Report on ENGO View of Industry-Provincial Offset Group (IPOG) Design Process and Report

March 20, 2007

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This report sets out the ENGO view of the role of a domestic carbon offsets system in Canada and highlights some of the major concerns that were identified by ENGOs in the offset design developed by the Industry-Provincial Offset Group (IPOG) and laid out in the IPOG final report published in February 2007 (see http://www.offsetsgroup.ca/).

The Pembina Institute would first like to express its appreciation for having been included in the latter portion of the deliberations of the IPOG and for being able to provide input to the deign process on behalf of ENGOs. However, Pembina is deeply concerned that, as they currently stand, the IPOG recommendations on the design of a Canadian offset system do not uphold the high standards of environmental integrity required. Thus, after the final workshop on January 25, 2007, we arrived at the conclusion that the Pembina Institute could not be identified in the IPOG Final Report as a “participating organization” or endorse the report.

We would like to reiterate our keen interest in continuing to provide input to the IPOG process, and we hope that private sector participants find our perspectives valuable. But we also look forward to participating fully in a future process to develop a truly representative and credible Canadian offsets system that adequately balances private sector and environmental/public interests.

GENERAL COMMENTS

While the concept of a domestic offset system is straightforward, its detailed design is critical. Like any financial system it must be based on rigorous accounting. An offset system will only deliver real reductions if based on rigorous emission accounting. Unfortunately, recommendations made by IPOG introduce emissions accounting that could compromise the integrity and credibility of a domestic offset system. This will result in large industrial emitters delivering significantly fewer emission reductions. Every tonne of reductions that large industrial emitters fail to deliver through the domestic offset system is an extra burden on the climate and an extra tonne that the government – and taxpayers – will have to find and pay for elsewhere.

A domestic offset system should also be viewed as an additional source of financing for projects that reduce or remove GHG emissions. The offset system must not preclude regulatory, financing and other climate change measures where these policy tools are more effective in reducing GHG emissions, such as low-impact renewable energy sources, building construction and retrofits, appliance and equipment efficiency, and vehicle fuel efficiency. An offset system should complement existing and future programs designed to reduce non-price barriers. It will be ineffective if those programs are not left in place. Regulatory measures have been and remain a particularly cost-effective and successful means of achieving many environmental objectives and must not be discarded in favour of an offset system that has uncertain outcomes.

In development and refinement of domestic offset rules it will be important to find a balance between the interests of buyers, sellers and traders to have easy access to offset credits, and the public interest of having effective environmental benefits and compliance with international climate obligations.

AREAS OF DISAGREEMENT

The key areas of concern in the IPOG process and final report are:

- Placement of private sector above environmental and public interests
- Lack of a robust additionality criterion for offsets
- Insufficient transparency
- Lack of accountability
- Selection of grid emissions factors is a technical rather than a political issue

Public versus Private Sector Interest

The IPOG Final Report of February 2007 makes several recommendations that appear to place private sector needs above environmental and public interest. Indeed, the Introduction (p.7) describes the objective of the group as meeting only “the needs of those who will be engaged in reducing” GHGs. An offset system should be viewed as a privilege granted to polluting industries by society that allows them to manage their emissions – investing in new non-emitting projects as a lower cost option to reducing their own emissions. Industry is not obliged to participate in an offset system and this system should be designed to achieve environmental objectives based on society’s terms and not industries’.

We are encouraged that IPOG sees regulation of GHG emissions as inevitable and is making detailed preparations for a regulated future. However, we feel that private sector participants may not be acting in their best interest in recommending a process that marginalizes the environmental and public interest. Policy proposals that do not meet the test of public credibility face a serious obstacle to implementation.

An example of where the IPOG report appears to place industry interests over public interest is in the section on balancing timeliness, cost and integrity. Integrity has to be given priority otherwise the offset system will not achieve its primary objective, which is to reduce GHG emissions. Yet the IPOG report gives equal weight to all three and implies a cost “burden” if this is not followed.

Another example is the suggestion in the IPOG report that protocols developed for specific projects should be proprietary and would not be available for use by similar projects. As well as adding undue expense for project developers, this is not in the spirit of a societal effort to reduce emissions in the most cost effective manner.

