

September 19, 2016

Chair Mary Nichols and ARB Staff
Air Resources Board, California Environmental Protection Agency
1001 I Street
Sacramento, CA 95812

RE: Comments on the Proposed Amendments to the Cap and Trade Regulation

Dear Members of the Board:

Finite Carbon is an active participant in the California compliance offset market and is currently developing 28 improved forest management projects for the program.

We have enclosed several comments which we hope the Air Resources Board will take into consideration as it continues its efforts to improve the Cap and Trade Regulation and establish new forest management policy throughout the United States.

We thank you for your consideration and would be happy to answer any questions you may have.

Sincerely,



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§95973. Requirements for Offset Projects Using ARB Compliance Offset Protocols

ARB has proposed language in §95973(b)(1) that significantly changes the consequences of projects being out of regulatory compliance, but only for certain offset protocol types -- including livestock projects and mine methane capture projects. In its Initial Statement of Reasons, ARB stated that “staff determined it is appropriate, when possible, to limit the period of ineligibility to the period the project was out of regulatory compliance.” We commend ARB for making this change but we urge ARB to extend this proposed modification to all offset project types including forestry. Applying a “pro rata approach” to regulatory compliance is especially appropriate in the forestry context. Forestry reporting periods are long; the initial reporting period can be 24 months and the subsequent reporting periods are 12 months. A single violation associated with site preparation, planting, harvesting or monitoring often has *de minimus* effects, if any, on the carbon stocks of the forest or the integrity of the generated offsets (i.e. incorrectly harvesting a single tree may lead to a violation in some situations but may have no bearing on carbon stocks). The information used to determine the period of ineligibility – including documents from the oversight body, monitoring data, and witness statements -- to determine the start and end date of a violation related to those offset project activities that were outlined for the livestock and mine methane protocols could be readily applied to the forest protocol.¹ Likewise, the process for determining GHG emissions reductions or GHG removal enhancements for the Reporting Period as modified to reflect any period the offset project was out of regulatory compliance that was proposed in the revised Regulation could be applied to forestry projects.

We think that, whenever possible, all of the offset protocols should operate on equal footing. Providing more favorable terms to certain protocol types creates price differentiation in the offset market. This situation arose in previous versions of the Regulation under which Forest Owners were responsible for the invalidation liability from their projects; however, for all other protocol types, the offset buyers bore the invalidation liability under the Regulation. This disparity created a significant price differentiation in the market, and was subsequently corrected so that all protocol types operated under a consistent set of rules. Likewise, we think the rules for determining the period of regulatory compliance must be kept consistent across all protocol types.

¹ For example, the proposed language states that “the date when the offset project is deemed to have returned to regulatory compliance is the date that the relevant local, state, or federal regulatory oversight body that initiated the enforcement action(s) in questions determines that the project is back in regulatory compliance. This date is not necessarily the date that the activity ends or the device is repaired, and may include time for the payment of fines or completion of any additional requirements placed on the offset project by the regulatory oversight body, as determined by the regulatory oversight body.” 95973(b)(1)(B). We see no reason why this same standard could not readily be applied to any regulatory body that has oversight of forestry projects.

§95977. Verification of GHG Emission Reductions and GHG Removal Enhancements from Offset Projects

In 95977(c), ARB has proposed new language which states that for “offset projects that do not renew their crediting period, verification must still be conducted at least once every six years for the remainder of the project life. However, after a successful verification of an Offset Project Data Report indicating that Actual Onsite Carbon Stocks (in MTCO_{2e}) are at least 25% greater than the Actual Onsite Carbon Stocks in the final Offset Project Data Report of the final crediting period, the next full offset verification service may be deferred for twelve years.”

We commend ARB for developing rules that allow forest owners to maintain these projects over the timeframe required in the Compliance Offset Protocol in ways that are more economically feasible for the forest owners participating in the program. However, we urge ARB to change this amendment to allow if the onsite stocks at the end of the final crediting period are 25% higher than the *Initial* Carbon Stocks of the final crediting period then the 12-year cycle will apply.

The purpose of this amendment is to recognize and benefit landowners who have demonstrated a history of significant carbon sequestration during the course of their projects. A 25% increase in carbon stocks is a significant threshold -- a forest growing 3% per year and harvesting only 50% of growth annually would take 15 years to increase stocks by 25%. A landowner who increases stocks 25% during any crediting period demonstrates the same pattern of significant carbon sequestration as a landowner who increases stocks 25% from the end of a crediting period. This revision would provide landowners with an additional economic incentive to sequester more carbon during the crediting period rather than wait until after the crediting period, and earlier emissions reductions are inherently more valuable in addressing climate change than later reductions.

