

EXECUTIVE SUMMARY

ENSURING OFFSET QUALITY

Integrating High Quality Greenhouse
Gas Offsets Into North American
Cap-and-Trade Policy

JULY 2008





The Offset Quality Initiative

(OQI) was founded in November 2007 to provide leadership on greenhouse gas offset policy and best practices. OQI is a collaborative, consensus-based effort that brings together the collective expertise of its six nonprofit member organizations: The Climate Trust, Pew Center on Global Climate Change, California Climate Action Registry, the Environmental Resources Trust, Greenhouse Gas Management Institute, and The Climate Group.

The four primary objectives of the Offset Quality Initiative are:

- To provide leadership, education, and expert analysis on the issues and challenges related to the design and use of offsets in climate change policy
- To identify, articulate, and promote key principles that ensure the quality of greenhouse gas emission offsets
- To advance the integration of those principles in emerging climate change policies at the state, regional, and federal levels
- To serve as a source of credible information on greenhouse gas offsets, leveraging the diverse collective knowledge and experience of OQI members

Purpose

The purpose of this report is to provide the Offset Quality Initiative's (OQI) comprehensive recommendations to policymakers regarding the integration of greenhouse gas (GHG) offsets ("offsets") into climate change mitigation policy. OQI was founded in November 2007 as a collaborative, consensus-based coalition to provide leadership on offset policy and best practices. OQI brings together the collective expertise of its six nonprofit member organizations: The Climate Trust, Pew Center on Global Climate Change, California Climate Action Registry, Greenhouse Gas Management Institute, and The Climate Group.

I. Introduction and Background

The use of offsets is among the most important, complex, and controversial strategies to reduce GHG emissions. OQI defines an offset as the reduction, removal or avoidance of GHG emissions from a specific project that is used to compensate for emissions occurring elsewhere. The purpose of an offset is to achieve real and verifiable reductions in GHG emissions beyond what would have otherwise occurred. There are many advantages to integrating offsets into climate change policy. Most notably, offsets can result in lower costs, emission reductions in uncapped sectors, and the development and deployment of new technology.

II. Key Offset Quality Criteria

For offsets to generate credible emission reductions, they must meet a number of quality criteria. Offsets should be real; in other words, they should represent actual emission reductions and not be artifacts of incomplete or inaccurate accounting. They should also be monitored and quantified in accordance with established standards, and be verified by an independent third party. Moreover, offset quantification standards should address the issues of leakage and permanence. Finally, offsets should be unambiguously owned, serialized, and accounted for in a registry to ensure they are not double counted. The following presents additional key principles essential to ensuring high quality GHG offsets.

Offset Additionality. Determining a project's additionality is an essential but approximate process. The reductions resulting from offset projects must be shown to be "in addition to" reductions that would have occurred without the incentive provided by offset credits. Put another way, the revenue from selling the project's emission reductions should be reasonably expected to have incentivized the project's implementation. However, establishing why a project was implemented can be difficult; thus, practitioners and regulators generally rely on a series of tests to demonstrate a project's additionality. OQI supports the development of cost-effective, robust, and flexible additionality assessment tools that provide a standardized, transparent, and rigorous framework for determining the eligibility of offset projects or project types.

Offset Baseline and Additionality Assessment. All offsets should be based on a realistic baseline that forecasts emission levels in the offset project’s absence. Offset project additionality and baselines may be assessed through project-specific, standardized, or hybrid methodologies. OQI recommends the use of hybrid assessments because they can balance the flexibility and adaptability of project-specific assessments with the transparency and consistency of standardized assessments.

III. Offset Policy Design Principles and Recommendations

OQI recommends several key design principles for the optimal incorporation of offsets into emerging climate change mitigation policy.

Environmental Integrity. Offset programs should ensure high environmental integrity by focusing on achieving real, measured reductions in GHG emissions.

