



September 29, 2008

## **The Climate Trust Comments to the Midwest Greenhouse Gas Reduction Accord on Draft Recommendations of the Advisory Group**

### **Introduction**

Thank you for providing The Climate Trust with the opportunity to submit comments to the Midwestern Greenhouse Gas Reduction Accord (“the Accord”) regarding the Draft Recommendations of the Advisory Group.

The Climate Trust is a non-profit organization with the mission of promoting climate change solutions by providing high-quality greenhouse gas offset projects and advancing sound offset policy. The Climate Trust was established under the United States’ first regulation of greenhouse gases, the Oregon Carbon Dioxide Standard. The Climate Trust solicits, negotiates, 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 close to 2.6 million metric tons of carbon dioxide.

We commend the member states and provinces for their pioneering lead in the establishment of regional greenhouse gas emission reduction goals and a cap-and-trade program. Cap-and-Trade is an important policy tool for mitigating climate change.

### **Overview and Summary**

These comments address the role of greenhouse gas offsets in the Accord’s cap-and-trade system as set forth in the Preliminary Offset Recommendations of section 4.0 of the Draft Recommendations. Specifically they address the following:

#### **1. Offset Permanence (4.2.4)**

The Climate Trust discourages the provision of temporary offset allowances and instead recommends alternative policies to address the potential for emission reductions reversals.

#### **2. Limits on the Use of Offsets (4.4)**

The Climate Trust recommends a 50 percent limit on a regulated entity’s reduction obligations to be met through the purchase and retirement of high quality offsets.

#### **3. Geographic Location of Offsets (4.5.1)**

The Climate Trust strongly discourages the imposition of limits based on the geographic location of an offset project.

#### **4. Incorporation of the CDM and JI (4.5.2)**

The Climate Trust strongly encourages the inclusion of offsets sourced from international programs, particularly those from the CDM and JI programs, as well as international credits sourced outside of the CDM and JI that meet the quality criteria and standards established by the WCI system. The Climate Trust also discourages the imposition of additional regulatory requirements for projects sourced from these programs that have been approved to issue Certified Emission Reductions (CERs) or Emission Reduction Units (ERUs) by CDM and JI's governing bodies.

#### **5. Offset Project Types (4.6)**

The Climate Trust suggests maintaining the Accord's focus on quality offsets, while including a broad list of eligible project types.

#### **6. Offset Methodologies (4.7)**

The Climate Trust recommends the hybrid assessment methodology for quantifying and monitoring emission reductions.

#### **7. Centralized Administrative Body (4.8)**

The Climate Trust recommends a centralized administrative body to coordinate the implementation of a regional offset program across multiple jurisdictions.

#### **8. Establishment of an Accord Offset Advisory Group**

The Climate Trust strongly encourages the Accord to establish an offset advisory committee that would serve as a resource for the Accord as it develops the design of the regional offset system, and would provide a set of recommendations addressing a number of key outstanding issues.

#### **1. Offset Permanence (4.2.4)**

While the Draft Recommendations of the Advisory Group advise that offsets be permanent, the Preliminary Offset Recommendations note the possibility of awarding "temporary offset allowances" to some project types that face the risk of reversal. The Climate Trust is a leading member of the Offset Quality Initiative (OQI), which opposes the inclusion of such temporary offset allowances in any cap-and-trade program:

While some advocate a special "temporary offset" category for certain types of potentially non-permanent emission reductions, OQI recommends against this approach due to its barriers to inter-market fungibility, additional administrative requirements, and movement towards a globally tradable and credible commodity. OQI believes that if sufficient assurances and measures are in place to ensure replacement of offset credits in the event of project reversal, offset credits sourced from projects that face permanence issues should be treated as any other reduction that meets the applicable offset eligibility requirements.<sup>1</sup>

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<sup>1</sup> The Offset Quality Initiative. "Ensuring Offset Quality: Integrating High Quality Greenhouse Gas Offsets into North American Cap-and-Trade Policy." July 2008: 19.

