it has proposed, the Board should make it clear that only invalidated offset credits that have been used for compliance (placed into a Compliance Account) need be replaced, rather than all invalidated credits (Section §95985(f)). In an emissions trading system, if an incorrectly issued credit has not yet been used for compliance, its removal from the system is sufficient to ensure the system's atmospheric integrity. The holder of the invalidated credit should then be entitled to make its own decision regarding replacement with another offset or an allowance.

Fifth, to ensure the integrity of registry offset credits and to help identify problems or misstatements with projects before registry offset credits become eligible as ARB offset credits (and thereby reduce the risk of credits being invalidated later), we would strongly recommend that offset registries not be limited in their responsibilities to only checking that verification reports are complete (Section 95977.1(b)(3)(R)(4.)(a.)). Instead, registries should also be required to review the substance of those reports for accuracy, just as the Reserve does with every project in its system today. Requiring this type of quality assurance and control will provide the Board with an important security step in the approval process. The Reserve does not issue credits without a significant level of review and oversight of verification reports and the Board should similarly require that offset registries provide this level of strict quality assurance before a credit can be considered as an ARB offset credit.

Sixth, given the complexity and necessary knowledge required for these tasks, the Reserve would recommend that any entity that seeks to operate as an offsets registry under the California program first have several years of experience doing so outside the program (Section §95986(d)). Indeed, the draft regulation requires that verification bodies have experience before they may be accredited, but does not impose similar requirements for the registries that are meant to provide the first-level oversight of those verifiers. We believe the Board should not accredit a registry that has never before performed that function anywhere.

Similarly, the competency requirements for staff at an offset registry should either be the same as, or stricter than, the competency requirements for staff at accredited verification bodies (specified in Title 17 at Section §95132), since offset registries are required to check the work of the verification bodies through Offset Project Data Report review and verification audits. We would recommend that additional requirements be imposed on offset registries in the Regulation (at Section §95986(c)(1)) that mirror the requirements already imposed on verification bodies.

Seventh, to maintain program integrity, registries must be free of real and perceived conflicts of interest. The revised Regulation provides that verification bodies be assessed for conflict of interest before being permitted to verify a project. Included in this review are limits on acting

as a consultant to a project. The prior version of the Regulation made it clear that for a registry to be accredited by the Board its primary function must be operating an offsets registry. However, the revised Regulation now would allow any entity to designate a subdivision to provide registry services. If such entities provide other services in addition to registry functions, then they too must be free of conflicts of interest, including not being permitted to provide consulting services to offset projects, verifiers, or others involved in the carbon market. We would recommend either modifying this section to prevent such conflicts of interest (again, mirroring the requirements imposed on verification bodies) or returning to the December 16, 2010 language entirely by removing sections 95986(c)(2)(F) and 95986(d)(3).

Finally, the Board, acting through the Executive Officer, should have the discretion to limit the number of approved registries as it determines necessary and adequate. As drafted, the revised Regulation appears to require the Executive Officer to accredit any entity that seeks to provide registry services so long as it meets the Board's minimal criteria (Section (§95986(j)(3)), though this appears to be inconsistent with the language at §95986(b) that may provide more discretion. Such an approach could potentially lead to a proliferation of registries of variable quality and integrity. We recommend that the Executive Officer fully evaluate the procedures, operations, and capabilities of each Offset Project Registry to determine whether they are adequate to ensure that all offset credits issued meet the requirements of the Regulation. Further, the Executive Officer should be provided the authority to not approve additional registries if it is determined that a sufficient number have been accredited to serve the program's needs. Limiting the total number of accredited registries will also serve to minimize the potential for errors and reduce the resource burden on the Board staff in overseeing such entities and their activities.

In summary, we urge you to direct the staff to make the following modifications to the revised Regulation:

1. Clarify the language at Section §95972(a)(9) to state that Compliance Offset Protocols must determine the eligibility and additionality of projects using standard criteria rather than project-specific assessments, and that they quantify emission reductions using standard baseline assumptions, emission factors, and monitoring methods;
2. Consider and adopt additional standardized, performance-based protocols as soon as possible;
3. Impose liability for the replacement of invalidated credits on the underlying project rather than on purchasers of such credits (Section §95985);
4. If purchasers do remain liable for replacing invalidated credits, clarify that they must only replace invalidated credits that have been used for compliance (Sections §95985(b)(2) and §95985(f));
5. Require that offset registries conduct quality assurance review of all verification reports to not only ensure their completeness, but also their accuracy, before offset credits are issued;
6. Require that entities seeking to provide offset registry services for the regulatory cap-and-trade program have at least three years of demonstrated experience in operating a

- registry before they can be accredited, and establish competency requirements for registries equivalent to or better than those required for verification bodies;
7. Return to the December 16, 2010, regulation language stipulating that providing registry services must be the primary function of any entity seeking accreditation as a registry (thereby removing the language at §95986(c)(2)(F) and §95986(d)(3) allowing 'subdivisions' of larger entities to be accredited) or modify the Regulation to prohibit such entities from providing consulting services to project developers, verifiers, compliance entities, and other affiliated organizations in order to avoid real or perceived conflicts of interest; and
 8. Provide the Executive Officer with the discretion to approve the accreditation of offset registries as necessary for the efficient and effective operation of the cap-and-trade program (Section §95986(j)(3)).

On behalf of the Board of Directors and all of the Reserve staff, I thank you for this opportunity to share our comments and voice our support for the cap-and-trade Regulation. The Reserve is proud of its close collaboration with the Air Resources Board and looks forward to serving as a strong partner in the years to come as we work together to ensure the integrity of the offsets system, and the cap-and-trade program overall.

Sincerely,



Gary Gero
President