Commentary

By Derald J. Hay

CAR's Forest Project Protocol: Potential Pitfalls May Limit Enrollment for Carbon Credits

On September 1, 2009, the Climate Action Reserve issued the Forest Project Protocol (FPP), which provides guidance to allow any qualifying forest projects throughout the nation the opportunity to earn carbon credits, which can be sold as offsets on carbon markets. (See "Climate Action Registry's Forest Carbon Protocol Goes National," October.) The protocol sets forth a process for quantifying the net carbon sequestered from activities on forestland and outlines the process for landowners to obtain carbon credits for projects that result in a net increase in sequestered carbon. These offsets then translate into a publicly tradable asset on the various carbon exchanges, currently trading around $9 per carbon ton.

The broad applicability of the FPP may open doors to help improve forest management, in some circumstances, on a national scale. It is designed to provide the flexibility necessary for a national policy addressing local forest management. However, there are significant issues with the FPP that may result in reduced participation, such as prohibitive costs and the scope of the management commitment.

Three types of projects are eligible for carbon credits:

▶Reforestation: planting understocked forestland (has had less than 10 percent tree canopy cover for at least 10 years, or a significant disturbance has removed at least 20 percent of above-ground live biomass.)

▶Improved forest management: a project must increase carbon sequestration through additional "natural forest management" and "sustainable" practices. The FPP recognizes certification programs by such groups as the Forest Stewardship Council, Sustainable Forestry Initiative, and Tree Farm System, as sustainable management; however, forests already certified are not eligible to use their current management practices for carbon credits, because these practices would not result in additional carbon sequestration.

▶Avoided conversion: requires a private forest landowner to dedicate the property to continuous forest cover through a conservation easement or transfer to public ownership. To be eligible, the most profitable use of the property, as determined through an appraiser, must be development.

The costs of enrolling and complying with the requirements of the FPP may be prohibitive, especially considering the risks and uncertainties of the carbon market due to regulatory flux on the federal level. Many of the costs involved are sunk into the process before the credits are issued or sold. For instance, sunk costs can include scoping the project, developing a carbon inventory, quantifying the net carbon change, and implementation of the project until the project can undergo an onsite verification by an independent, third party. In fact, the total number of credits generated by a project may not even be quantified until after significant costs have been spent in the implementation process. So, there may be unrecoverable costs and overhead that a landowner must cover even if the project is not eligible for enrollment or the total number of credits from the project is less than expected. This makes the cost-benefit calculus a moving target.

Landowners may face a risk that natural disaster, disease, or other elements out of their control may result in fewer credits or potential penalties. As a form of insurance, a "buffer pool" of credits is held in reserve to cover any unplanned losses of trees. For unavoidable carbon losses from natural processes, landowners are required to contribute a certain percentage of the project's eligible credits (thus adding to the transaction costs) to the pool when credits are issued. However, if the amount of sequestered carbon is reduced because of landowner negligence, gross negligence, or willful misconduct, called an "avoidable reversal," landowners must retire credits from their own account. "Negligence" is a tricky term, because it could mean decisions could result in penalizing a landowner if, looking back, there was a better management decision which would not have resulted in carbon loss. For instance, it may be negligent to perform a controlled burn that behaves unexpectedly and results in carbon loss.

Another significant issue is that the minimum time commitment for a project is a period of 100 years following the issuance of any sequestration credits. This time commitment may be prohibitive to landowners of both large and small tracts because of uncertainty. Understandably, the program is based on selling a pledge that some amount of carbon will be permanently sequestered in the forestland to provide offsets for another entity's immediate carbon emissions; however, properties may change ownership several times over a century. Saddling future property owners with significant monitoring and report obligations may provide a disincentive to enroll properties in the program. Depending on the market, the FPP may significantly reduce property values because of the risks of the carbon market, the increased costs of ownership, and penalties associated with resignation.