Coverage. Regulatory offset programs should, at a minimum, cover all six categories of greenhouse gases identified by the Intergovernmental Panel on Climate Change (IPCC). They should also cover a wide variety of economic sectors.

Geographic and Quantitative Restrictions. Regulatory offset programs should not impose geographic or quantitative restrictions on the use of offsets for meeting emission-reduction compliance obligations. Because the location of an emission reduction is immaterial to its climate change impacts, offset eligibility should not be restricted by geographic source. Moreover, in order to ensure that the lowest-cost emission reductions are available for use in meeting emission-reduction mandates, offset policy should avoid quantitative restrictions on offset supply and use.

Nevertheless, OQI recognizes that offset projects can have important local impacts and co-benefits, and regulation should be designed to ensure that these non-GHG considerations are adequately addressed, while recognizing the global nature of GHG emission impacts. OQI also recognizes that legitimate concerns exist that technological change will not be properly incentivized in capped sectors if large amounts of offsets from other sectors are allowed. If geographic or quantitative restrictions on offsets are sought by policymakers, careful consideration should be given to how and where those limits are imposed in order to avoid undue market distortion.

Offset Crediting. Regulatory offset programs should establish reasonable crediting periods. OQI recommends multiyear, conservative, and potentially renewable crediting periods for offset project types. Forward crediting — the issuance of tradable offset credits before the actual emission reduction occurs and is verified — should be prohibited. However, forward selling — the sale of rights to future emission reductions in advance of an offset project’s implementation, or occurrence of the GHG emission reductions — should be allowed. In addition, quantification and baseline assessment protocols should adhere to the principles of accuracy and conservatism in calculating emission reductions.

Offset Program Administration. Regulatory offset programs should have a centralized administrator. This is necessary to coordinate and maintain consistency and linkages between and among jurisdictions and offset programs, especially in regional contexts. Moreover, governance and assessment of offset projects need to be transparent to ensure credibility and reduce investment uncertainty. Finally, regulatory offset programs should allow for adaptation and adjustment of offset protocols over time and should include a mechanism for the addition of new project types.

Linkage. Where practical, regulatory offset programs should be designed to be as compatible as possible with other existing and emerging regimes, both domestically and internationally, as long as those regimes have comparable environmental integrity. Offset standards and markets should work towards the recognition of a globally fungible offset credit commodity, which will increase global liquidity and market efficiency. Additionally, the diverse geopolitical contexts of the countries from which offset projects originate should be considered in order to maintain both flexibility and accuracy when designing offset policy.

Offset Project Start Date. Regulatory offset programs should establish a reasonable start date after which projects are eligible to generate offset credits; OQI recommends this date be set at three to five years before emission allowances are issued under new regulation.

IV. GHG Reduction Project Categories and Considerations

Broadly speaking, OQI believes that direct emission-reduction projects — projects that cause emission reductions at the project site, such as capture and combustion of landfill methane — are best suited for use in a regulatory offset program.

Indirect emission-reduction projects are defined as projects that cause emission reductions at a location other than the project site, such as the installation of energy efficient equipment in a building that results in reduced power plant emissions. OQI believes indirect emission reductions are best incentivized in the United States through complementary policy measures and alternative funding mechanisms, rather than offsets. This is due to a variety of reasons, which range from difficulty in establishing clear ownership over emission reductions, to challenges in ensuring that emission-reduction credits are not double counted.

Biological sequestration projects, such as reforestation and rangeland management, utilize natural processes to remove and store GHGs from the atmosphere or avoid GHG emissions by preventing the release of stored carbon. OQI recognizes that while this is a vital category of mitigation opportunities, there are unique challenges inherent in integrating biologically based sequestration credits into a regulatory offset framework. These challenges include issues surrounding baseline establishment, permanence, and leakage. However, OQI believes that policy mechanisms and criteria can be designed and implemented to ensure that biological sequestration activities play a credible role in the offset market. OQI intends to develop a more detailed set of recommendations on this issue after further evaluation.