

August 12, 2009

Dean Stinson O’Gorman
Manager, Canada’s Offset System for Greenhouse Gases
Environment Canada
351 St-Joseph Blvd. 19th Floor
Gatineau, Quebec K1A 0H3

Dear Mr. O’Gorman:

RE: Canada's Offset System for Greenhouse Gases: “Program Rules and Guidance for Project Proponents and Canada's Offset System for Greenhouse Gases: Program Rules for Verification and Guidance for Verification Bodies” (*Discussion Guides*) released in Part I of the Canada Gazette on June 13, 2009.

On behalf of Canada’s Industry-Provincial Offset Group (IPOG), please accept the following comments in response to the Government of Canada’s release of the Discussion Guides. IPOG is a multi-stakeholder group with more than 20 members including four provincial governments, large industry and offset developers. IPOG members represent over 60% of industrial greenhouse gas (GHG) emissions in Canada. Our work on the development of offset protocols has also including a broader range of industry participants, including non-governmental organizations (NGOs). Over the last two years, IPOG has focused on constructive engagement on issues and governance in developing sound offsets markets.

IPOG would like to thank Environment Canada for the release of the two remaining draft Program Rules and Guidance documents, and appreciates the opportunity to provide an extensive submission. By providing the level of detail in the Discussion Guides, you have helped ensure a more meaningful and technical debate on how to achieve an offset policy that will result in substantial emission reductions and a significant volume of credible and fungible offset credits. IPOG agrees with the Offset System Principles and applauds Environment Canada's support for:

- development of a robust and accessible source of offsets as a compliance mechanism;
- maximum scope in the project type;
- clarity on the project cycle and protocol approval process;
- the negative market effects of a temporary offset credit;
- the importance of offset certification in the project cycle; and
- practical engagement with industry and provinces to ensure the system works for those relying on it.

We would like to provide comments on aspects of the offset system as is currently contemplated in the two Discussion Guides and provide you with our additional thoughts on how a more robust and accessible offset system could be implemented. IPOG understands there needs to be a correct balance between maximizing the volume of emission reductions while maintaining the environmental integrity of the system. However, we are collectively concerned that the system rules as they are currently defined:

- limit offset market liquidity in the early years of the system;
- impede the use of offsets as an effective compliance cost containment tool;
- put financial market stability at risk; and,
- ultimately hurt competitiveness of Canadian industry.

Each of IPOG's key issues and recommendations are detailed in the sections below and include:

- the shift in project and credit start dates;
- the liability period associated with biological sink projects;
- the implications of limiting the project and Protocol scope of the offset system
 - Multiple crediting periods
 - Verification
 - Revision and re-verification
- the impact of regulations;
- the impacts of climate change incentives; and
- a number of administrative issues
 - the relationship between the project proponent and the Minister
 - appeal rights
 - reasons for decisions
 - response timelines

As IPOG has indicated at earlier meetings, we are prepared to work closely with the respective government agencies to ensure that these issues are resolved in favour of a functioning offset system.

Overall Concerns with Competitiveness

The first function of a domestic offsets system is to moderate the price spikes in the compliance system. In a regulated system demand is set by regulation. In a market based system the supply/demand balance sets the price. With fixed demand the level of supply has a direct impact on price volatility. As a consequence the domestic offsets system is the 'safety valve' that can inject liquidity into the system with the resulting moderation to prices. From a competitiveness perspective the concern of Canadian industry is that their cost of compliance should not be out of line with their major trading partners. The Waxman Markey Bill clearly anticipates the domestic offsets market to play a significant role.

Currently, significant price differentials in compliance price forecasts exists for the Canadian and US markets. Although both systems are in a state of flux, the difference between the two is striking and an area of concern. In the US, the US Environmental Protection Agency and the Congressional Budget Office have provided offset price forecasts to ACES in the range of USD\$13-22 in the 2012 to 2020 time period¹. In August 2009, the EIA projected in their base

¹ EPA Preliminary Analysis of the Waxman-Markey Discussion Draft, U.S. Environmental Protection Agency, April 20, 2009. Congressional Budget Office Cost Estimate, American Clean Energy and Security Act of 2009, Congressional Budget Office, United States Government, June 5, 2009

scenario a cost of USD\$19-32 in the same time period². As a comparison, in Canada the National Round Table on the Environment and the Economy projected prices in the range of CDN\$50-100 in the same time period³. Finally, Environment Canada has previously projected compliance prices in the range of CDN\$35-65⁴.