Instead of allowing temporary offsets, The Climate Trust recommends the second option the Offsets Subgroup proposes for dealing with permanence noted in the Preliminary Offset Recommendations: “that administrative procedures be adopted to provide for the replacement or reversal of offset credits associated with sequestered emissions that have been reversed.” In order to proactively address and mitigate potential risks from such project types, the Offset Quality Initiative notes several policy options to address unintentional losses:

- Insurance and bonding mechanisms to secure funding for replacement tons in the event of underperformance or reversal.
- Buffer accounts that provide additional reductions that can be tapped in the event of underperformance or reversal.
- Strict covenants and easements on the use of land and forested areas, as well as long-term leases.<sup>2</sup>

To make certain high-quality offsets are used to meet Accord compliance obligations, the Advisory Group should implement the above policy alternatives in lieu of awarding temporary offset credits to projects that face the risk of reversal.

## **2. Limits on the Use of Offsets (4.4)**

The Advisory Group is currently considering limiting the use of offsets to 10 to 50 percent of the emission reductions to be achieved by the program compared to business as usual. The Climate Trust strongly advises allowing offsets to potentially account for the maximum percentage of reductions under consideration, 50 percent.

There are a number of considerations that must be weighed when establishing quantitative limits on the use of offsets to meet emission reduction compliance obligation requirements under the Accord. Imposition of a quantitative limit that is too stringent could unnecessarily increase the costs of achieving emission reduction targets, potentially weakening support for emission reduction requirements and resulting in unintended political consequences. For example, if the costs of compliance with the emission reduction targets are too great, the entire program could lose support and face widespread public opposition.

On the other hand, if the limit on the use of offsets is set too high, few emission reductions could be achieved in the capped sectors, resulting in lost faith in the efficacy of a cap-and-trade system to drive emission reductions in sectors covered by the program, despite global emissions being reduced. Emission reduction regimes should be designed to ensure that technology transformation and adaptation is occurring in the capped sectors, as these are often the largest sources of emissions in a given system. Ideally, cap-and-trade policy will be designed to ensure that emission reduction opportunities at reasonable costs in the capped sectors are incentivized, while also ensuring access to

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<sup>2</sup> The Offset Quality Initiative. “Ensuring Offset Quality: Integrating High Quality Greenhouse Gas Offsets into North American Cap-and-Trade Policy.” July 2008: 20.

lower-cost emission reduction opportunities in uncapped sectors through a robust offset program.

The Regional Greenhouse Gas Initiative (“RGGI”) and the Western Climate Initiative (“WCI”) have both set the quantitative limit on offsets to allow approximately 50% of reductions to come from offset and “outside”<sup>3</sup> system allowance purchase and retirement, and 50% to come from “inside” allowance purchase and retirement. In order to stimulate the optimal mix of reductions in capped sectors, along with cost-containment in meeting compliance obligations, the Accord should apply the same limit of 50% for its restrictions on offset use.

### **3. Geographic Location of Offsets (4.5.1)**

The Advisory Group should strongly reconsider its recommendation to constrain the geographic scope of offset projects to only Accord states and states with an MOU with the Accord jurisdictions. The WCI, in its final “Design Recommendations for the WCI Regional Cap-and-Trade Program” in section 9.3, opted to “encourage the development of offset-projects located within WCI jurisdictions for compliance purposes...”. The Climate Trust supports this approach to encouraging the development of offset projects in member jurisdictions.

In general, The Climate Trust does not support geographic limits on offset project eligibility. Imposing quantitative limits can severely impact the cost and supply of offset credits available for use. If the Accord imposes very strict geographic limits as well, it is highly likely that there will be insufficient supply to meet demand in the program, thereby driving up the overall cost of the program and potentially weakening its political support and viability in both the short and long terms. Moreover, limiting offset eligibility by geographic source runs contrary to the fundamental ideal of developing global solutions to a global problem.

A recent report by Deutsche Bank estimated that prices for carbon credits eligible under California’s GHG regulatory program would fall between \$15 and \$60 per ton. However, the same study also found that if stringent restrictions were to be placed on the geographic source of offset credits, the limited supply could cause prices to surpass \$60 per credit.<sup>4</sup>

Based on The Climate Trust’s experience with the Regional Greenhouse Gas Initiative program (RGGI), it is unlikely that sufficient projects will be located in Accord member jurisdictions to meet demand for offset credits, particularly because much of the economy in the member jurisdictions will fall under an emissions cap as the program is currently proposed. In addition, even though RGGI also allowed for projects in non-RGGI states that signed MOUs with participating states, the cumbersome MOU process has limited the supply of offsets eligible in the RGGI program. The Accord risks the same problems

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<sup>3</sup> Outside refers to allowances from other Cap-and-Trade systems purchased and retired by capped entities under the Accord.