§95985. Invalidation of ARB Offset Credits

§95985(c)(2) -- Grounds for Initial Determination of Invalidation

ARB has proposed changes to §95985(c)(2) to harmonize this provision with the proposed amendments to §95973(b) (discussed above). The proposed amendments to §95985(c)(2) allow certain offset project types including mine methane capture projects and livestock projects to take a pro rata deduction in offsets credits from a Reporting Period following an invalidation event -- based on the amount of time the project was out of regulatory compliance -- instead of losing offset credits from the entire reporting period. We urge ARB to extend this language to all offset project types including forest carbon projects so that only credits that correspond to the time period that the offset project is determined to be out of regulatory compliance are subject to invalidation.

The risk profile associated with an offset and the consequences associated with its potential invalidation are the primary determinants of price and salability of that offset in the offset market. Creating vastly different rules for determining the consequences of invalidation for the different offset protocols will result in huge disparities in the market and may have a chilling effect on the marketability of offsets generated under the protocols with less favorable invalidation rules.

We urge ARB to apply the pro rata approach to all offset protocol types. The methods laid out in §95985(c)(2) for determining the period for invalidation for livestock and mine methane could just as easily be applied to forest carbon projects, and everyone in the system – including project developers, regulated entities and offset buyers – benefits from increased consistency, uniformity and equity across the offset market.

§95985(h) – Requirements for Replacement of ARB Offset Credits

ARB has proposed language that states that the Offset Project Operator identified in section §95985(e)(3) (i.e. the current or most recent Forest Owner(s)) of an offset project that had ARB offset credits removed from the Forest Buffer Account pursuant to section §95985(g)(1)(A)3 or (g)(1)(B) must replace 50 percent of the ARB offset credits removed from the Forest Buffer Account. We think that holding existing landowners liable for replacement of the credits in the Buffer Account is going to severely hamper the ability to sell land with a carbon project developed on it. This provision essentially turns forest carbon projects into a real encumbrance on the property.

We urge ARB to delete this proposed change because it is not necessary to maintain the integrity of the Forest Buffer Account. If forestry offset credits from a certain Reporting Period are invalidated, they will be removed from the appropriate Retirement Account or Holding Account, and the corresponding credits originating from that Reporting Period will be removed from the Forest Buffer Account. However, because all of these credits will be removed from the system simultaneously, the overall risk ratio for forestry projects within the Cap and Trade system remains the same.

A hypothetical example may be illustrative here: If we assume the Cap and Trade system consists of two forest offset projects, A and B. Each generated 100 credits in its first reporting period, and of those credits, 20 from each project went into the Forest Buffer Account (pursuant to a 20% risk rating) yielding an overall buffer percentage for the system of 20%. If the credits from Project A are invalidated, the 80 credits from Project A are removed from the appropriate Retirement Account² and the 20 credits from Project A are removed from the Forest Buffer Account. The system now only has 100 credits in it (all from Project B), but the overall buffer percentage is still 20% because

² We'll assume it's a Retirement Account for the purposes of this example.

the buffer credits from Project B still remain. If we then assume the 80 invalidated credits are then replaced with non-forestry credits, the integrity of the buffer pool still remains intact.

However, under the proposed language, the Forest Owner of Project A would now have to procure 10 additional offsets (50% of the 20 removed due to invalidation) and add them to the 20 offsets from Project B existing in the Forest Buffer Account. The system would now have 110 offset credits, but 30 would be part of the Buffer Account, thereby raising the percentage of offsets in the Buffer Account to over 27% of the overall offsets in the system.

If ARB's goal is to increase the overall percentage of offsets in the Forest Buffer Account, we think it is more efficient to increase the percentage of offsets required to be placed into the Buffer Account at the time of project issuance. The Offset Project Operator at the time of issuance can factor in these increases into its overall planning and budget at the project outset. Placing the burden of replacing offsets on existing landowners (who may be an entirely different entity than the original OPO) will make it increasingly difficult to buy and sell land enrolled in the compliance program. Future purchasers of forestland will address this new liability by discounting the acquisition price of the land enrolled in the program. Because the price of offsets could potentially increase significantly over time, it will be exceedingly difficult for potential buyers to accurately assess the risk, leading to a disproportionate discount on land prices.