These compliance price differences, should they be accurate, represent very different cost burdens on industries located in Canada and the United States. One key difference why the US price forecasts are lower is due to the US proposing a robust offsets market with up to 2 billion tons of domestic and international credits being available on an annual basis. The volume of offsets would exceed the total reduction requirement for several years of their system. The above mentioned study by the Congressional Budget Office has indicated that the presence of offsets as currently proposed would lower the cost of compliance by 64% from the anticipated level in the absence of offsets.

It is important to understand how offset project financing is likely to develop, based on experiences in other functioning markets. Project Proponents will seek financing from external parties for both equity and debt financing. However, for many projects the most important source of financing will be in the form of a pre-payment from a prospective buyer, in exchange for a competitive price on a forward delivery of instruments.

Regardless of the source of financing, any type of uncertainty introduced by the policy regime with regards to the potential volume of offset credits will decrease the likelihood that a project can secure the financing. Policy choices such as revocable credits, discretionary choices by the Minister, and changes to the baseline within a registration period will increase the associated risks and therefore reduce the amount investors or lenders are willing to provide and will prevent projects from moving forward. Markets are designed to harness innovation and in order to achieve that they need clear rules and minimum discretion. Providing this clarity leads to long term predictability which creates substantial and sustainable sources of financing. Should this not occur, financing will continue to flow however it will be redirected to other markets and GHG regimes where less uncertainty exists.

Given the stated intention of the Canadian government to have comparable targets to the US, it is equally important to have comparable compliance options (including a robust, broad offset system) to prevent disproportionate costs being borne by Canadian companies and the possibility of the shifting of industry to other jurisdictions with lower compliance costs. The suggestions made by IPOG throughout this memo would alleviate most of the constraints on the proposed Canadian offset system and improve liquidity and cost containment.

Technical Review and Recommendations

Project Start Date and Crediting Date

² Energy Market and Economic Impacts of H.R. 2454, the American Clean Energy and Security Act of 2009, Energy Information Administration, U.S. Department of Energy, July 2009

³ Achieving 2050: A Carbon Pricing Policy for Canada, National Round Table on the Environment and the Economy, 2009

⁴ Turning the Corner: Detailed Emissions and Economic Modeling, Environment Canada, March 2008

In the fall of 2008, the government announced a Start Date of January 1, 2000 and Crediting Date of January 1, 2008 in the Draft Guide for Protocol Developers. Since this was a relevant and material government policy announcement, a number of business investments were then made. IPOG supported this policy as it was a reasonable balance between recognition of early action and ensuring the environmental integrity of the overall compliance regime.

However, the changes to these dates proposed in the Discussion Guides (Start Date of January 2006 and Crediting Date of January 2011) announced in June are unfair and will now serve to strand investments made in good faith and does not properly recognize any of the early actions performed with the anticipation that they would receive offset credits. This change in policy signal not only creates uncertainty and doubt in the minds of developers and offset buyers, it dampens supply in the beginning years of the regulatory regime at a time when liquidity will be very important to ensure costs are contained as a new market – in Canada and in North America – is being developed.

The newly proposed Start Date of January 1, 2006 will prevent real projects undertaken over a long six year period from having any recognition within the offsets system. The shift in Crediting Date to January 1, 2011 poses the strongest supply concern as it imposes a loss of three years of supply to the system, and effectively discourages technological innovation and follow-on investment for years 2009 and 2010 inclusive. Currently a number of large projects requiring significant capital investment are on hold because offset benefits won't be realized until the credit start date takes effect. This capital and potentially future capital could be invested in offset projects in other jurisdictions where opportunities exist to create valid offset credits prior to the proposed Crediting Date.