Environmental Integrity

An offset must be equivalent to the reductions in emission foregone by the polluting industry that purchases the offset. The investment in the offset must therefore result in additional emissions reductions that would not otherwise have occurred *if offset credits were not available.* An industry can either reduce its own emissions or invest in a project that would not otherwise have happened without some financial support through the offset system. If the project invested in was going ahead anyway, no net global emissions reduction will occur when an offset is purchased. Thus, it is not an offset at all.

This robust definition of additionality was accepted by an IPOG Sub-Working Group that was created to define key principles to build the Canadian Offset System. Robust additionality was captured in the definition of the "Environmental benefits" principle as follows:

> "To be eligible for offset credits, a project must result, with high confidence, in lower greenhouse gas emissions or higher greenhouse gas removals than would be the case if offset credits were not available. Non-greenhouse gas environmental benefits and impacts must also be addressed when considering project eligibility."[1]

However, at an IPOG meeting on January 25, 2007, the broader group voted to remove references to: "than would be the case if offset credits were not available." In doing so the IPOG effectively removed all environmental integrity and credibility from the offset system design, and removed any likelihood of public acceptance of the proposed system. The recent surge in interest in global warming and its solutions among the public and business has been accompanied by a growing understanding of emissions trading. The media has many reports on voluntary offset systems and the importance of making them credible. The key issue in many of these reports is additionality – ensuring the offset makes something new happen that would not have happened anyway.[2] If there is this concern over voluntary offsets, one can imagine the concern over an official government domestic offset system that does not have a robust addtionality requirement.

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1 All Key Principles agreed to by the IPOG Sub-Working Group were preceded by the following caveat: "The following are Key Principles that will guide the development, implementation and delivery of an effective and efficient offset system that supports, with integrity, the achievement of associated environmental outcomes. Consideration and application of these Key Principles must recognize that:

- They are an integrated package of ideas and concepts serving to mutually support each other. While each element is important as a stand-alone item, they must be considered in the context of one another.
- They reflect the desired attributes of a national system that is fully functional and in operation. Initial implementation needs to reflect the spirit of these Key Principles, but include appropriate flexibility upfront to initiate a system that recognizes and integrates as appropriate with other existing or planned climate change policies in Canada to support a coherent national system that will be improved over time to reflect these attributes."

2 See for example, Globe and Mail March 20, 2007, page B1

Applying a robust additionality requirement is not difficult or onerous. Practical rules can be adopted to ensure business-as-usual projects cannot receive credits, as demonstrated by the Kyoto Protocol's Clean Development Mechanism (CDM), which uses an "Additionality Tool" that provides a rigorous and clear way to do this. The CDM additionality tool provides a project developer with several paths to prove additionality: (i) the offset makes the project more cost-effective, (ii) the offset removes key barriers preventing the project going ahead (e.g. foreign exchange allows a bigger loan), (iii) the offset allows the introduction of a newer technology than was otherwise planned, or (iv) the offset allows a project to increase emissions reductions over what was planned (e.g. higher energy efficiency).[3] The CDM tool has been effectively used by project developers and investors for three years in the only official operating offset system, the CDM.

It is true that the CDM has suffered from administrative bottlenecks in the past, but this was a result of dramatic under-funding of the CDM Executive Board, and because there were few buyers and experienced sellers – it is not a result of additionality rules. Additionality rules actually contribute to decreasing uncertainty because they make it very clear to project proponents whether their projects will qualify or not. Before the use of a tool similar to the CDM Additionality Tool in Canada's offset system is dismissed, the federal government must conduct a proper examination of the experience of using the tool in the CDM, quantify the expected volume of credits that could be granted to business-as-usual projects if such a tool is not adopted in the offset system, and consult stakeholders on the outcomes of both evaluations.

To reiterate, requiring only that an offset project reduces emissions over a baseline, as the final IPOG design does, provides no assurance that new additional reductions will occurs as result of the offset investment.

Transparency

The IPOG report appears to limit the transparency of the proposed carbon market established by the proposed offset system. The system would only be open to public scrutiny up until the validation of a project, after which purchase and sale of emissions reductions would be deemed confidential. This is not in line with international practice under the CDM where each verified CER is registered publicly. As noted above, an offset system is a privilege provided to polluting industries by society. If industries are concerned about confidentiality they can choose not to use the system.

