



January 31, 2008

The Climate Trust Comments to the Western Climate Initiative on the Summary of Major Options for a GHG Offsets System to Support the WCI System

Thank you for providing The Climate Trust with the opportunity to submit comments to the Western Climate Initiative (WCI) regarding the summary of options for a greenhouse gas offset system. We commend the member states and provinces for their pioneering lead in committing to designing and implementing a regional cap-and-trade system for the West.

The Climate Trust is a non-profit organization whose mission is to promote climate change solutions by providing high-quality greenhouse gas offset projects and advancing sound offset policy. The Climate Trust solicits, evaluates, and contracts to purchase offsets on behalf of its funders, including regulated power plants, businesses, and individuals. Since its founding in 1997, The Climate Trust has directed \$8.8 million in funding into 16 greenhouse gas offset projects that are expected to offset nearly 2.6 million metric tons of carbon dioxide. The Climate Trust is the largest supplier of offsets approved under a greenhouse gas regulatory regime in the U.S.

Introduction

These comments address certain design questions for stakeholder review and comment as set forth in the Western Climate Initiative (WCI) Summary of Major Options for a GHG Offset System. These comments focus on the role that we believe greenhouse gas offsets should play in the regional reduction framework for the WCI system, specifically:

- The Climate Trust believes that greenhouse gas offsets have an important role to play in the WCI reduction framework and should be included as an integral part of the region's greenhouse gas reduction strategy.
- The voluntary and regulatory greenhouse gas offset markets are actively addressing many of the challenges presented in this document regarding the integration of offsets into the WCI framework; we do not believe that these challenges should preclude the inclusion of offsets into the WCI system.
- The Oregon Carbon Dioxide Standard and experience of The Climate Trust in implementing the U.S.' oldest greenhouse gas offset program provides a notable model for the WCI reduction regime. The Climate Trust strongly encourages consideration of the development of a greenhouse gas offset administrator to implement and administer a greenhouse gas offset program under the WCI system.

Question 1: Should the WCI allow offsets as a compliance mechanism?

The Climate Trust believes that offsets have an important and valuable role to play in state, regional, national and international greenhouse gas reduction efforts, and that they should be included in the WCI greenhouse gas reduction framework. Oregon's experience with greenhouse offsets under its pioneering Carbon Dioxide Standard illustrates that offsets can be an important component of the successful regulation and reduction of carbon dioxide. It also demonstrates that it is feasible to purchase offsets that meet very high eligibility and quality criteria in a cost-effective manner.

Per the integration of offsets into the WCI system, given the scale and magnitude of emissions reductions needed to avert the most catastrophic impacts of climate change, every available emissions reduction tool and resource will be needed in the coming decades. A market-based cap and trade system is an important component of the comprehensive suite of carbon reduction policies that will be needed; however, cap and trade alone will not be sufficient. Mechanisms such as fuel efficiency standards, system benefit charges, tax credits, energy efficiency standards, and other regulatory measures will also be necessary to achieve economy-wide emissions reductions. Greenhouse gas offsets are one of these tools and have a valuable role to play in the transition to a lower carbon economy, both in the Western United States and globally.

Rather than reiterate the well-summarized advantages in the options document, we would like to focus on ways that the regulatory and voluntary greenhouse gas offset regimes are overcoming the disadvantages presented in this document. The Climate Trust believes that the disadvantages stated in the summary are valid concerns, but as an active market participant, have observed the voluntary and regulatory regimes effectively address many of the concerns set forth here over the past several years. We believe that these disadvantages can be overcome through careful and thoughtful policy and regulatory design.

Disadvantage 1: Offsets can pose a risk to the environmental integrity of the cap, if issues surrounding additionality, permanence, leakage, quantification or verification are not addressed.

The rapidly developing offset market in the United States, as well as existing regulatory frameworks under the Kyoto Protocol's Clean Development Mechanism, have resulted in robust and comprehensive means of addressing and mitigating the challenges surrounding the issues of additionality, permanence, leakage, quantification and verification. The Climate Trust believes that it is feasible to develop a robust, yet flexible framework for integrating a greenhouse gas offset mechanism in the WCI system without compromising the environmental integrity of the cap.