Recognition of early action and policy certainty are both required to develop a robust and successful offset system and support 'green' project investments, so IPOG proposes Environment Canada:

- 1. Reconfirm their commitment to a Start Date of January 1, 2000.**
- 2. Move the Crediting Date to January 1, 2006.**

A Crediting Date of January 1, 2006 is consistent with the baseline year for the regulatory targets. A shift in Crediting Date ensures reductions are incremental without placing unnecessary restrictions on the potential supply of eligible offsets and would: further recognize and respect good faith investments; restore stakeholder confidence in the system; and, encourage productive investment in technologies that support long-term prosperity and further contribute to the development of a robust and successful offset system.

One alternative to the above recommended dates is to create an early offset supply program, similar to the program proposed in the US within the American Clean Energy and Security Act. This program would recognize projects registered under other government-recognized regulatory programs and allow for projects in all regions of Canada to be granted offsets should they not meet the Start Date or Crediting Date requirements. The projects and associated provincial systems would need to rely on a similar level of rigor as Canada's Offset System. An early offset supply provision would support the development of a robust offset market and increase market liquidity, without compromising the incremental requirements of the system. The approach would

also protect the offset project investments made by proponents under these Canadian regulatory regimes.

Offset Permanence for Biological Sinks

The current proposal is to have a 25-year liability period for biological sink projects occur after the end of the last registration period. In addition, a discount factor will be applied to projects while they are in operation. IPOG feels that the combination of these two constraints would in effect create temporary offset credits for all biological sink projects due to the actual and perceived permanence risk during this period. If this policy is implemented, it will provide a significant barrier to developing any biologic sink projects and further will significantly devalue any credits created from these project types.

IPOG supports a risk-based approach to managing reversals and permanence issues. A risk-based approach is commonly used in insuring other products and processes (e.g. automobiles, houses and health from fire, flood, hurricanes, etc.). Statistical estimates of risk, based on historical data or other means (reliable prediction tools), are used to devise actuarial tables and risk premiums. Similar techniques can and are already being applied to offset projects. The Canadian Forest Service has extensive data on the incidence of reversals in the Canadian managed forest by region and forest type and this data combined with a premium for conservativeness would result in a discount factor that would balance the unintentional reversal risk.

The Canadian government is uniquely positioned to effectively and efficiently manage reversal risk due to the scale of the national inventory, the access to relevant data, and the ability to update the crediting factors for biosequestration projects. Small and large industry alike do not possess these tools and available tools in other sectors for managing risk, such as insurance projects, are unlikely to become available for a number years and may be cost prohibitive if they do become available.

IPOG recommends the use of a government approved assurance factor be embedded in the relevant protocol. Choosing a conservative factor, which guarantees more carbon reserves than the level of risk assessment, would serve to ensure that future reversals are reasonably accounted.

Regular monitoring and recalibration to adjust the assurance factor and the resulting size of the reserve based on actual loss experience would be desirable. The reserve would never be returned to the offset pool. This assurance mechanism will offer the credibility and environmental integrity of the sink offsets, as well as provide the incentive and management flexibility required for commercializing a new project by providing permanent offsets to the project developer.

Project Types and Protocol Development

One of Environment Canada's principles underlying the design of the offset system is maximum scope, which serves to promote projects in as many sectors and for as many project types as practical. To support this, it seems counter intuitive to now create a narrow and definitive list of approved project types. Project developers should be able to submit offset Protocols on any project that reduces GHG emissions and does not include capped emission sources.

Ensuring an early broad scope to the system encourages offset project development and supply. A limited or restrictive list will jointly reduce supply and constrain the innovation and technology deployment for emission sources without approved protocols. Collaboration with existing systems will be very important to share best practices and reduce the resource requirements for Canada's Offset System. The project and protocol approval processes will require significant resources in order to provide timely review cycles, and current allocated resources will unlikely meet demand, especially at the onset of the system.

