INDUSTRY-PROVINCIAL OFFSET GROUP (IPOG)

SUBMISSION TO ENVIRONMENT CANADA ON CROSS-CUTTING ELEMENTS

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IPOG
INDUSTRY PROVINCIAL OFFSETS GROUP

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Executive Summary

This report represents the view of the Industry Provincial Offsets Working Group (IPOG), a group of representatives from provincial governments, industry and service providers. IPOG was formed to develop useful, constructive recommendations on the design elements of a domestic offset system that reflect the needs of those engaged in reducing and removing greenhouse gas (GHG) emissions across Canada. This submission represents the recommendations of more than 50 participating organizations engaged in the process over the last year.

This submission provides the federal government with technical input and recommendations on the development of a robust, efficient domestic greenhouse gas (GHG) offsets system in Canada. Specifically, the report presents IPOG's observations and recommendations on potential technical and process issues with the proposed offset design, as well as alternatives to a more effective and efficient national system.

In addition to discussing key design elements and recommendations, IPOG has also developed a go-forward timeline, which illustrates how these elements can merge to achieve a July 1, 2008 launch to the national scheme. After lengthy discussion and information-sharing activities, our group finds this launch date not only achievable, but essential to stimulate the investment and participation required for Canada to meet its climate change objectives.

The proposed domestic offsets system is the only compliance option that has no limit, based on the Regulatory Framework, released April 26, 2007. A robust and efficient offsets system will be critical to providing industry the flexibility needed to meet their compliance targets in an economically efficient manner. IPOG represents both potential buyers and suppliers who share a common interest in having an efficient functioning offsets system. These stakeholders are prepared to lend their considerable expertise to many of the critical technical issues that need to be resolved, if these mutually sought after objectives are to be achieved.

With the goal of shifting policy blueprint into effective implementation, IPOG has identified the following areas of immediate interest/opportunity that should be prioritized:

- There is an urgent need for an operating offsets system to be in place not later than July 1st 2008. It is also critical that the system be market driven to capitalize on the economic efficiency that markets can provide in achieving environmental goals. Appendix C of this document lays out a time line for achieving this objective and Appendix D lists in some detail the specific elements that need to be included to achieve the objective of a real market based system.

- The development of protocols aimed at ensuring a number and range of projects can be developed and sufficient volume of offsets created to meet compliance driven demand;

- The role of the government is to set the rules for the creation of the carbon currency. To this end, the government should establish clear rules and a process for accrediting validators and verifiers, but these functions should be left in the private sector; and

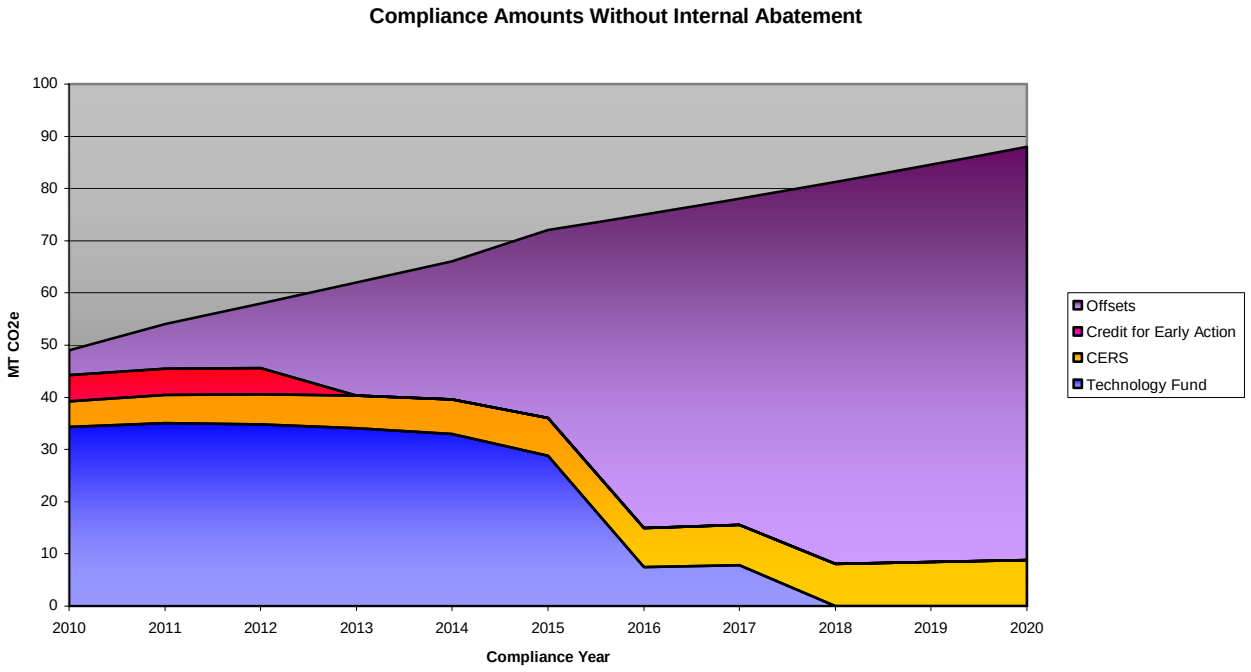
- It is critical that the government establish a registry as soon as possible. This registry must have the capability to track credits from other jurisdictions that Canada may wish to link with, at some point in the future. At the same time, we must recognize that a lot of learning will take place, as the system gets up and running, and fees, if any, should be minimized during this early stage of implementation.

It is the intention of IPOG to continue to work actively with the Department to achieve the objectives outlined above and to act as a ready reference group based on our collective experience as market participants to ensure that we learn from the development of other trading systems and optimize the design.

Introduction

Recognizing the importance of having a workable offset system, the Industry-Provincial Offsets Group (IPOG) began in June 2006 as a group of approximately 20 representatives from Provincial Governments and industry associated with a significant percentage of large industrial emitters' greenhouse gas (GHG) emissions to discuss the technical elements of a GHG offset systems and the Canadian context. Co-chaired by Spectra Energy and Alberta Environment, the objective of the group is to serve as the principal process to develop useful, constructive recommendations on policy options that reflect the needs of those who will be engaged in reducing greenhouse gas emissions across Canada through a domestic offset system.