The essential promise of a greenhouse gas offset is the achievement of a real and verifiable reduction in greenhouse gas emission levels equal to reductions that would have been realized by onsite mitigation measures by emitters. Onsite greenhouse gas mitigation measures generally require mitigating entities to invest in greater efficiency or

equipment retrofits or upgrades, which can be quite costly. By directing mitigation funding to equivalent greenhouse gas reducing activities offsite, greenhouse gas offsets can provide a less costly and equally effective means of achieving emissions reduction goals. However, strong quality criteria must be in place to ensure that the environmental integrity of the cap is maintained.

One of the most important of these criteria is additionality. Strong methodologies currently exist for the assessment of additionality through a variety of programs, including the Voluntary Carbon Standard and the Clean Development Mechanism. We recommend drawing from the extensive work that has already been done in this area as WCI considers the development of an offset program. Moreover, designing a system that is compatible with and complementary to existing international frameworks will advance the development of a global, fungible carbon market.

Because assessing additionality relies upon forecasting what would happen in a future without carbon funding, no assessment is perfect. Additionality tests must be stringent enough to ensure the environmental benefit of offset projects, yet lenient enough to allow the carbon market to support desirable projects. Additionality tests that are too stringent will falsely determine that many truly additional projects are non-additional and viable and cost-effective emissions reduction opportunities will be forgone. Too much stringency could also prevent the encouragement of new, low-carbon technologies. On the other hand, additionality tests that are too lenient will allow many business-as-usual projects to be considered additional, which means that offsets would provide few environmental benefits. The correct balance between the stringency and leniency of additionality tests depends upon the policy goals of a market or an offset buyer.

The Climate Trust believes that a hybrid approach to additionality and quantification best strikes the balance in addressing effective additionality and quantification criteria. In hybrid assessments, baseline and additionality determinations can combine elements of project-specific and standardized assessments. A range of different hybrid combinations, some favoring project-specific methodologies and others emphasizing the standardized approach, can be used. For additionality tests, for example, a standardized approach can first screen out non-additional projects and a project-specific evaluation can then be used to review a sub-set of projects. In creating baselines, a project developer can rely mostly on site-specific measurements, but supplement this data with a few sector wide generalizations; or, project developers can use mostly sector-wide emissions factors supplemented with some site-specific data.¹

¹ For a more detailed discussion of standardizing offset crediting procedures and methodologies we recommend the paper: “Expanding Global Emissions Trading: Prospects for Standardized Carbon Offset Crediting”. The paper was prepared by Derik Broekhoff from the World Resources Institute for the International Emissions Trading Association and published November, 2007. It provides an in-depth and detailed discussion of the various types of offset qualification and quantification methodologies. The paper can be found here: <http://www.ieta.org/ieta/www/pages/download.php?docID=2733>

Disadvantage 2: Reduces incentive for investment and innovation in lower-emitting technologies by sources and sectors included in the cap-and-trade program.

The Climate Trust believes that this disadvantage can be most effectively addressed through careful policy design. As long as the cap is set to an appropriately stringent level, and a reasonably limited proportion (between 25% and 50% of total required reductions) of reduction requirements can be met through the purchase of offsets, reduced incentives for innovation should not be a significant issue. The electricity sector is faced with enormous challenges in meeting steadily increasing demand for power, with increasingly constrained generation options. In order to operate profitably and effectively in a lower carbon energy economy, power providers have a strong incentive to develop new and innovative low-emitting technologies.

Moreover, allowing offsets does not mean that innovation is sacrificed; quite the contrary. Offsets can and do play a vital role in funding new technologies and project types that are on the margin of profitability in uncapped sectors. Offsets are not a “get out of jail free” card, rather they are a means of transferring greenhouse gas emissions reduction funding to the sectors of the economy where they can be achieved most cost effectively first. As long as the WCI offset program is designed to ensure the environmental integrity of offsets allowed in the system, emissions reduction targets will be achieved in the most efficient and cost-effective manner.