Significant work and investment has been done by industry, in good faith in response to the 2008 Gazette notice, which provided a proposed eligibility list from existing best practice guidance for the Fast Track Process. To the extent that the Protocols meet the requirements of the Minister, IPOG recommends this work should continue to be leveraged and that Environment Canada return to accepting Protocol submissions as defined in Annex J: Proposed Fast Track Eligibility List and Protocol Submission Workplan to the Guide for Protocol Developers.

There are a number of other specific issues relating to protocol development as detailed below.

Multiple Crediting Periods

While IPOG is pleased to see the inclusion of a second eight-year registration period under the draft Discussion Guides, placing a one time only re-registration limit on the number of times an offset project may apply for re-registration is too conservative. A given project can and will deliver reductions over its project life (e.g. 10-60 years), restricting the maximum number of crediting periods could prove problematic from a carbon financing perspective and not fully represent the environmental benefit the project creates.

IPOG recommends that there are no limits on the number of re-registrations as each time a project is re-registered, the baseline must be validated ensuring that environmental integrity is sustained. Should a project not be additional due to changes in public policy, industry technology or other factors, it would not be allowed to register and the project would not be allowed to create additional offset credits.

Verification

IPOG feels that the current document is limited and further guidance and criteria have to be provided, to all market participants, on what constitutes the selected level of assurance for a credible and transparent verification system. The extra guidance will help to clarify the data requirements, management, retention, Quality Assurance/Quality Control and other aspects for a project proponent and what activities and records need to be available for the verifier to review the project.

Any potential impacts of assurance requirements on project costs and offset supply are highly dependant upon the details of the system such as: protocol requirements; project monitoring and measurement requirements; and guidance provided to project proponents and verifiers. As an example, the cost for a verification with a limited level of assurance under the Alberta Offsets System are in the range of \$15,000 to \$30,000, depending on the complexity of the project, whereas verifying to a reasonable level of assurance would entail more costly data management requirements that may be very difficult to attain by

the project proponent, at least in the first few years of the program. It is also important to consider the impacts of the selected level of assurance on the cost to verify projects developed prior to the final release of the Discussion Guides as well as small scale projects. Special recognition may be considered for these projects.

IPOG supports the flexibility offered to the majority of project types with respect to the verification period however we have concerns with the requirement for yearly verification of agricultural sink projects. Verification costs will be material and requiring an annual verification will create additional costs and act as a barrier to implementing small projects. We would suggest the removal of this requirement and that agricultural sink projects have the same stringent verification requirements as other project types.

The proposal currently is to require records to be kept for a minimum of eight years after the end of the registration period. As IPOG believes once a credit is certified and issued by the Minister, it should be not be revocable, we would suggest a more limited record keeping period of two years. This time period would give the Project Proponent sufficient time to have all reductions submitted for approval and the Minister the time it requires to certify the reductions.

Revision and Re-verification

Where revision or re-verification of credits issued by the Minister is required, it is unclear who is responsible for replacing the tonnes in the event a Project Proponent is issued too many offset credits. The process of Certification assures a regulated entity that its investment in offsets will qualify for compliance purposes. The concept of a revocable credit will pose a significant barrier to trade if a regulated entity is held responsible for replacing tonnes that were accepted for compliance purposes under the federal greenhouse gas emissions regulations.

IPOG believes that all due diligence required to ensure the credit meets the requirements is performed before certification of the credit. Therefore, IPOG recommends that, after certification, there should be no ability to revoke a credit to provide confidence to the market regarding the permanence and value of a credit. In the specific case where fraud is determined after certification, there are existing mechanisms both civilly and criminally to prosecute any entity that has knowingly committed a fraudulent act and these should be relied upon instead of reserving the right to revoke a credit.