In *Canada's Regulatory Framework for Air Emissions*, released in April 2007, the government announced its intention to develop an emissions trading system that includes domestic offset credits. If properly developed and implemented, the domestic offset system will effectively engage non-regulated sectors to pursue verified emission reductions, while helping regulated entities to meet compliance in a cost-effective manner through the purchase of credits issued for these reductions. The system will further allow reduction credits to be purchased by organizations or citizens wishing to "offset" their carbon footprint. The following figure, showing the targets and primary compliance options for capped emitters, illustrates the significant gap, over the medium and long-term, that will have to be filled through offset credits. This clearly stresses the need to design and implement a fully functional national offset system, in order for Canada to stay on course towards meeting its targets.



In developing the offset system framework, the government has indicated that it will build on experience and lessons learned with similar schemes, both at home and abroad, as well ensure the private sector plays a central role in both the verification of emission reductions while "providing the infrastructure and services required for the trading of credits"[1]. Further, to provide the time necessary for offset projects to generate reductions, the government aims to implement the domestic offset system as soon as possible. If these objectives are met, and a fully-functional offset system successfully takes shape by next summer, a federal offset system has the potential to incent the broad participation and transformational change required to achieve real, long-term environmental and economic benefits across the country, while also helping to position Canada as a leader in international climate policy.

As illustrated above, the proposed framework clearly states that the private sector can play a significant role in the establishment of an emissions trading system, including an offset component, for Canada. Industry proponents (including service providers) bring a wealth of direct practical experience in project design and implementation from within Canada and internationally. Provincial governments bring expertise in offset project development issues and a desire to include offsets as part of a system that helps meet provincial expectations on climate change.

Based on a series of information sharing activities and discussions with Environment Canada, the most recent phase of IPOG's collaboration has centered on building consensus around unresolved issues and furthering development of the technical and process elements within the proposed offset system. Working Group meetings to conclude this work have included participants from a broad spectrum of private sector and public sector interests, including industry, project proponents, service providers as well as the provinces of BC, Alberta, and Manitoba, Ontario and Quebec (as observers). Participants have experience in the development of components of the Canadian offset system (including PERT, GERT, NESCAUM, CACI, EMA and PERRL) and had a working knowledge of the European Union Emissions Trading System (EUETS). Several of the participants have actual emissions trading experience and involvement in emission reduction projects.

The final results of discussions are provided in this submission. The report is not a policy position paper, nor is it a recommendation for a "rules re-write". Instead, it is a reflection of common needs and expectations around technical and process design elements of a domestic offset system, with the intent to engage in further policy development with the federal government in the future.

Some basic conditions were assumed by participants in conducting discussions:

[1] ecoACTION. http://www.ec.gc.ca/default.asp?lang=En&n=714D9AAE-1&news=00A362E1-A98E-4D5C-9997-8FB7AF9ECF2C

- The proper design of the market-based mechanism is key to its success
- The integrity of an offsets program can be balanced with efficiency to support a robust, liquid carbon market in Canada.
- A staged approach to an offset program in Canada will promote adaptability of participants, build capacity and confidence to employ new technology and develop offset projects, and achieve low cost reductions through increased efficiency in the carbon market.
- Readily available and cost effective protocols (or standard methodologies) are essential to the efficient functioning of an offsets system.
- Implementation should be sooner rather than later, to allow regulated entities and other program participants (and the government) to gain valuable experience and knowledge through "learning by doing".

With regard to the working group meeting formalities please note that:

- Not every individual voted on every issue
- Not every group voted on every issue
- Consensus is defined as 66% + 1 of participants, in the majority of meetings
- Detailed meeting notes are available but not presented here

Key Principles & Observations

We believe the following key principles should guide the development, implementation and delivery of an effective and efficient national offset system that supports, with integrity, the achievement of associated environmental outcomes.

1. Broad participation in an offset system against rigorous criteria and reporting.

2. Maximize offsets through a range of offset projects potentially from all sectors of the economy and all sizes.

3. Based on market principles and management:
    - Government should facilitate, ensure integrity, provide regulatory framework but not control each element; and
    - System must not stifle participation and innovation with unnecessarily cumbersome processes.

4. Acknowledge the importance of offsets to:
    - Meeting Canada's climate change objectives; and
    - Stimulate investment by provinces, municipalities and business.

Building on these principles, we believe the following key observations should drive the next steps of the national system's policy design and implementation process.

- Experience has proven that establishing the conditions for an emissions trading market is not itself enough to ensure that the market will function effectively,

fairly, and/or achieve the desired goals. As in any trading market, a functional and successful emissions trading market in Canada will be based on three crucial elements: efficiency; verifiability; and transparency. Although valued differently by various market stakeholders, each of these elements can help provide signals to market participants, and the balance between them can directly influence the functionality of the market.

- Rather than stress the principle of cost-recovery in designing the offset system's fee structure, we encourage the government to underscore the offset system principles involved in market liquidity and the achievement of Canada's commitments to emission reductions. Since a central goal of establishing an offset system is to increase the supply of compliance units in the market, it is vital in the initial years to recognize that most participants will be learning by doing and will not achieve optimum efficiency. As a consequence transactional fees should be waived or minimized until after the 5 year review in 2012.

- A functioning trading market will need to find a balance between minimizing transaction costs, minimizing project approval time and market transaction time, and maximizing tangible, transparent and real reductions. It is reasonable to anticipate that designing a new trading market in Canada will not be perfect the first time. Therefore, Canada should work towards establishing an operational market, with a review mechanism to fine-tune and adjust the rules of the market over time. Adjustments can work to achieve an optimal balance between the three elements of functionality; and they can also help to maximize opportunities to support a shift in industrial emission intensity and accelerate emission reductions across Canada.