Question 2a: Location: Should WCI allow offsets (only)* from projects located within its partner jurisdictions?

The Climate Trust strongly discourages limiting the eligibility of offset projects by geographic source. It is important to remember that greenhouse gases are global pollutants and that the location of an emissions reduction is immaterial to its impact on atmospheric concentrations of greenhouse gases. While we recognize that there are important positive environmental and economic externalities associated with the implementation of offsets within the member states, we believe that there are compelling geo-political and economic reasons for allowing offsets from a broad geographic scope.

We believe that by limiting the geographic scope of offsets, regulators could significantly decrease the available supply of offsets, thereby driving up their cost; particularly in the early years of the WCI program when demand for flexible compliance mechanisms is anticipated to be the greatest. Moreover, there are currently fairly limited numbers of offsets available from U.S. based offset quantification programs such as CCAR and VCS. While this should change over time as greater certainty emerges regarding the shape and structure of the WCI and other regional markets, the potential exists for a serious supply deficit in the early years of the program. Additionally, tapping into the more mature and robust frameworks already established at the international level through the Kyoto Protocol will greatly facilitate the integration of offsets into the WCI system when they are needed most, in the early years of the program.

Second, as more sectors of the economy are capped in the U.S., there will be fewer and fewer eligible sources of offsets over time from within the capped economy. If offsets are only allowed from the member states and the pool of available credits shrinks over time, the benefits of integrating offsets into the WCI framework will be limited.

The Climate Trust believes that in the long term, most eligible offset project types will be located in uncapped economies, predominantly in the developing world. We believe that by only allowing offset projects from within the member states, or within the U.S., WCI will miss out on the true advantage of a cap-and-trade system: the ability to achieve emissions reductions from the lowest-cost options from around the globe.

Additionally, we believe that WCI should work to develop mechanisms for verification to ensure the certainty and equivalency of out of region projects. Additionally, strong project verification networks already exist under the Kyoto Protocol programs that will ensure the integrity of offset projects occurring in other parts of the world.

3a: Should there be quantitative limits on the use of offsets (perhaps based on their location) to meet compliance obligations?

The Climate Trust believes that some form of quantitative limit on the use of offsets by capped entities in meeting their compliance obligations is reasonable in order to ensure that infrastructure transitions to lower emitting sources within capped sectors are properly incentivized in the early years of the program. The Climate Trust recommends that the initial quantitative limit be set in the 25-50% of reductions range and gradually decrease over time.

Another possible means of ensuring that technological changes are stimulated appropriately could include a larger amount of greenhouse gas offsets allowed for capped entities to meet their emissions reduction compliance obligations in the early years of the program, with progressively declining amounts over time. This structure would serve important cost-containment purposes in the beginning years of the program, and stimulate reductions in sectors not amenable to a cap, or not yet covered by the cap, while still ensuring that capped entities are making the necessary infrastructure changes toward lower-emitting generating sources. A portion of the overall allowed offset percentage could have geographic stipulations to ensure that a least a portion of compliance offsets are sourced domestically.

4.a: Should the WCI decide by August 2008 upon an initial list of approved project types, possibly including approved baseline and monitoring methodologies, prior to a cap-and-trade design?

The Climate Trust does not recommend that WCI attempt to independently develop project or sector-specific additionality and quantification methodologies before the August design recommendation deadline. In fact, given the time constraints the WCI is facing and the complexity of the task at hand, developing new additionality and quantification methodologies would be extremely difficult. We believe that the WCI system would be best served by defining a clear process by which an offset mechanism could be developed by the time the regime takes effect.

Initially, we recommend that WCI screen existing additionality and quantification methodologies such as those from the Clean Development Mechanism, the California Climate Action Registry, The Regional Greenhouse Gas Initiative, The Climate Trust, Environmental Resources Trust, EPA Climate leaders, and the Voluntary Carbon Standard, for use in the early stages of the WCI to begin qualifying projects and credits for use in the program.

