

**INDUSTRY PROVINCIAL OFFSETS GROUP (IPOG)
WORKING GROUP ON OWNERSHIP AND ELIGIBILITY**

**OFFSET ELIGIBILITY AND OWNERSHIP UNDER CANADA'S
FEDERAL OFFSET SYSTEM**

CROSS CUTTING ISSUES SUBMISSION TO ENVIRONMENT CANADA

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SUBMITTED BY



INTRODUCTION

This [submission represents the majority view] of the cross-cutting working group on offset ownership and eligibility and the Industry Provincial Offsets Working Group (IPOG), a group of representatives from provincial governments, industry and service providers. IPOG is dedicated to providing useful, constructive recommendations on the design elements of a domestic offsets system that reflects the needs of those engaged in reducing and removing greenhouse gas emission (GHG) across Canada.

BACKGROUND

Following the release of Environment Canada's Draft Protocol Developers Guide in August 2008, IPOG organized a number of representatives from Canadian industry, government, and non-government organizations into working groups to develop and submit Greenhouse Gas Emissions Offset Quantification Protocols (OSQPs) according to the federal fast track protocol process¹. The working groups are supported by IPOG but designed for all decisions to be made independently within and, where warranted, across the working groups. It was also determined that for several policy decisions that affect multiple protocols there should be a focused venue for discussion. Hence, both protocol and cross cutting issue working groups were initiated at a plenary session held by IPOG in the fall of 2008.

This cross cutting issues paper examines offsets incrementality from those projects which may be impacted by government incentive programs and regulatory initiatives.

DEFINING THE ISSUE

Environment Canada's Draft Protocol Developers Guide states that GHG reduction projects must satisfy six criteria in order to be eligible to generate offset credits under a Federal Offset System. Of the six (6) criteria that must be satisfied for an offset project to generate credits, two (2) are of particular concern to working group members. These are outlined below:

1. To go beyond what is expected from the receipt of "climate change incentives"
2. To be surplus to all legal requirements (federal, provincial/territorial and regional).

CLIMATE CHANGE INCENTIVES

Many stakeholders in Canada have recently built or are in the advanced planning stages of large capital projects involving biofuels, energy efficiency, and renewable energy. Many of these projects were planned assuming a climate change framework that would recognize the value to the carbon reduction benefit of these project types and the ability of the project developer to

¹ Insert URL, refer to Annex J

claim those benefits. However, the two criteria stated above calls those assumptions into question. Having certainty around the status of offsets in Canada is necessary for business planning and budgeting and projects could be delayed or cancelled without some guidance related to the future of the Canadian offsets system. Project developers currently lack clarity on whether their project's offset eligibility is impacted by federal and/or provincial/territorial incentives for three reasons:

1. Impact on offset ownership on past and future incentives - Project developers have and will continue to enter into contracts for incentives under a number of incentive programs offered by governments at all levels. Of concern are those cases where no explicit claims to the carbon environmental attributes associated with the project are made by the federal or provincial/territorial government upon issuance of the incentive or other delivery mechanism. When carbon environmental attributes are not addressed in the terms and conditions related to these incentives, project developers have the right to assume ownership of these attributes and the resulting offsets as well as the corresponding impact on project economics. If a government has not claimed ownership over these attributes through an already established contract, the government cannot in retrospect claim the ownership of the associated carbon environmental attributes citing that the project fell under a climate change incentive program.

In addition, future government incentives that directly intend to reduce GHG emissions or indirectly result in GHG reductions must clearly claim ownership of the carbon environmental attributes in the terms and conditions of the incentive program or resulting agreement with the project developer in order for the government to require offsets to go "beyond what is expected from the receipt of climate change incentives."

2. Incremental emission reductions - As stated by Environment Canada, if the climate change incentive establishes a performance requirement, only reductions which go beyond those requirements would be considered eligible for offsets.^{2 3} In cases where the incentive establishes a performance requirement and the federal or provincial/territorial government clearly claimed ownership of the environmental attributes, project proponents require a framework and methodology by which any incremental credits can be quantified.

3. A clear definition of climate change incentive is required – The Draft Guide for Protocol Developers does not provide a definition of a climate change incentive. The lack of a definition leaves open to interpretation what constitutes a "climate change incentive" versus other types of incentives - such as market access incentives. This

² Section 69-71, Page 15, *Turning the Corner: Canada's Offset System for Greenhouse Gases*, 2008

³ In addition, incentives with an explicitly stated transfer of the GHG attributes to the issuer would impact offset eligibility from projects funded by these dollars of if a "sufficient claw-back mechanism" were in place. A claw-back mechanism is defined as an arrangement whereby some or all of an incentive payment is revoked if the recipient project exceeds a predefined return – level or profit or price per unit.

ambiguity again creates uncertainty for project developers that makes it more difficult to commit financial resources to a project.