- The element of transparency is essential to ensure public "confidence" in the process, and to facilitate price discovery. Price discovery is an important component of any successful trading mechanism, especially as it relates to market evolution. Price signals drive investment in offset projects (both regulated and non-regulated entities) and allow emitters to forecast costs and undertake appropriate risk management activities. Without proper price discovery, regulated emitters are unable to properly asses whether to invest in emissions abatement internally or go to the marketplace to purchase credits. Similarly project developers will be unable to calculate the potential value of projects.

- While transparency is integral to establishing public confidence and price discovery, a system that requires disclosure of every detail of each transaction can deter some participants from joining. Some details of transactions could be commercially confidential and in general details about who bought and sold and the nature of the project will only open market participants to third party criticism. The predictable result of excessive transparency will be to encourage market participants to transact bilaterally where no disclosure is required. The result will

be a reduction in price discovery, which does not serve the public interest or the interest of market participants.

Design Elements

With the above principles and observations in mind, the following examines potential technical and process issues with the proposed offset design, as well as alternatives for a more effective and efficient national system. In more detail, this work builds on a series of observations and recommendations, submitted to Environment Canada in February 2007. In addition to discussing key design elements and providing recommendations, IPOG has also developed a go-forward timeline, which illustrates how these elements can merge to achieve a July 1, 2008 start to the national scheme. After lengthy discussion and information-sharing activities, our group finds this start date is not only achievable, but essential to stimulate the investment and participation required for Canada to meet its climate change objectives.

1. Protocols

Issue: As protocols (or standard methodologies) are essential to the efficient functioning of an offsets system, limiting their scope to only government-developed/approved protocols may cause unnecessary barriers and delays within the system, while stifling innovation.

Recommendations:

Adoption & Adaptation of Existing Protocols

Over the mid-term (2-3 years), and where applicable, the federal government should adapt and adopt protocols from recognized trading systems (e.g CDM, CCX, JI, NSW, GERT, PERT, CACI, Alberta), which house numerous expert and publicly-reviewed protocols. To date, work has also been done by provincial, territorial and the federal government on quantification protocols through the National Offsets Quantification Team (NOQT), which should also be considered in a future offset system. These existing protocols should be reviewed and, if deemed eligible, identified as compliant and appropriate to be transferred to the Canadian context. Where necessary they should be adapted to specific Canadian circumstances. The key point is that a range of protocols need to be available in anticipation of the launch of the offset trading system.

In addition, projects that differ in a few identifiable elements from those with existing applicable protocols should be able to adapt existing protocols and propose a related/alternative approach without having to have the protocol/methodology undergo the complete review and approval process. This staged process will expedite the offset system objective of incenting project development and generation of emission reductions (ERs).

In determining protocol eligibility, both the government and recognized third parties should play a role; however, in order to facilitate the adaptation and adoption of external protocols, the government will have to define project eligibility criteria as soon as possible.

In IPOG's previous submission to Environment Canada, our sub-working group on protocols provided a checklist of basic requirements for a filter mechanism that could be used to determine the protocols potentially eligible at the outset of an emerging domestic offset system. It would also be very useful, if the government could provide a list of the protocols currently under development. Such an initiative would allow project developers to know if their specific projects will have the protocols necessary to proceed (see recommendation, below).

Protocol Development by Private Sector

The government should share the burden of protocol development by encouraging experienced private sector stakeholders to be involved with the exercise. In opening the doors to the private sector, a clear, streamlined process must be established, which allows for new protocols to be submitted by industry, then approved by government, in a time sensitive fashion. Issues related to both ownership and proprietary information will have to be addressed, while developing this process.

Protocol Review Process

The federal government should develop a public, transparent process for protocol review, adaptation and private-sector development. Such a process, which must include a mechanism for properly assessing and managing comments, should be set up to expedite the approval of all protocols. Public postings, as well as solicitation of relevant comments, of protocols will be essential to ensure transparency and robustness of the process. Like Ontario Reg.397/01, these steps could form an inherent part of the system's registry process.

Protocol Accessibility: Public Library & List

Another step in the process should be the development of a transparent, easily-accessible library of protocols, which is managed and maintained by the federal government. Also, by compiling and circulating a regularly updated list of protocols, both existing and under development, stakeholders can gauge where the challenges and opportunities lie with respect to project development, registration and the generation of credits.

Protocol Lifetime and Cancellation Dates

Government should ensure that protocols are valid for at least eight (8) years and within a defined subject manner. Likewise, no protocols should be cancelled until a replacement protocol has been developed and approved, unless BAU eventually becomes applicable to that activity[2].

[2] Government will have to provide a clear definition of BAU. This step will also help to overcome the impasse associated with concept of incrementality.

Targets & Timeframes for Protocol Development

Establishing a schedule, procedure and types for protocol development will ensure that stakeholders are cognizant of how many protocols exist, dictating the kinds of projects that will be available over various timeframes. Experience shows that, in pursuing policy goals, a targeted approach based on clear timelines is an effective tactic. Assigning targets and timeframes to protocol development will also signal investment opportunities and help potential suppliers plan approaches to project development and registration.

2. Validation

Issue: A government-only validation process would create a cumbersome, delayed offset system and compromise its integrity in the process. Rather than control each design element, the role of government should be to facilitate and enhance, not hinder, the integrity of Canada's emerging system.

Recommendations:

Validation Methods

When designing validation methods, fundamental to any effective approach should be the concept of practicality. For example, validation methods could be developed based on a tiered approach, accompanied by set timelines (e.g. Income Tax Model[3]). A tiered-approach to validation – accompanied by periodic audits – could become incorporated into the system at a later date. For instance, this idea could be re-visited, during the 2012 review process, at a point when more trust and confidence has been built in the system. Other design ideas, based on ensuring a high degree of practicality within the system, include: the validation of the first X application of each type of protocol, with subsequent projects being subject to spot audits; or establishing a threshold size, above which validation is mandatory. Any final policy decision should involve the private sector undertaking validation work, with validation costs being covered by the government to stimulate high levels of system activity. As well, decisions should be delivered to parties within a set period of time (i.e. 4 weeks).

