

More Gain, Less Pain

Principles and Recommendations for a U.S. Offset Program

The effectiveness of a U.S. climate change program will in large part be measured by the extent to which policy facilitates real and immediate greenhouse gas (GHG) emission reductions at the lowest possible cost. Verdeo Group believes that establishing a robust offset program will provide optimal cost-containment within a cap-and-trade program and mitigate allowance price volatility. Due to the global effect of GHG emissions, a well-designed offset program is an efficient tool to drive emission reductions as widely as possible throughout the economy to help meet the nation's GHG targets. An offset program that encourages emission reduction projects in the U.S. will also foster new innovation, deploy clean technology and protect jobs.

To achieve these policy objectives, we believe that an offset program should ensure that a diverse range of U.S. sectors are incentivized to reduce emissions, and should leverage work already being undertaken at the state and regional levels. An offset program should also encourage and reward those that undertake early emission reduction projects that are real, permanent, and verifiable. In principle, an offset program should be designed to:

- **Facilitate credible, domestic emission reductions.** Allowing methane emission reduction projects at landfills, natural gas systems, mines, and livestock farms to generate offsets will enable a near-term, permanent, cost-effective, and domestic supply of emission reductions, without which compliance buyers will be forced to source international offsets generated from the very same sectors in other countries.
- **Incentivize immediate reductions of GHG emissions.** By guaranteeing the ability of all EPA approved offset projects to generate offset credits for the duration of their approved crediting period, regardless of subsequent regulatory changes, companies will have an incentive to quickly develop emission reduction projects that generate immediate and lasting environmental benefits.
- **Maximize cost-containment benefits.** By providing a means for all project types approved under eligible offset programs to petition an offset program administrator for recognition under a federal program, the U.S. will increase the supply of offsets in the critical early years of the cap-and-trade program, lowering costs for regulated facilities, businesses and consumers.

Verdeo appreciates the consideration by Members of Congress and their staff of the following detailed recommendations on offset program design and implementation.

I. Facilitate credible, domestic emission reductions

Methane is emitted from a range of anthropogenic and natural sources in the U.S. including landfills, natural gas systems, mines, and livestock farms. According to the 2007 EPA GHG Inventory, these sources collectively account for just 4.7% of total U.S. GHG emissions, totaling approximately 339.2 million tons of CO₂e per year. Projects

developed to reduce these emissions generate permanent, low-cost emission reductions that can be realized in the near-term. These project types are an important source of domestic offsets and allow a number of important sectors to proactively participate in the effort to reduce emissions. Domestic offset projects generate a number of additional tangible benefits for the U.S., including new sources of energy, economic development, and technology deployment and innovation. Leading compliance and pre-compliance programs such as the Regional Greenhouse Gas Initiative (RGGI) and the Climate Action Reserve (Reserve) already recognize many of these methane-based project types as high-quality offset projects.

Despite these benefits, there have been recent efforts to eliminate these project types from the pool of domestic offsets. For example, Section 811 of the recently passed H.R. 2454, the *American Clean Energy and Security Act of 2009 (ACESA)*, requires the EPA to promulgate regulatory performance standards under the Clean Air Act to regulate new and existing sources of emissions from landfills, natural gas systems, and coal mines. While regulating these emissions will achieve some GHG reductions over the long-term, Verdeo Group believes that greater, more rapid environmental benefit will be realized by addressing these emissions under a compliance-based offset program.

Allowing methane emission reduction projects to generate offsets will enable reductions to occur sooner than they would under regulatory standards. Developing regulation under the Clean Air Act would likely take years to formulate and implement, and the threat of litigation further decreases the likelihood that any reductions would be achieved in the near-term as emitters await regulatory certainty. In addition, regulating smaller emissions sources contradicts the EPA’s own analysis which, in the Proposed Mandatory Greenhouse Gas Reporting Rule, concluded that subjecting sources generating less than 25,000 tons of CO₂e per year to the rule would do little to further the objectives of a program to cap or regulate GHG emissions¹. Under an offset program, companies will have an incentive to proactively develop projects as early as possible, thus generating GHG reductions more quickly than under regulatory performance standards. In addition, the generation of offsets gives companies an ongoing incentive to take action above and beyond that required by regulation, therefore maximizing reductions that are achieved while increasing the supply of offsets to provide cost-containment relief.

In its analysis of the Waxman-Markey Discussion Draft, the EPA concluded that addressing landfill and coal mine methane under an offset program instead of regulatory performance standards would increase domestic offset usage by 45% and decrease allowance prices by 9%². Without these offsets, capped facilities will be under pressure to use more international offsets, which presents unique verification and monitoring challenges. We believe that U.S. businesses in these sectors should be allowed to take advantage of the same offset generating opportunities that are already enjoyed by companies in countries like China and India that seek to export offsets to the U.S. through international offset provisions.

For these reasons, projects that reduce methane from landfills, natural gas systems, mines, and livestock farms should be recognized under an offset program. If a positive list of project types is included in legislation, projects from these sectors should be designated as eligible to generate offset credits. This will ultimately provide a source of real and permanent offsets, enabling the U.S. get a head start on achieving its national emission reduction objectives at a reasonable economic cost.

