August 21, 2009

Thank you for considering these comments submitted by the Western Climate Advocates Network (WeCAN) Offsets Committee* on behalf of WeCAN – a network of environmental and public interest organizations around the Western U.S. and Canada working to advance critical issues related to the Western Climate Initiative (WCI).

This document represents the majority opinion among WeCAN members; not all individual member organizations have endorsed all of these comments. WeCAN member organizations may communicate with you separately to express individual opinions.

Task 1: Offset System Essential Elements

Thank you for considering these comments regarding the WCI Offsets Committee White Paper: Task I: Offset Systems and Essential Elements. WeCAN submitted comments on offset parameters on August 8, 2008. These comments build on and expand the concepts submitted previously.

WeCAN appreciates the thoughtful and comprehensive approach taken in defining the essential elements of a potential offset system for the WCI. We believe that the WCI's first priority must be to ensure the environmental integrity of the emissions cap and any offsets that may be used to achieve the regional cap. The WCI must develop processes to ensure that offsets deliver reductions that are real, additional, verifiable and enforceable by WCI partners, and result in maximum emission reductions or co-benefits within the region.

We recognize the inherent inequity in a system where some sectors are required to comply with firm emissions caps and others fall outside of the cap and can voluntarily choose to receive payments to engage in emission reduction projects. As offset projects prove they are able to achieve widespread verifiable reductions, we recommend expanding the cap and trade program or other regulatory frameworks to include as many sectors as is practicable. The WCI should announce this intention at the onset of the cap and trade program to avoid the inevitable political difficulties of transferring sectors from offset providers to regulated entities.

3. Offset Definition

3.2.1 Ownership

We encourage the WCI to require ownership of the offset credit to be established and tracked through contracts. There are many instances in which ownership may not be clear-cut. For instance, in a forest management offset project – a contract may need to establish whether the offset credit belongs to the owner of the land, the owner of the conservation easement, or those who carry out the management activities. Contracts or other legally enforceable measures may be necessary for sequestration projects to ensure permanence. Legally-established ownership of the offset credit is also an essential foundation of the enforcement program.

Offset credits must be registered in a regional or international registry to establish legal ownership and ensure that offsets are not owned or used by more than one entity.

3.2.2 Use of Approved Protocols

The foundation of any sound offset program is a science-based approach to developing protocols and methodologies used to quantify the emission reductions achieved by various offset projects. The credibility, accuracy, and transparency of the protocols and methodologies used to approve offset credits are vital to the long-term viability of the entire program. Scientific integrity in protocol and methodology development will lead to environmental integrity of the program overall.

The process for developing and approving offset protocols and methodologies must be accessible to the public, and allow an opportunity for public and stakeholder input and response to this input.

WCI should establish an Offset Scientific Integrity Board (OSIB) composed of members with the scientific and technical expertise necessary to evaluate proposed protocols and methodologies, and without any conflicts of interest. The OSIB should authorize protocols and methodologies used with offsets that are accepted within the WCI. The OSIB can help the WCI establish, review, and update a list of offset project types that, based on the current state of the science, can be accurately quantified, monitored, and verified, and that are permanent and do not result in leakage. The WCI Offsets white paper appears to agree with the need for scientific review of offsets measurement methods. It states, in section 4.2.1 that “there should be sufficient scientific research and expert review to support the use of a given methodology and monitoring.”

WCI partners must also have some role in approving offset protocols and methodologies to ensure that offsets meet any criteria established by state or provincial law or rule. WeCAN believes that standardized protocols and methodologies offer fairness, simplicity, transparency and, if the performance standard is set with rigor, environmental integrity. WeCAN believes the WCI should move towards widespread utilization of standardized protocols, provided that these performance standards are based on scientifically reviewed protocols and are set at a level encouraging the highest possible environmental quality and maximized carbon reduction. However, we realize that particularly in the forest and agricultural sectors, there is currently a lack of high quality data, making it impossible to set accurate sector-wide standards. In these cases, we recommend WCI investment in collecting acceptable data. While this information is being collected, the WCI could choose to not issue offset credits to forest or agricultural projects, or it could temporarily review projects in these sectors at the project level or utilize a hybrid approach.

If the WCI or the OSIB determines that it is particularly difficult to develop an objective, standardized approach to accurately quantify the additional emission reductions from a certain offset project, they may determine that the project is not suitable for the offset program but may be suitable for another source of incentive funding, such as a percentage of allowance revenue. The WCI should consider establishing an incentive fund for projects that are likely to achieve additional emission reductions but do not meet the strict quantification requirements for offset crediting. This incentive fund would also be available to entities currently practicing high-quality carbon sequestering activities that cannot meet the test of additionality.