Flexible Validation Approach

Given that validation examines whether a project meets eligibility criteria and verification ensures the project is implemented according to the protocol, a staggered approach to the validation process (based on efficiency) should be considered the best option to pursue. After much discussion, the consensus among our group is that validation is a necessary step, but not one that has to precede the initiation of the project. Though this flexible approach carries the risk that some projects may go ahead that are

[3] In IPOG's Feb 2007 submission to the federal government, There was lack of consensus that validation/verification should follow the "tax" model or the "financial" model. Under this model, the developer is subject to spot audit by the Federal Government. Under the financial model, third party verification is a necessary part of the reporting process.

not valid, this is ultimately a business risk to be managed by the developer. To see a template of a validation check-list, please see Appendix B.

Private Sector Involvement
Government should capitalize on existing private sector infrastructure to undertake validation in a manner that is both efficient and sound.

Accreditation Process
Current capacity to conduct validation in the private and public sector is limited. The early transitional phase of the offset system must reflect this and develop a stable of qualified validators across Canada. Working in collaboration with provincial governments, the federal government should define and implement an accreditation process, aimed at training and qualifying project validators across Canada.

Rules-Based Validation
To ensure quality offsets and provide efficient operation of the system, rules-based validation should be established. A central element to this approach would see the Program Authority conducting periodic, sampled audits, in order to check the integrity of the validation process.

3. Verification

Issue: Government-review of all verification plans and requiring the highest level of assurance (reasonable level) will unnecessarily encumber the system.

Recommendations:

Verifier Designation
All verifiers should be designated "expert persons" in the field where they are conducting the verification. The skill set necessary to verify a gas re-injection project is fundamentally different from the skills necessary to verify a biological sink. The CCX has a workable system of third-party verification by project category. It is prudent for the federal government to develop a comprehensive list of "qualified/recognized" firms/individuals or a professional designation. These entities should be independent from industry generating or buying compliance units.

Accreditation Process
Current capacity to conduct verification in the private and public sector is limited. The early transitional phase of the offset system must reflect this and develop a network of qualified verifiers across Canada. In collaboration with provincial governments, it is recommended that a 'review' level audit take place, in order to help clearly define the accreditation process for third-party verifiers.

Private Sector Involvement
Government should use existing infrastructure to allow for private sector verification. With its wealth of resources and experience, the private sector can perform the most

efficient and effective independent reviews and ex-post determinations of the volume of reductions claimed as a result of project activity during the verification period (typically annually). It is also important to recognize that there is extensive international experience in project validation and verification that will be readily transferred to Canada.

Rules-Based Verification

To promote clarity, transparency and certainty in the operation of the system, rules-based verification should be incorporated into the framework. This approach would see private sector verifiers conducting periodic, sampled audits, in order to check the integrity of the verification process, and thus the system as a whole.

Leveraging Off Other Auditing Systems

Where relevant, the government should encourage verifiers to leverage off other, universally-accepted audit systems and existing industry practices. Here, the government should adopt, rather than develop, and prescribe an approach to verification, by using existing requirements, such as those included in the CDM OE requirements and ISO 14064-3. This makes maximum use of already implemented reporting mechanisms in many corporate structures, contributing to a faster start of the offset system, and minimizing the incremental time and effort to bring projects to registration. Exploring the value and applicability of such existing programs and mechanisms may save project proponents and the government a significant amount of resources and time.

4. Offset System Dates

Issue: The government needs to assume responsibility for a continued set of signals on climate change action, including domestic emissions trading. Given that the purpose of the system is to create liquidity in the market, while also ensuring currency will be consistent and fungible, any discussion regarding system dates must address these basic market needs.

Recommendations:

Launch Date

In view of a 2010-2015 timeframe for defined demand for emission reductions and removal enhancements, which is driven by emitters seeking low cost methods to meet regulated targets, the Canadian offset market should be launched no later than July 1, 2008. This date will be in conjunction with the project eligibility and credit generation dates of January 1, 2000. These policy decisions should be based on the understanding that if reduction projects meet required criteria, they should be given the benefit of offset credits as of their initial start date.

Project Eligibility Date

A baseline year from which offset projects are accepted needs to be determined. After the 2005 stakeholder consultation process on the federal climate change plan, it became clear that the most acceptable date for project eligibility is January 1, 2000. This period is strongly recommended to test the offset system and allow for creation of compliance

units to meet demand. If a project was undertaken post-2000 and meets all eligibility criteria, reductions should be counted from day one. Therefore, credits will be eligible from January 1, 2000 on, and should be issued for 10 years, or 3 x 8 years, from the project start date (defined as the date of operational commissioning).

Proposed Timeline

To expedite implementation and delivery of the offset system process, a phased implementation of the program should be adopted and initiated immediately with scheduled review and improvement. IPOG has developed a proposed timeline for the government to follow, between now and July 1, 2008, the proposed launch date. This timeline can be found in Appendix C.

5. Regulations & Incrementality

Issue: Definitions of incrementality can seriously hamper opportunity and innovation in the system. Return to first principles is critical. In the spirit of the administrative simplicity principle, any consideration of system design, implementation and key functions, should be administered in a simple, cost-effective and timely manner; this concept should dictate the way in which to approach incrementality issues.

Recommendations:

Clear and Consistent Definition

To remain consistent, the definition of incrementality should be in line with that found in the federal government's 2005 consultation paper, in which any reduction that occurs as the result of meeting a federal regulatory requirement is not a creditable activity.

Environmental Additionality

The most reliable test in gauging the incrementality of a project is by measuring its environmental additionality. For example, if a forestry company converts its boilers to burning biomass the environmental benefit is clear. Whether the company in question is the first, the tenth or the twentieth, the environmental benefit remains the same. A late adopter might have had a multi-year diesel supply contract that had to expire. Making a determination about the point at which an investment is business as usual is arbitrary and ignores the underlying environmental benefit, which should be the determining criteria.