Concurrently, The Climate Trust recommends the establishment of an independent offset market administrator that would be tasked with synthesizing existing and developing new additionality assessment and quantification methodologies, among other things. It will be particularly important to have an independent, centralized body to assist the states in administering an ongoing offset program if one is established. The Regional Greenhouse Gas Initiative (RGGI) member states have chosen to establish a non-profit, central administrative body, with one of its purview being offsets. The State of Oregon's pioneering efforts in carbon offsets have also developed such an entity specific to offsets: The Climate Trust.

We believe that WCI would be well served by incorporating a greenhouse gas offset administrator into the offset program framework. Under this model, each member state could hold a seat on the board of the organization, which would ensure that all states had an equal voice. Advantages of the non-profit offset administrator model approach include:

- Administrative efficiency;
- Adaptability of the program over time;
- Centralization of resources, knowledge and expertise;
- Consistency across states in regulations and rules;
- Increased transparency and accountability;
- Greater oversight by member states; and
- Impartial and independent implementation of the WCI offset program.

The greenhouse gas offset administrator would serve several vital functions in executing a multi-sector greenhouse gas reduction program under the WCI offset framework. This organization would serve under the guidance of the states and would:

- Evaluate existing protocols and methodologies for compliance with and eligibility to participate in the WCI system, and develop new protocols and methodologies using a “project to protocol” approach.
- Oversee modifications and changes to offset regulation, criteria and eligibility over time.
- Evaluate proposed offset projects under the system and determine their eligibility with the WCI standards and qualification methodologies.
- Serve as the registry for WCI compliant tons, including allowances/reduction credits and offsets, perhaps in partnership with another organization.

The greenhouse gas offset field is highly technical and is evolving rapidly. The WCI system will need to develop a significant amount of capacity related to qualifying and quantifying greenhouse gas offsets in a relatively short amount of time. The WCI offset

program could face the substantial challenge of delivering high volumes of quality greenhouse gas offsets in its early years. The implementing organization will have relatively little time to scale up to the level needed to implement a region-wide greenhouse gas offset program. Thus, demonstrated expertise in implementing and operating offset programs will be necessary to meet this challenge.

One example of where significant expertise and experience with offset project analysis will be needed is in the protocol development arena. Protocol development is an emerging field with a wide variety of quantification methodologies and additionality assessments currently in use. Preliminary analysis indicates that there is a large variation in the amount of greenhouse gas emissions reductions resulting from a single project depending on the quantification and qualification protocol used. If multiple methodological assessments are allowed for a single project type, project developers could “protocol shop” in order to obtain the greatest amount of reduction credits for their particular project.

For this reason, having an experienced, knowledgeable and proficient body to administer an offset program under WCI will be of paramount importance. By having a centralized, expert organization tasked with ensuring the environmental integrity and administrative efficiency of an offset program under the WCI system, many of the concerns expressed in this document regarding the integration of offsets into the WCI framework could be addressed.

Oregon, through The Climate Trust, has nearly a decade of experience in implementing a successful greenhouse gas offset program. The Climate Trust stands ready to contribute its experience and success in the greenhouse gas offset field to help WCI develop and administer a robust and efficient offset program for the West.

Question 4b: Should the WCI allow offsets from sources capped and regulated by the cap-and-trade system or from indirect emissions reductions in sectors covered by the cap-and-trade system?

The essential promise of a greenhouse gas offset is to ensure that an equivalent amount of greenhouse gases are avoided or sequestered than would have been achieved by an on-site mitigation measure by a regulated entity. Allowing emissions reductions to be double and even potentially triple counted, seems directly at odds with the stated aims of the program. Moreover, an emissions reduction that is double counted should not be allowed as an offset. In order for the offset market to maintain (or regain) its credibility, the fundamental underpinning of an offset must be upheld; an emissions reduction implemented offsite intended to compensate for emissions occurring at the point of regulation. Offsets are an emissions reduction undertaken on behalf of an entity either voluntarily or required to reduce its emissions.

If there are particular technology types that are extremely valuable, or lacking in current incentive structures (such as energy efficiency) we recommend that WCI consider alternative means of funding these activities. Direct subsidies, rebates, and tax incentives are examples of alternative funding streams available to incentivize these types of emission reduction activities.