¹ “Mandatory Reporting of Greenhouse Gases; Proposed Rule,” 40 CFR Parts 86, 87, 89, et al. (10 April 2009), pp. 16468.

² Executive Summary, EPA Analysis of the Waxman-Markey Discussion Draft: the American Clean Energy and Security Act of 2009 (April 20, 2009)

II. Incentivize immediate reductions of GHG emissions

Legislative provisions to award credit for early action can help promote the development of emission reduction projects prior to the commencement of a cap-and-trade program, and ensure there is a robust supply of offsets available for capped facilities that need offsets to lower compliance costs in the early years of a program. However, action today is deterred by the risk that a company’s investment in an emission reduction project today will not be allowed to generate benefits in the future. This is an outcome that the U.S. can ill afford, as an insufficient supply of offsets will result in significantly higher costs for capped facilities, as well as the nation’s consumers, and businesses. As a result, we believe an offset program should enable companies that take measurable, credible steps to reduce GHG emissions in advance of a cap-and-trade program to receive full recognition for their actions. This means protecting the full crediting period for all EPA-approved projects, regardless of whether those projects begin before or after the start date of the program.

Offset crediting periods serve a critical purpose by providing companies with certainty that projects will be able to generate carbon offset revenue for a designated period of time, thereby allowing companies to justify making a capital investment. It is good policy to require that, over time, an offset program administrator like the EPA periodically re-evaluate the eligibility of offset project types to ensure that emission reductions are additional, have not become business as usual in a sector, and are not required by any new law or regulation. However, projects implemented and approved before any such changes are made should always be allowed to generate offsets for the duration of their crediting period, even if a change in regulation or offset program eligibility requirements eliminates the possibility for any *new* projects of that type to generate offsets. This also extends to projects developed in advance of a cap-and-trade program that meet eligibility criteria for early action credit. Companies should not be liable for regulatory or programmatic changes that are beyond their control, and which were not known at the time of project approval.

Legislation should promote the development of verifiable, high-quality emission reduction projects before implementation of a cap-and-trade program by clearly stating that such projects will be able to generate offsets for the full duration of their approved crediting period. Guarantees should also be provided that any offset project approved during the cap-and-trade program will be permitted to generate offsets for the duration of its approved crediting period, regardless of subsequent regulatory changes that may impact the eligibility of future projects.

III. Maximize cost-containment benefits

An effective offset program should be designed to maximize the level of domestic GHG emission reductions that can be achieved in the early years of a cap-and-trade regime in order to minimize compliance costs across the U.S. economy. This involves two critical components: providing a means for all project types approved under eligible offset programs to petition a program administrator for recognition under a federal program; and by having incentives that encourage the private sector to devise new and increasingly effective means to reduce emissions. Proposed legislation such as the *ACESA* recognizes the value that innovation can play in enabling emission reductions, and commendably provides project proponents with the opportunity to petition an offset program administrator to consider approving new offset project types over the duration of a cap-and-trade program.

Notably, a significant amount of project-level innovation has already taken place in anticipation of a federal cap-and-trade program, much of which has been recognized by existing high-quality voluntary offset programs. This innovation should be recognized under a federal offset program, in addition to the work of existing state programs that the ACESA explicitly recognizes. While we believe that wholesale recognition of all existing methodologies in the voluntary market could allow projects of questionable merit into a federal system, we believe that an offset program administrator like the EPA has the experience and judgment to determine which methodologies and projects meet a level of quality that warrants recognition. An EPA review process will also play an important role in assisting the Agency with the development of new, ongoing standards for project sectors and activities, helping to ensure that the U.S. has an early supply of offsets available to meet cost-containment goals.

Under ACESA, only emission reductions in 2009 and beyond from state programs such as RGGI and the Reserve are guaranteed recognition under a federal program. To our knowledge, RGGI has not registered any offset projects since its implementation³, and while the Reserve has issued just under 1.3 million offset credits, these only represent reductions achieved from 2005 to 2008⁴. If the U.S. is to increase its supply of offset credits that can be available in the first several years of an offset program (and reach anywhere near the 1 billion ton domestic offset quantity allowed under the ACESA), the EPA should evaluate project types and individual projects registered under other offset programs that it deems to be of similar quality to state-based programs.

Legislation should direct the EPA to review methodologies and project types in high-quality voluntary programs such as the Voluntary Carbon Standard and the American Carbon Registry to select projects that meet stringent quality criteria for recognition under a federal offset program.

About Verdeo Group, Inc.

Verdeo Group provides comprehensive technology, project development and finance solutions to help U.S. companies identify, develop and monetize GHG emission reduction opportunities, preparing them for impending state, regional and federal GHG regulation. We specialize in working with companies that have extensive sources of methane emissions, including those in the mining and oil & gas sectors, as well as the livestock, landfill and food processing sectors. Our clients are located in states such as Texas, Oklahoma, Wyoming, Pennsylvania, Utah, West Virginia, Louisiana, New Mexico, and Colorado.

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³ The prices at which RGGI allowances have been trading is commonly cited as too low to facilitate demand for offsets and stimulate the development of projects.

⁴ Information is available at: <http://www.climateactionreserve.org/>