Baseline Stability

As mentioned above, the lifetime of protocols should be at least eight years. A project developer needs to know that a protocol, if used for a project, will not change during the crediting period; or, if it does change, will not affect the crediting of existing projects.

Publicly Supported Reductions

For projects receiving federal incentives, such as technology fund grants, offsets should still be allowed; however, under the arrangement, the federally-owned portion should be a contractual issue between the project developer and the government.

6. Registry

Issue: A registry of domestic offsets and a trading exchange are necessities in any offset system. The role of the registry must be clear and transparent to all stakeholders, and it does not have to be controlled by the government; in fact, private sector administration and operation of the registry will work to heighten its efficacy and efficiency, while allowing price discovery to occur. Registration must be mandatory for all projects.

Recommendations:

Privately Administered & Operated

All project level information should be posted on a privately developed and operated registry to monitor and track a compliance unit. Although the government will have ultimate 'ownership' over the registry, all of its related administration and operation should be private-sector based. Similar to OETR, these functions will include tracking offsets and other tradable units and managing and distributing information relevant for public review and comment.

Single Registry

In light of the developmental nature of current markets, a single, centralized registry is the preferred option. In creating a currency (an offset), it is of paramount concern to gain public confidence and trust in the system/units. This goal could be more difficult to achieve with multiple registries than one, which works to consolidate all resources to a single space. In the absence of a centralized registry, multiple registries will have to be inter-linked to bolster the confidence of market players and Canadians. It should be noted, the European experience has shown that implementing multiple registries have proven cumbersome and at times problematic.

Role & Nature of Exchange

Registries and exchanges are not synonymous, but are rather two different entities with differing roles. The registry should be linked to any and all exchanges that decide to trade carbon compliance units. The exchanges will make a business decision as to whether or not they should participate in the market and the government should avoid favouring any exchange in this process. The role of the exchange or exchanges will be to make essential transaction level market information, summarized on a non-confidential level available to market players. Along with the registry, the exchange will enable the price discovery required to grow the nascent market, in which price signals will drive investment in offset projects and allow emitters to forecast costs and undertake appropriate risk management activities.

7. Jurisdictional Flexibility

Issue: Considering each province has unique energy and carbon management challenges and opportunities, offset projects should not be stifled by too generic an approach to design implementation. The challenge in developing a federal offset system will be to reconcile regional diversity issues with those related to equity.

Recommendation:

Recognizing Jurisdictional Differences

Recognizing the federal government's intent to enter into equivalency agreements with provinces, we recommend that the goal of achieving a broadly based, robust and liquid trading market should be central to all of these negotiations. IPOG believes that going beyond this principle will prove fruitless for all jurisdictions involved. In the near-term, the federal government should take steps towards discussing unique offset-related circumstances with provinces, where necessary, and based on a technical approach, reflecting the realities in each province.

Jurisdictions have the authority to develop specific emissions reduction programs to reflect their unique circumstances, with many having already developed regional action plans. An appropriate level of flexibility must therefore be instilled in the system, at the outset, to recognize and allow for the integration of other existing or planned climate change policies across Canada, while working in support of a coherent national system that will be improved over time.

8. Biological Sequestration

Issue: Biological sequestration, in the areas of agriculture and forestry, offers multiple environmental benefits and can significantly contribute to Canada's national balance. However, the government's previous temporary offset credit proposal was polarizing the market, in which the liability period for a carbon offset credit acted as a deterrent to engagement of the 'price-taking' agricultural sector.

Recommendations:

Crediting for Agricultural Sinks

We recommend that agricultural sink crediting go back to 2000, as for other projects, but that adjusted baselines be based on 1996 tillage activities as reflected in the Census of Agriculture. This view is based on Canada's agriculture sector experiencing early signals that carbon would have value (in some cases as early as 1995[4]), as well as the fact that the federal government was assuming 10 Mt of carbon, between 1990 and 2002, that was sequestered due to agricultural soil stewardship. Furthermore, over the first five years of no-till action, numerous problems typically occur, and the system takes time to establish, after which time soil sequestration rates significantly increase.

Special Consideration for Forest Projects

Biological sequestration activities, particularly in the forestry sector, are unique in that there can be a significant time lapse between the implementation of an activity and actual

[4] 1995 is particularly significant year for agricultural sink activity in Canada. In a 1994 agreement, between SSCA and TransAlta, parties recognizes the need to extend existing agricultural sink activity as well as initiate new ones. In this case, all BAU activities ceased.

sequestration of carbon from the atmosphere. Due to this reality, we recommend that forestry projects be provided special consideration in the design of the offset system based on the use of the Carbon Budget Model. Forest carbon management (FCM) can provide an opportunity for a significant amount of carbon dioxide to be removed from the atmosphere, provided the right activities are incented.

Different Modalities

We recommend that different modalities be used to account for the impermanent nature of carbon sinks. While offset projects in general should be subject to a common system, including the elements of the standard project cycle, lessons learned indicate that certain activities, such as biological sequestration, may warrant unique approaches (including estimation and verification procedures) for providing a consistent level of assurance around associated removals/reductions. These unique approaches must be pursued in a manner that more appropriately reflects environmental, temporal, technical and/or other dimensions of such actions. An assurance factor, such as Alberta's, or allowing private-based insurance are options that should be considered by the federal government. Our group believes that the allocation of temporary credits for sequestration activities not be recognized.

9. Compatibility

Issue: To be proactive on fungibility and ensure access to larger volumes, it becomes critical to link the market as soon as possible with other systems. At present, there is concern about the system's current design elements potentially leading to a lack of liquidity and competition in the marketplace. The system design must seek to maximize efficiency and resources by building on and linking with existing programs and trading systems.