ENGOs would not be able to support an offset system unless:

- All project level information, evaluator report and other information relevant to public review were posted on an independently operated public registry.
- The registry should be linked to an independently operated public exchange. Essential transaction level market information should be made available through the exchange.

3 See http://cdm.unfccc.int/methodologies/PAmethodologies/AdditionalityTools/Additionality_tool.pdf

Accountability

Unlike the CDM, the project cycle included in the IPOG report does not include an explicit public review step. This step provides the public with an opportunity to provide their views on a project before it is registered. The registering body must take these views into account when approving or disallowing a project. The public (stakeholders) would provide input on:

- Environmental integrity – including additionality
- Any non-GHG environmental impacts or concerns about the project
- Any social impacts of the project

ENGOs would not support the offset process unless the following explicit step is included in the project cycle:

> ***Public Comment Period***
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> *Once a project is validated the project document, the protocol used and validation report are posted for public and stakeholder comments. This allows issues such as social and non-GHG environmental impacts (not covered by any EIA requirements), local concerns, conformance with offset eligibility criteria, and confidence that the project will produce additional GHG reductions to be addressed by the public or other stakeholders. The comments and any recommendations from the public comment period are taken into account during project registration*

The IPOG report is also silent about the body or bodies that would oversee a domestic offset system and registration system. These bodies must be public and overseen by a multi-stakeholder board that has no financial or other interest in the offset projects themselves. They must have independent technical advisory services available for issues such as protocol evaluation. Under no circumstances should industries purchasing offsets or selling emissions reductions be part of the overseeing process.

Finally, the IPOG report is silent on who would validate projects and verify emissions reductions. There needs to be accredited third party independent agents who apply and carry out these tasks on behalf of the overseeing offset body.

National vs. Regional Emission Factors – a technical not a political issue

Some IPOG participants claimed that selection of emissions factors used to calculate emission reduction from electricity based offset projects was a political rather than a technical issue. It is true that there is some desire to create a level playing field across the country for alternative energy projects. However, the reality is that displacing a kilowatt-hour of coal-fired electricity with wind power has greater environmental value than displacing a kilowatt/hour of hydroelectric power.

In jurisdictions that have a low carbon intensity electricity sector—provinces that have significant hydroelectric power, for example—using a national intensity factor means that electricity saved will be credited with more offsets than actually deserved based on the actual amount of reduced GHG emissions. Meanwhile, projects that displace electricity

with high carbon intensity, like coal-fired power, will be given fewer offset credits than the emissions actually displaced. This favours projects that have the smallest GHG benefit, and will generally discourage project proponents from using the offset system. Finally, no independent verifier could possibly verify that actual reductions had occurred if a national factor were used.

Having an intensity factor for each individual province would strike the right balance between simplicity, environmental integrity and accuracy. The CDM approach of using a standard protocol to estimate the weighted average emissions factor in each independent grid should be followed (see also below).

AREAS OF AGREEMENT

There were many areas where there was agreement between the ENGO and industry view, including:

Omission of Tiered Approach

We agreed that the tiered approach originally proposed was unworkable and would lead to different prices for the same emissions reductions. It is also not equitable to reward those would have the wherewithal to use more complex protocols to estimate the same emissions reductions. A well managed protocol system with simplified procedures for smaller projects is a better alternative.

Using CDM Protocols

We agreed that the use of already developed CDM baseline and monitoring protocols and a CDM-like process for developing new protocols was an efficient and effective way to proceed. Using simplified procedures to reduce the cost of estimating and monitoring reductions for small projects is also effective, as long as the size limit is not too small or penalizes community scale projects that aggregate many small initiatives.

The CDM approach eliminates many of the immeasurable emissions from embodied energy and also provides a way of estimating difficult power grid emissions factors without excessive data collection. We agree with using the CDM guidelines for establishing electricity grid emission factor based on regional grid and not national grid.

Using the CDM Project Cycle

With the exception of the omission of the Public Comment Step (see above), we are in agreement that the CDM project cycle should be used as the basis for a Canadian domestic Offset System.