<sup>4</sup> “Offset limits could push California carbon prices above \$60/t – participants.” *Carbon Finance*. 10 Sept. 2008

even if it allows offset projects in states that have signed an MOU with Accord jurisdictions.

The Draft Recommendations also suggest the possibility of further limiting the geographic scope of offset projects to include only states with a GHG regulatory program at least as stringent as the Accord. While this provision may have the intent of rewarding states that have implemented legitimate GHG programs, it is likely the vast majority of offset projects in already-regulated states will be used to meet the offset demands of those states, in effect further limiting the supply of offset credits eligible under the Accord.

For the reasons noted above, the Climate Trust advises against geographic restrictions on offset eligibility in the Accord. By only allowing offset projects from within the member states, or even within the United States, the Accord will miss out on the true advantage of a cap-and-trade system: the ability to achieve quality emissions reductions from the lowest-cost options from around the globe.

#### **4. Incorporation of the CDM and JI (4.5.2)**

The Climate Trust strongly encourages the inclusion of offsets sourced from international programs, particularly those from the CDM and JI, as well as international credits sourced outside of the CDM and JI that meet the quality criteria and standards established by the Accord. Both the CDM and JI produce quality offsets through a rigorous system that has evolved over time. Given the offset supply challenges a nascent Midwestern program will likely face, much would be gained from increasing the supply of credits by incorporating CDM and JI offsets into the Accord from its commencement, namely a ready supply of high quality offset credits on day one of the program.

The Climate Trust also discourages the imposition of additional regulatory requirements for credits sourced from programs that have been approved to issue Certified Emission Reductions (CERs) or Emission Reduction Units (ERUs) by the CDM and JI governing bodies. Adding additional layers of bureaucracy, cost and time to an already bureaucratic, costly and time-intensive program will not contribute to a strong and fungible global offset market. Moreover, requiring that credits sourced from CDM or JI meet additional criteria does not facilitate market linkage nor cost effectiveness in these systems. Tremendous time, resources and funding have been invested in the existing approval mechanisms under the CDM program, and these processes continue to be refined and improved over time. Emerging regulatory programs should build on and strengthen the extensive resources and experience offered by the CDM program, not undermine it through the addition of unnecessary and costly layers of bureaucracy.

#### **5. Offset Project Types (4.6)**

The Climate Trust commends the Accord for requiring offsets to meet quality program design principles. As the Accord moves forward in identifying project categories to be considered eligible in its offset program, it is advised to maintain this focus on quality while including a broad list of eligible project types. Most importantly, the supply and cost of available offsets at the start of the program will be largely dictated by the types and location of eligible offset project types available for use in the Accord system.

One of the primary advantages of including offsets in a greenhouse gas reduction regime is the ability to capitalize on lower cost emission reductions in a broad array of sectors outside of the cap. If there are a very limited number of eligible offset project types, that benefit will not be fully realized.

In general, The Climate Trust recommends direct emission reduction projects as ideal for inclusion in regulatory offset programs. Direct emission reduction projects are defined as projects where the emission reductions occur at the site of the offset project. This includes projects from the transportation sector, such as truck stop electrification projects, among others. Allowing offset projects from sectors that will be subject to a cap in later years of the program could help spur early downstream reductions and make the transition to a cap less costly over the long run, or allow for the establishment of greater emission reduction targets and more stringent caps when those sectors come under the cap.

#### **6. Offset Methodologies (4.7)**

While the Advisory Group notes that offset methodologies should be “as standardized to the extent possible, while ensuring accuracy,” it gives few specifics on how this will be practically implemented. The Climate Trust recommends the hybrid assessment methodology to meet the Accord’s goals in quantifying and monitoring emission reductions.