Recommendations:

Clear Harmonization Schedule

It is liquidity (broad, deep supply and demand) that drives price discovery, required to achieve economically efficient regulatory compliance. In general, larger trading systems prove more successful by providing access to as much supply as possible, which in turn increases the efficiency of the market place. The size of the market determines the level of economic efficiency because the availability of supply, from different sellers at different prices, will set the credit price based on the cost of the last unit abated - the marginal cost. In a well functioning and competitive market, the price of emissions should reflect the marginal cost. However, as the market size is reduced, the liquidity and economic efficiency of the market are comparably reduced.

Due to the potentially small size of the Canadian offset market (supply and demand), it is important that Canadian buyers and sellers have access to as much flexibility and fungibility as possible. Enabling access to broader and deeper international markets will incent suppliers (project developers) to bring forward projects to meet not only the demand of the Canadian (constrained) market but global (broad as possible) demand.

Furthermore, Canadian buyers will be able to balance a multinational portfolio that leverages made-in-Canada emission reduction projects and international investments. With this in mind, it is essential that the government factor in system linking/arbitrage with other schemes as soon as possible. To accomplish this, the national system and particularly the registry, should be designed to link with other systems over the short, medium and long-term.

Reciprocal Linkages

In pursuing and building linkages with other trading systems, the government should ensure that each linkage allows for the buying and selling of credits in both directions. A mandated reciprocal approach will ensure that market fundamentals of supply and demand are not adversely impacted during harmonization.

International Expansion and Review

To achieve a supply/demand and cost/benefit balance in the Canadian system and to put Canadian industry on an equal footing with their global competitors, we believe that constraints should not be placed on the ability of external credits, conformant with Canadian offset system requirements, to trade into the Canadian market. Though opportunities to trade and expand the offset market should be maximized, we understand that linking one trading system directly to another can require lengthy international negotiations to ensure consistency and equivalency. Therefore, in the near-term, rather than directly *linking* Canada's trading system to RGGI or the Western Governors there could be mutual recognition treaties between trading systems. Under these agreements if a Canadian entity for example acquired credits in the RGGI system they would be cancelled on the RGGI registry and concurrently created on the Canadian registry. Recognizing that different trading systems may have different criteria for recognizing credits, each treaty could specify the positive list of credits that the receiving registry would accept. This would require each registry to record the protocol used in the credit creation so credits could be tracked by project type.

It is also important to recognize the emergence of CERs and ERUs as important elements of the global carbon market. As remarked earlier, many of the capped emitters in our economy face significant international competition and it is important that they be able to achieve compliance in a cost efficient manner. Given the Tech Fund and credit for early action, the limited access to the CER market is not problematic in the early term. These issues must be revisited during the 2012 policy review process including expanding international access to include the ERUs.

Registry Compatibility

In order to sustain the market's integrity and liquidity, registry compatibility between linked systems is critical. The federal government must understand that the more robust and compatible an overall domestic trading system is with other international programs, the more options will exist for linking.

10. Small/Two-Track Projects

Issue: It is clear that small offset projects with relatively low returns simply cannot withstand a costly, high overhead regulatory framework.

Recommendation:

De Minimus Threshold for Project Size and/or Project Complexity

The goal is to move towards as deep and wide participation in reduction activities as possible. However it is important to note that such a system should not create different types of credits as it is recognized that a functional and effective market is dependent on all credits being equal. To ensure maximum scope of transformational change, an approach must be designed that balances administrative burden against project size and project complexity (e.g. aggregated projects), such as the approach taken by the CDM fast track process to enable smaller projects. We recommend that a de minimus threshold for project size be implemented, in which smaller offset projects follow a more streamlined process.

11. Non-National Inventory Activities

Issue: Certain activities that are not accounted for in the national inventory have the potential to bring multiple environmental benefits to Canada's national balance.

Recommendation:

Recognize Non-National Inventory Activities

Considerations to projects that are not accounted for in the national inventory, such as carbon forestry management and wetlands restoration, should be incorporated into the national system design. From a nationwide perspective, these activities can play significant roles in helping Canada meet its climate change targets. For example, any reductions attributed to FCM should be credited as an offset under Canada's domestic plan, even thought the government has chosen not to account for FCM activities in national accounting procedures under Kyoto[5]. The key issue should be that if the environmental benefit can be quantified the credit should be recognized.

If Canada starts to promote and reward environmentally beneficial non-national inventory activities now, it may be in a position to champion these activities in the international policy arena, incorporate them into the NIR process, as well as share information on lessons learned and best practices regarding these unconventional, but rewarding, approaches to emission reductions.

12. Administration of the Offset System

Issue: In the design of offsets markets, transaction costs, lack of transparency and time delays can act as significant barriers to entry when bringing credits to market.

[5] National accounting accounts for afforestation, reforestation and deforestation.

Recommendations:

Administrative Costs Borne by Government

To incent the prompt and early participation in the offset market required to address the initial shortfall of supply, over the near-term, the government should be responsible for the costs associated with the registration/re-registration and processing of offset projects. Transaction costs are a direct add-on to the price of compliance units. If these costs are significant, two things happen. First, it incents capped emitters to focus on internal abatement to avoid the transaction costs. Second, it reduces the potential revenue to the compliance unit creator and therefore creates a disincentive to the creation of compliance units. The ultimate purpose of setting up a trading system is to achieve environmental compliance in an economically efficient manner. Consequently, excessive transaction costs, based on attempting to achieve maximum verifiability, undermine the rationale for setting up a trading system in the first instance. These problems can be avoided by having the government bear the initial costs associated with administration. This approach, based on a "learning by doing" principle, will effectively "kick start" the system. Once the system is well established and fee structures known to all participants, the elements of this approach can be revisited during the 2012 review process.

Provincial Systems

To ensure the public, project proponents and potential buyers have trust in the integrity of an offset system, the integration of administrative structures and capabilities should occur in a transparent manner.

Time-Limited Approval Process

A timeframe for project review and approval should be defined and disclosed in the form of a guaranteed turnaround time. This approach will heighten confidence and certainty within the system, help drive investment in offset projects and allow emitters to forecast costs and undertake appropriate risk management activities. In addition, the project approval time should also be minimized, given that the project documentation development, validation, public review and registration (expert review) are important, and the time associated with each process will prove material. Minimizing the time associated with "approving" projects is essential to ensure an active and liquid market.