Another issue that may limit enrollment in the program is that credits are only issued for carbon that is sequestered at higher-than-normal rates. Therefore, landowners who took a proactive role in sustainable forest management will need to find a way to increase sequestration over and above the sustainable practices already implemented to be eligible. This may pose a substantial burden for commercial forest landowners, because their management techniques have already been vetted through significant processes to optimize the long-term profit and sustainability of the forest.

Unfortunately, the carbon market is relatively weak, because of the low demand and uncertain need for carbon credits. Until the federal government takes an affirmative action (one way or the other), there remains a significant uncertainty over the value of carbon credits because many states are waiting for guidance from above before instituting a carbon program to avoid duplicative or contradictory regulatory programs. The uncertainty is likely to prevent forest landowners from entering the FPP process because of potential carbon market failure or the failure of government regulations to recognize the FPP. Uncertainty results in risk, reduced demand, and a less robust market and translates to a lower trading value.

Notwithstanding these issues, there are some forests for which the FPP may make sense. For instance, private landowners considering the prospect of donating a conservation easement on a property or obtaining forest certification might be able to justify the additional expense. There may be tax benefits, such as reduced local property taxes and income tax deduction, for donating conservation easements. While certified forests are not trending toward increased prices for timber, the marketability of the logs, lumber, and pulp is increased and the prospect of carbon credits may convince some landowners to go through the certification process.

One caution: landowners should seek legal counsel when drafting a conservation easement or providing advice on taxes or regulatory implications. Many states prohibit nonlawyers from drafting legal documents such as conservation easements or providing legal advice. In addition, professional liability insurance carriers may not cover a mistake by a forest consultant in rendering these services, because legal malpractice may be outside the scope of the insurance coverage.

The FPP offers private landowners an opportunity to generate additional profit from their forestland by taking additional steps associated with best management and sustainable forestry practices. However, until the risks and costs of compliance are more in line with the value of carbon credits, there may be very limited participation in the program.

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vestment fund managed by The Forestland Group, LLC. The $15.1 million purchase price will be comprised of a combination of state and federal money, as well as funding by The Nature Conservancy, The Conservation Fund, American Electric Power, and other parties.

The Albedo Effect

A study by scientists at four US universities shows that all land-use changes result in higher regional surface temperatures—except the conversion of land to agricultural uses.

"A clear exception is conversion of land from other uses to agriculture, which produces relative cooling, presumably because of increased evaporation," said Eugenia Kalnay, a professor in the Department of Atmospheric and Oceanic Science at the University of Maryland and one of the study's coauthors.

Not surprisingly, the urbanization of forest-, grass-, shrub-, and farmland results in the highest temperature increases. Converting barren land and farmland to forest generally results in warming, while converting urban areas or grass/shrub lands to forest results in cooling.

The study will be published in the Royal Meteorological Society's *International Journal of Climatology*.

An article in the October edition of *National Geographic* outlines the history of Pacific Lumber Company and its bankruptcy and acquisition last year by Mendocino Redwood.

Penn's Oil

The Pennsylvania Department of Conservation and Natural Resources will open six tracts of land, totaling nearly 32,000 acres, for oil and gas lease sales. The lease sale requires a minimum bid of $2,000 an acre and royalties of 18 percent. Pennsylvania owns and manages about 2.1 million acres of forestland.

"For each tract, we have identified the number of well pads that will be allowed, and we will encourage developers to use existing roads," said the department's acting secretary, John Quigley. "Additionally, there are portions of the tracts that cannot be developed on the surface in order to protect wild or natural areas, ecosystems, water bodies, recreational opportunities, and visual impacts from vistas and trails."

Have You Seen the New Online Edition of *The Forestry Source*?

Beginning with its August 2009 issue, *The Forestry Source* is now posted online in a "digital magazine" format, which makes it easier for readers to find and link to articles and share *Source* items with their friends and colleagues. In addition, as more issues of the *Source* come online, the new and improved archive feature will make it easier to search back issues. To check it out, just visit the SAF website and click on "Periodicals," and the *"The Forestry Source."*