The hybrid assessment methodology provides for an optimal balance between the strengths and weaknesses of both project-specific and standardized methodologies through the evaluation of a project-based on streamlined project-type specific standards as well as the project’s unique qualities.

Regarding hybrid assessment methodologies, the Offset Quality Initiative supports

the development of cost-effective, robust, and flexible offset project assessment tools that provide a rigorous and transparent framework for the evaluation of offset projects. Regulation should strive to integrate the transparency and consistency of standardized approaches, while capitalizing on the flexibility and adaptability of project-specific approaches. For this reason, OQI recommends the hybrid approach to developing regulations for the assessment of offset project additionality, baseline establishment, quantification, and crediting periods. We believe that a hybrid approach strikes the best balance between transparency and standardization, while taking into account the consideration of project-specific circumstances. Emerging regulatory regimes should build on the existing groundwork that has been completed at the regional and international levels, and seek to design policy that incorporates the lessons learned from current activities, while allowing for flexibility, innovation, and adaptation over time.<sup>5</sup>

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<sup>5</sup> The Offset Quality Initiative. “Ensuring Offset Quality: Integrating High Quality Greenhouse Gas Offsets into North American Cap-and-Trade Policy.” July 2008: 8.

## **7. Centralized Administrative Body (4.8)**

Although the Draft Recommendations of the Advisory Group make no mention of it, the Preliminary Offset Recommendations discusses a regional organization that would centralize offset program implementation. The Climate Trust commends the Accord for recognizing the importance of a centralized administrative body. It is recommended, however, that the role of the administrative organization be strengthened beyond evaluating project categories.

The Climate Trust strongly encourages the Accord to consider incorporating a non-profit greenhouse gas offset administrator into the offset program framework. Advantages of the non-profit offset administrator model approach include:

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

Regulatory offset programs can be complex and time intensive to administer. We believe a regional organization staffed by experts and guided by a board of directors composed of representatives from the member jurisdictions (similar to the model established by The Climate Registry) will be the most efficient and cost-effective means of administering a regional offset program.

A centralized administrative entity could serve several vital functions in administering and executing a multi-sector greenhouse gas reduction program under the WCI reduction framework in addition to the functions listed in the Draft Design Recommendations document. This organization could also:

- Serve as or partner with an organization to serve as the registry for Accord-compliant offsets.
- Enforce the offset program requirements and evaluate and monitor Accord offset projects used for compliance over their lifetimes.
- Assist regulated entities in meeting their greenhouse gas emission reduction requirements through a dedicated fund that small regulated entities could pay into. These funds could be used to procure high quality greenhouse gas offsets on their behalf, similar to the Oregon Climate Trust model.
- Administer a public greenhouse gas reduction fund that would fund greenhouse gas reducing activities and projects that may not fit within the Accord offset framework, possibly funded through auction revenues generated through the sale of emission allowances. Auction funds could be directed to fund greenhouse gas reducing activities in capped sectors that are located downstream (or upstream if appropriate) from the point of regulation, thereby ensuring that the necessary infrastructural changes are taking place up and down the supply chain. They could also be directed towards emission reduction opportunities that are not included in the Accord offset framework and are outside of a sector covered by an emissions cap.

The Climate Trust strongly encourages the Accord to develop a unified regional GHG compliance offset program that is agreed upon from the outset of the Accord cap and trade program launch and evenly applied across the member jurisdictions of the Accord. Offset programs can be costly to establish and administer over time; a coordinated regional approach will employ important economies of scale and provide necessary certainty for regulated entities and other market participants, such as offset originators, as well as ensuring the greatest degree of coordination and environmental consistency.

### **8. Establishment of an Accord Offset Advisory Group**

In order to develop a coordinated regional greenhouse gas offset system, The Climate Trust recommends that the Accord establish an Offset Advisory Committee. This committee could be comprised of a diverse cross sector of participants in the greenhouse gas reduction field and could provide recommendations regarding a range of technical issues necessary for the establishment of a robust, rigorous and efficient Accord offset system.

Capitalizing on the extensive experience and knowledge of the existing GHG offset field will assist the Accord in developing a robust, comprehensive and adaptable compliance offset system. The Climate Trust stands ready to contribute our experience and assistance to the formation and coordination of an expert advisory committee should the Accord choose to implement one.

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