Case Example: ecoEnergy for Biofuels

The Treasury Board lists expected results for the ecoEnergy for Biofuels program as, "Increased domestic production and development of a competitive domestic renewable fuel industry." This indicates the incentive could be considered a production and market access incentive rather than a directed "climate change" incentive. At present the ecoENERGY for Biofuels program Contribution Agreement is silent on any implied ownership of GHG rights by Natural Resources Canada. As such, IPOG recommends that the eligibility and ownership of any GHG reduction associated with this incentive should not be reduced or prevented due to the recipient's acceptance of the incentive.

IPOG Position

Definition of "Climate Change Incentive"

IPOG Recommends that in order to reduce uncertainty for project developers, the federal government should clearly communicate which specific government incentives they consider to be climate change incentives and provide a clear definition of "Climate Change Incentive".

IPOG proposes that a climate change incentive be defined as a funding program that is explicit in its intent to contractually require a transfer of ownership of the carbon environmental attributes created under that program to the federal government.

Impact on offset ownership on past and future incentives

IPOG recommends that in order to claim ownership of the GHG reductions associated with a past incentive, the federal government must have clearly stated this intent in their contract with the project proponent(s). For future government programs, the government must clearly state their intent to claim GHG reductions or the carbon environmental attributes from projects receiving a Climate Change Incentive. If no explicit claim is made, the carbon environmental attributes should accrue to the project developer.

LEGAL REQUIREMENTS

IPOG recommends that if there is a government ownership claim to carbon environmental attributes, project proponents should be able to claim emission reductions that are incremental to the government incentive. The IPOG protocol working groups will each be providing specific methodological approaches to address incrementality as a component of their respective base protocol applications.

As long as the federal government incorporates expected emission reductions associated with the incentives, and project developers can prove additionality beyond those expected emissions, the offsets granted for these projects will maintain their environmental integrity.

The March 2008 Turning the Corner document on offsets outlines that where legal requirements differ across Canada they may require the use of an adjusted baseline. In addition, the document states, "The surplus requirement will ensure that activities covered by any future federal greenhouse gas regulations will not be eligible to generate offset credits."

The ability of project developers to generate offsets useable under economy-wide carbon pricing regulation should be allowed beyond those emission reductions required by other regulation (such as a renewable fuel standard (RFS)/ renewable portfolio standard (RPS)). For example, as different biofuels and renewable energy sources have varying GHG reduction performance, the ability to commoditize incremental GHG reductions will enhance the market viability of renewables. Should a regulation impact the eligibility, then an adjusted baseline would be the acceptable policy mechanism to ensure offset credits allocated are incremental to federal climate change regulations.

The federal government should evaluate a methodology by which the baseline condition of the offset project may be 'adjusted' to account for specific regulatory requirements thereby facilitating the quantification of offsets that are considered surplus. This adjusted baseline approach provides a continued incentive for the development of projects like renewable fuel and electricity that decrease emissions beyond regulatory requirements. Enabling these projects to participate in the offsets market will drive innovation toward further emission reductions. If no incentive is given beyond the legal requirements, it is quite likely that the full potential of emission reductions available in eligible offset project sectors will not be pursued. The approach to adjusting a baseline to reflect these eligibility factors will be addressed by individual working groups. Potential methodologies for the quantification of the adjusted baselines will be sent to the federal government as suggestions for use in the future offset system.

IPOG Position

IPOG supports the allocation of offset credits to project types that are incremental to federal/provincial/territorial climate change regulations. IPOG and its specific protocol working groups look forward to working with the federal government to identify methodologies to quantify incremental emissions in a way that avoids gaming and maintains the environmental intent of federal GHG reduction regulation. Individual protocol working groups will be submitting baseline proposals relevant to their different project types. In the case where a regulation requires projects to meet an environmental performance standard, emission reductions which are surplus to these requirements should be eligible for offsets.

CONCLUSION

In determining offset eligibility policy with respect to incentives and climate change regulation, IPOG recommends that the federal government reduce uncertainty by clarifying their policies in the final Draft Guidance Document for Protocol Developers. Ongoing uncertainty creates an environment in which makes it difficult for companies to financially commit to projects.

- A clear definition of "Climate Change Incentives" should be provided along with government policy with respect to the ownership of carbon environmental attributes. A list of climate change incentives should be provided for further clarity.
- The GHG reductions associated with a past incentive should accrue to the project developer unless the federal government had stated their intent to retain the carbon environmental attributes in their contract with the project proponent(s). For future government programs, the government must clearly state their intent to claim GHG reductions or the carbon environmental attributes from projects receiving a Climate Change Incentive.
- With respect to regulation, IPOG would like to work with the federal government to establish methodologies that allow offset credits to be produced for projects that create GHG reductions that are incremental to regulation.