Education/Awareness and Outreach Program Development

The government should consider designing and developing an education/awareness program for sectors new to the offset process. With government support, outreach initiatives could overcome information and knowledge barriers that currently exist in various communities. For example, during IPOG discussions, it was noted that the agricultural community could benefit from such a program by stimulating further action and awareness within the sector.

Conclusions & Next Steps

There is a common belief held by industry, provinces, and other stakeholders that a domestic offset system for greenhouse gases is a cost effective compliance mechanism for regulated entities and provides important benefits to a broad range of economic sectors and to Canadian society. Furthermore the development of a Canadian offset system need not start from a standstill. Experience has shown that project based offset systems have common elements – every attempt should be made to ensure congruency with other existing and evolving systems.

With the goal of shifting policy blueprint into effective implementation, IPOG has identified the following areas of immediate interest/opportunity that should be prioritized by the federal government:

- The development of protocols aimed at ensuring a number and range of projects can be developed and sufficient volume of offsets created to meet compliance driven demand;

- The role of the government is to set the rules for the creation of the carbon currency. To this end, the government should establish clear rules and a process for accrediting validators and verifiers, but these functions should be left in the private sector; and

- It is critical that the government establish a registry as soon as possible. This registry must have the capability to track credits from other jurisdictions that Canada may wish to link with, at some point in the future. At the same time, we must recognize that a lot of learning will take place, as the system gets up and running, and fees, if any, should be minimized during this early stage of implementation.

Appendix A: Participants

Representatives of the following organizations participated in some or all of the consultations that led to the development of this submission. They lent their considerable expertise, which was sincerely appreciated by the co-chairs. This document represents the views and input of the agencies listed below, but it does not necessarily represent in whole, or in part, the policy positions of these organizations.

Alberta Government
Alberta Research Council
Baseline Emissions Management Inc.
Biothermica Energy Inc.
Bruce Power
Canadian Cattleman's Association
Canadian Electricity Association
Cement Association of Canada
Climate Change Central
Department of Foreign Affairs and International Trade (observer)
Economic Development, Innovation and Exportation – Quebec (observer)
EPCOR
Golder Ecofys Solutions
ICF International
JD Irving Limited
Manitoba Government (observer)
Montreal Climate Exchange
Natsource
Ontario Ministry of the Environment (observer)
Ontario Power Generation
Sustainable Development, Environment and Parks – Quebec (observer)
SNC Lavalin Environmental
Soil Conservation Council of Canada
Spectra Energy (formally Duke Energy)
The Delphi Group
TransCanada
TransAlta

In addition, Canada's thermal generators (Atco, Epcor, TransAlta, Sask Power, Nova Scotia Power and New Brunswick Power) in a separate process have referenced and endorse the system design proposed by the IPOG group.

Appendix B: Validation Check-List

This Checklist will determine the need for validation on a case by case basis. It's designed to allow the project developer to determine whether validation is needed for a specific project type. This should introduce a level of practicality to the system, avoiding the need to validate each and every project.

Enter an X in the appropriate box for each statement. If any of the statements are true, then the project developer should contact the Program Authority or refer to the following website [www…] for information on accredited validators and/or special considerations for the project type.

The Checklist could include the following items:[6]

- Facility Name
- Facility Location
- City/District/Municipality/County
- Province/Territory
- Postal Code
- Approval Number(s) (i.e. EPEA)
- License/Registration Number(s) (i.e. EUB)
- Facility ID

In addition to the following:

☐ Is this project using it's own quantification methodology (ie. not a government approved protocol)
☐ Is this the first time a project of this type has been registered under the Canadian Offset System (as determined by a scan of available projects on the Registry)
☐ Does this project meet the de minimus threshold for small projects? (refer to URL)
☐ Is this an aggregated project?

[6] Please note, a working group could be formed to further flesh out the checklist; the above are provided as an example.

Appendix C: Proposed Offset System Timeline

Proposed Timeline (July 2007 to July 2008)					
Tasks by Group	Three Month Increments				
	1	2	3	4	5
	Jul-07	Oct-07	Jan-08	Apr-08	Jul-08
Federal Government					
Develop Rules for Offset System (D)					
Develop Guide for Quantification Methodologies (D)					
*Develop Process for Adaptation of Existing Protocols/Methodologies**					
Develop Validation & Verification Guidance Document(s)					
Release Rules for Offset System (D)					
Release Guide for Quantification Methodologies and Protocols (D)					
*Release Process for Adaptation of Existing Protocols/Methodologies**					
Release First Tranche of Federal Offset Protocols (D)					
Release Validation/Verification Guidance Documents (D)					
Release Second Tranche of Federal Offset Protocols (D)					
Release Third Tranche of Federal Offset Protocols (D)					
Release Plan for Registry and Exchange (D)					
Review and Offer Comment on Private Offset Protocols (1st tranche)					
Release Offset System Rules (F)					
Release Guide for Quantification Methodologies and Protocols (F)					
Release Validation/Verification Guidance Documents (F)					
Release Plan for Registry and Exchange (F)					
Release Offset Protocols - Private and Federally Authored (F)					
Review and Offer Comment on Private Offset Protocols (2nd tranche) (F)					
IPOG					
Help Government Develop Rules for Offset System					
Help Government Develop Guide for Quantification Methodologies					
*Help Government Develop Process for Adaptation of Existing Protocols/Methodologies**					
Help Government Develop Validation & Verification Guidance Document(s)					
Help Government Develop Requirements for Registry and Exchange					
Release Second Tranche of Private Offset Protocols					
Private Companies					
*Develop First Tranche of Private Offset Protocols**					
Release First Tranche of Private Offset Protocols					
*Develop Second Tranche of Private Offset Protocols***					
Release Second Tranche of Private Offset Protocols					