3.2.3. Geographic Limits

The WCI design recommendations "encourage" the development of offset projects located inside the WCI in order to capture co-benefits. WeCAN has previously stated that WCI offsets should be strictly limited to WCI states and provinces. We cite many reasons for this limit, including:

- Boosting confidence in the integrity of the offsets.
- Promoting WCI leadership in getting on track to make the steep reductions needed by 2050 to stay below dangerous warming thresholds.
- Avoiding diversion of WCI investment to other locations.
- Capturing GHG-reduction co-benefits for residents of WCI partner jurisdictions.
- Spurring clean tech innovation and exports from WCI states and provinces.

- Encouraging other states, provinces, and countries to adopt binding caps (a state or province would have a reduced incentive to adopt a cap or join a mandatory cap and trade program if it were enjoying the economic benefits of selling offset projects without joining).

WeCAN has also stated that the WCI should not approve Clean Development Mechanism (CDM) Certified Emissions Reductions (CERs) for credit within the WCI – mainly because of serious problems with additionality and sustainable development requirements that have been documented in the CDM. The CDM has a poor track record when it comes to additionality. A number of projects with adverse environmental and social impacts have been awarded carbon credits, including large hydropower projects, which comprise one-quarter of the projects in the CDM pipeline. Due to these problems, the CDM should be excluded from any regional offsetting program.

4. Real

WeCAN generally shares the WCI offset committee's thoughts and concerns articulated in this section.

The WCI must develop or participate in a global tracking system for offsets to ensure that offset credits are not sold or used more than once.

As mentioned in our comments on Section 3.2.2, the WCI should use standardized protocols and methodologies for assessing offsets used by capped entities in the WCI. Within these protocols and methodologies, there should be explicit provisions for periodic updating of quantification, monitoring, and verification requirements.

The WCI should only adopt protocols for projects in which a high level of confidence that the reductions occurred can be established. Rather than imposing an arbitrary discount factor to justify acceptance of projects that may not be real, discount factors could be used as one way to address a limited amount of uncertainty. If used, discount rates should be based on the relative uncertainly of the specific emission reduction and/or historic rates of "real-ness" where possible.

The WCI should use a conservative approach when projecting baselines and calculating emission reductions.

Addressing leakage is critical to the success of any offset program; if emissions are merely shifted from one project to another or one state to another, the emissions reduction objectives of the overall cap and trade program will not be met. The WCI should require that each protocol have a method to evaluate whether the potential for leakage exists, and to establish specific accounting methods for calculating potential leakage in emission reductions, within and outside of the WCI – this is especially critical with forest and agricultural offset projects. Discounting can be one way to address a relatively small potential for leakage in a project, however, project types that have significant leakage potential should not be included as WCI offsets in the first place.

5. Additional

Additionality is a difficult concept to implement mainly because it relies on an unobservable counter factual, it compares an outcome to a *projected* outcome without the program; often referred to as the business as usual or baseline scenario. The problem lies in identifying what would have happened. There is no way of knowing for sure what would have happened since unlike the scientific world, we cannot run 'controlled' experiments in real life. This implies that the policy maker faces serious information problems which are likely to compound the inherent unreliability of these estimates of the baseline or business as usual outcomes.

There are two serious asymmetric information problems. First, firms know more than policymakers their reasons for choosing to reduce emissions. Thus while the firm may adopt a new cost effective machine that has lower emissions for financial reasons, with offsets, the firm enjoys an additional revenue stream from the sale of offsets. In this instance the firm is rewarded for behavior that it would have pursued anyway and payment is made for emission reductions that would have occurred anyway, and so no additional emission reductions actually occur as a result of the offset market.

Second there is moral hazard in that the firm has strong financial incentives to inflate the base case or business as usual scenario by maximizing emissions now, since financial gains directly depend on reductions relative to this yardstick.

For these reasons, using conservative estimates in calculating baselines and assessing additionality will provide the WCI with the best chance of environmental integrity.

5.1 Policy and operational considerations in defining additional

To minimize and streamline the (financial and administrative) resource cost of assessing additionality, and to decrease incentives for gaming and fraud (as has been documented within the CDM), a performance standard approach is preferable to a project-specific approach, provided that these performance standards are based on scientifically reviewed protocols and are set at a level encouraging the highest possible environmental quality and maximized carbon reduction. The performance standard must be periodically updated to reflect current practices and technology development.

As noted above we realize that particularly in the forest and agricultural sectors, there is currently a lack of high quality data, making it impossible to set accurate sector-wide standards and that the WCI may need to temporarily review projects in these sectors at the project level or utilize a hybrid approach.

5.2.1 Baseline

There should be a standardized methodology for establishing a baseline within a project-type or sector. The methodology should require the baseline projection to be based on data external to the entity producing the offset and reflective of best or average industry practices. Some rate of innovation, productivity growth, financial evolution, and behavioral change must be built into the projection.