Impact of Regulations

While it is understood that reductions must be surplus to all legal requirements (federal, provincial/territorial and regional) it is not clear what the impact of new regulations will be in the event of the introduction of a legal requirement during the project registration period. To provide investment assurance, project proponents require baseline stability and therefore need to understand how new regulatory requirements will affect project eligibility and whether or not a project would be grandfathered for the remaining registration period. In addition, the draft Discussion Guides does not provide explicit language regarding the treatment of 'municipal' legal requirements. Municipalities are typically tied to project implementation through its own set of

mandates and measure, so the addition of a municipal legal requirement would only serve to add another degree of administrative complexity and would further constrain offset supply.

IPOG recommends that in both the regulatory program and the Protocol the legal requirement be specified up front and, for further clarity, that any potential municipal requirement be excluded as a component of the incremental criterion. Further, projects should have complete baseline stability during each crediting period.

Impacts of Climate Change Incentives

Climate change incentives should be defined as those government programs which clearly indicate that the government is providing funding to secure the GHG environmental attributes of the projects. **IPOG recommends that projects that receive a climate change incentive should still have the ability to qualify as an offset project however the volume of offsets provided to the project would not be the full amount as calculated under the relevant protocol. A pro-rata approach should be taken where by the incentive is compared with the overall cost of the project with the project receiving offset credits relative to the portion of the project that was self financed with the remaining environmental benefits held by the government. If an incentive was provided and it was not a climate change incentive, then the project should be able to qualify for the full amount of offsets generated by the relevant protocol, assuming the project meets all other criteria.**

Administrative Issues

Relationship between the Project Proponent and the Minister

The Project Application Form states "I acknowledge that I have read, understood and agree to abide by all the terms, conditions, instructions and notices set out in the Program Rules and Guidance for Project Proponents". In our view, this explicit declaration serves to create a binding relationship between the Project Proponent and the Minister. However, it is unclear what this relationship entails and potentially problematic if the Project Proponent is bound by the entire guide as the guide was clearly not written with this type of relationship in mind. Clarity with respect to the relationship between the Project Proponent and the Minister would be beneficial.

Appeal Rights

While a Project Proponent may appeal a decision of the Minister, the appeal is made to the Minister him/herself. This would seem problematic and we would suggest an appeal right be provided to a specifically created federal tribunal.

Reason for Decisions

The only instance where the Minister is required to provide any reasons for a particular decision is with respect to a decision to not register a project. It would helpful if be if all decisions of the Minister be provided to the Project Proponent in written format to ensure future applications or changes in a submission properly address the identified concerns.

Response Timelines

It is indicated that a Project Proponent must respond within 15 days to the Minister on a number of requests. Given the strong motivations present within the offset system, it will be very likely that all Project Proponents will be highly incented to complete a response as early as possible. However, we feel that this is very short time period to respond should a significant request be made. Another consideration is that some Project Proponents will have very few staff, and possibly only have one or two individuals. Should they be out of the office when a notice is made, they would likely be unable to respond in time to meet the deadline and have their project removed from the system. We would suggest that this fixed deadline be restated as a target response timeline with no fixed deadline.

Net Environmental Benefit

One of the principles of the Offset System described in Section 1.2 of the Guide for Project Proponents is that offset projects achieve a "net environmental benefit". It would be helpful to understand what is required to achieve a net environmental benefit or more specifically, what aspects of the project are to be included in the assessment. We believe that Canada has existing stringent requirements for all projects with regards to environmental impacts and that they be relied upon instead of placing additional burdens on Project Proponents.

Moving Forward

We appreciate the ongoing opportunities to provide feedback on this important issue. Based on the coalition formed the investment of time, resources and expertise displayed by the IPOG group, we hope that you will be able to incorporate our suggestions into Canada's offset framework. IPOG and its members will continue to offer our expertise, experience and knowledge to the Government of Canada and are prepared to collaborate with government to provide more detailed analysis from those who will rely on the offset system. Should you have any questions or would like to discuss further steps associated with IPOG's engagement in this policy process, please feel free to contact the undersigned at your earliest convenience.

Thank-you for your time and consideration, and we look forward to continued dialogue on all functional aspects of the offset system to ensure a robust and accessible offset system in Canada.

Sincerely,



Skip Willis
IPOG Co-Chair



Nathan Maycher
IPOG Co-Chair