* Taken from other systems; potential to be tied into Guide for Quantification Methodologies and Protocols
** Based on draft Guide for Quantification Methodologies and Protocols
*** Based on draft Guide for Quantification Methodologies and Protocols
(D): For Discussion; (F): Final

Appendix D: Summary Chart of Issues & Recommendations

Key Element	Issue	Recommendations
Protocols	Limiting the scope to government approved protocols stifles innovation, creates a cumbersome system and will cause delays	1. Adapt and adopt protocols from recognized trading systems (e.g CDM, CCX, JI, NSW, GERT) – where applicable 2. Develop a process to allow private-sector to develop protocols 3. Compile and circulate a list of protocols under development 4. Develop public, transparent process for protocol review, adaptation and private-sector development 5. Develop a schedule and procedures for protocol development (targets and timeframes) 6. Protocol should be valid for at least 8 years, and within a defined subject matter, no protocol should be cancelled until there is a replacement protocol (unless BAU now applies to the activity)
Validation	Government-only validation creates a cumbersome, delayed system. Government should facilitate and ensure integrity of the system, not control each element.	1. Methods for validating projects should be practical (eg Income Tax model) with set timelines (Tiered approach, checklist) 2. Use existing infrastructure to allow for private sector validation 3. Define an accreditation process, collaboratively with provincial governments, for training and qualifying validators 4. Allow for rules-based validation to ensure quality offsets and provide efficient operation of the system 5. Conduct periodic, sampled audits to 'check' the validation process
Verification	Government-review of all verification plans and requiring the highest level of assurance (reasonable level) will unnecessarily encumber the system.	1. Verifier designation based on 'expert persons' 2. Define the accreditation process collaboratively with provincial governments; a 'Review' level audit is recommended initially. 3. Use existing infrastructure to allow for private sector verification 4. Allow for rules-based verification to promote clarity, transparency and certainty in the operation of the system 5. Allow for leverage off of other audit systems and existing industry practices where relevant material is covered
Offset System Dates	The government needs to assume responsibility for a continued set of signals on climate change action, including domestic	1. Offset Launch Date no later than July 1, 2008 2. Project Eligibility of January 1, 2000 (2005 Consultation was a strong signal) 3. Credit Generation Date – credits eligible from Jan 1, 2000 on; issued for 10 y or 3 x 8 years 4. Ability to generate credits should be retroactive to the Launch Date, if project is registered in the start-up year

Key Element	Issue	Recommendations
	emissions trading	5. Project Start Date – date of operational commissioning (ie. end of commissioning period)
Regulations and Incrementality	Definitions of incrementality can seriously hamper opportunity and innovation in the system.	1. Consistent with the definition in 2005 consultation paper (federal regulations) 2. Environmental additionality is the most reliable test 3. Protocols should provide baseline stability for at least 8 years 4. For projects receiving federal incentives (eg., grants from technology fund) offsets should still be allowed, but the federally-owned portion should be a contractual issue between the project developer and the government
Registry	Registry's role needs to be clear, and doesn't need to be controlled by government. Private sector administration and operation will increase efficiencies.	1. Registry should track offsets and other tradable units, post documents for public scrutiny and input 2. Government is the ultimate 'owner', but administration and operation could be private sector based 3. Given the developmental nature of current markets, a single registry is the preferred option, in absence of that, the registries must be inter-linked 4. Registries and exchanges are not synonymous – these are two different entities with differing roles
Jurisdictional Flexibility	Each province has unique energy and carbon management challenges and opportunities. Projects can be stifled by too generic an approach. Equity must be a significant goal.	1. Recognizing the federal government will enter into quivalency agreements with provinces, there should be room for discussing the unique aspects of each province as it affects the offset system.
Biological Sequestration	Offers multiple environmental benefits. The past Temporary/Offset credit proposal was polarizing the market. The liability period for a carbon offset credit was a deterrent for the 'price-taking' agricultural sector to engage.	1. Given that agriculture had early signals that carbon would have value (1995); and that the federal government assumed 10 Mt of Carbon from 1990-2002 due to agricultural soil stewardship; we recommend that agriculture sink crediting abilities go back to 2000 to establish adjusted baselines and allow for some credit for early action. 2. Forestry projects require special consideration of the fact that environmental benefits accrue only after a prolonged period of time. Forest carbon management will provide an opportunity for a significant amount of CO_2 to be removed from the atmosphere provided the right activities are incented. 3. We recommend that different modalities be used to account for the impermanent nature of carbon sinks. An assurance factor like Alberta has developed or allowing private-based insurance are a couple of options. Temporary credits are not a preferred option.

Key Element	Issue	Recommendations
Compatibility	Vital to link as soon as possible to be proactive on fungibility and ensure access to larger volumes – concerns about current design and lack of apparent liquidity and competition in the marketplace.	1. Designed to link with other systems in near, medium and long term 2. Essential to factor in linking/arbitrage with other trading systems as soon as possible; however, the linkage has to allow buying and selling in both directions 3. In 2012 review, specifically readdress the 10% allowance of international units (CER/ERU) into the Canadian system 4. Registry compatibility essential
Small Projects/Two Track	It is clear that small offset projects with relatively low returns simply cannot withstand a very costly, high overhead regulatory framework.	1. De minimums threshold for project size; smaller projects need a streamlined approach
Non-NIR activities	Certain activities that are not accounted for in the national inventory have the potential to bring multiple environmental benefits to Canada's national balance.	1. Activities that could bring forward projects that are not accounted for in the inventory (e.g. carbon forest management, wetlands restoration) should be considered
Administration of Offset System	In designing the market, transaction costs, lack of transparency and time delays can act as significant barriers to entry when bringing credits to market.	1. Responsibility of the government in the short term to bear the costs (learning by doing; kickstarting); in 2012 review, once the system is well established and fee structures are known, this should be revisited; 2. Integration with other provincial systems should occur and be transparent 3. Approval process should be time-limited, with each process timeline specified 4. Develop an education/awareness program for sectors who are new to the process