5.2.2 Eligibility Date

WCI offset credits should only be considered additional if the emission reduction occurs after the cap is in place in 2012. Eligible offsets may come from projects established earlier, but the emission reductions must have occurred in the vintage year of 2012 or later. WeCAN reiterates our view that the simplest way to encourage early action in capped sectors is through the earliest possible announcement that 100% of allowances will be auctioned. To the extent that Early Reduction Allowances from uncapped sectors are allowed, caps should be lowered to compensate for these as we have advocated previously (see WeCAN comments from June 22, 2009).

5.2.3 Crediting Period

A fixed crediting period with the option for renewal will help maintain investor confidence for a steady stream of revenues and this should help with the financing of these emission reduction projects. Crediting periods for non-sequestration projects

should be a maximum of five years. Sequestration projects could have longer crediting periods. At the end of a crediting period, the OSIB and other appropriate WCI authorities should review additionality and other requirements before renewing the project for another crediting period.

6. Permanence

Ensuring offset permanence is clearly a critical component of any offset system. The most obvious ways to ensure adequate permanence is either to require insurance or a reserve/buffer pool of offset credits to use in case of project reversals. There must be requirements on either the project developer or offset buyer to be able to adequately account for reversals. Ultimate liability must lay with the WCI or partner jurisdictions that can take actions unavailable to private entities if necessary to account for widespread project reversals.

7. Verifiable

WeCAN supports third-party verification of offsets. In order to avoid incentives for cheating or collusion between offset developers and third-party verifiers, WCI partner governments, who will have regulatory oversight and enforcement responsibilities for the offsets, should assign verifiers to offset projects occurring in their jurisdictions. The partner governments could individually, or collectively, assign the verifiers. WCI partners should collectively agree on protocols and methodologies that are acceptable across the board and meet all requirements of partner states and provinces. The WCI partners should collectively agree on third-party verifier certification standards and certifying bodies. Each WCI partner and the public should have access to the verification data and reports.

Offset projects should be verified annually, except for forest-based sequestration projects, which could be verified every three to five years. This requirement will ensure that the project is being implemented in accordance with programmatic requirements and that emission reductions are being adequately tracked, recorded, and substantiated.

7.2.2 Enforcement

If WCI partners plans to accept credits from offset projects occurring outside of the WCI, the partners must establish a legally binding method of enforcing those reductions, which may entail the authority to take legal action against a party who violates the

offset rules or protocol requirements, as well as the authority to perform enforcement audits.

As a general rule, capped entities that purchase offsets must be held responsible for surrendering valid credits for their emissions. While verification and credit issuance by WCI partners should create a presumption that certified credits are valid, provisions should be developed to assign primary liability for offset credit invalidation to the offset purchaser. Mechanisms to address reversals of offset reductions and risks should be indentified and required.

There are several additional enforcement issues the WCI should consider, including:

- Provisions for sequestration offsets should require insurance in the form of offset buffer pools or insurance that will compensate for any reversals of reductions.
- The requirement of insurance should also be considered for other offset project types to address risks associated with the project.
- Any credited offsets that need to be replaced should be replaced at a ratio that acts as a disincentive for intentional reversals and compensate for any greenhouse gas accounting discrepancies that may result from invalidation.
- Special consideration should be given to post-crediting offset invalidation that is due to negligence, fraud, sequestration reversals or other mistakes.
- The WCI or WCI partners should consider invalidating certification of any third party verifier found to have engaged in malfeasance that results in project credit invalidation.
- The WCI or WCI partners should consider revoking the ability of an offset credit developer to supply credits to the WCI market if they are found to have engaged in malfeasance that results in project credit invalidation.
- WCI partners may exercise civil enforcement authority for the purposes of levying additional penalties for malfeasance by any responsible party.

8. Other considerations

Prioritization of offsets with local co-benefits

WCI should prioritize offset project types that achieve environmental and health co-benefits within WCI jurisdictions.

No Environmental or Social Harm
The WCI should adopt offset criteria that ensure that offsets that are used to meet the WCI emissions cap do not cause environmental or social harm, as determined by the OSIB in consultation with local affected communities. Many offset projects that sold credits through the Clean Development Mechanism and in voluntary markets have caused serious human and ecological harm—including poor people being forcibly displaced to make way for land flooded by dams and indigenous forest people being displaced to plant monoculture tree plantations.

Public Process/Transparency
A meaningful process for seeking, considering, and responding to public comment, including comment from community members living near or potentially affected by the offset project, should be developed and implemented as part of the process of deciding on project types and prioritization of project types, developing and adopting protocols and methodologies, issuing credits, and enforcement activities.

Offset project documents must be publically accessible in a timely manner. The public must be able to easily access information about the project, the protocols and methodologies that were used, its tracking number, if, when, and by whom it has been purchased, which entity has used it for compliance purposes, its selling price, the amount of reductions it represents, and any audit or enforcement activities related to the project.

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