



MEMORANDUM

To: Members of Working Group on Early Offsets Supply
From: Nicholas Institute (Lydia Olander, David Cooley, Brian Murray, and Jan Mazurek)
Re: Background information and questions for first call
Date: August 25, 2009, 2:00-3:30pm

The federal protocols for an offsets program have yet to be developed, generating uncertainty in the investment community and slowing investment in offsets projects. This is to be expected at this stage, since a federal cap-and-trade bill has not yet passed Congress. Moreover, if one does pass and is signed into law, the development of specific offset protocols is likely to be assigned to the Administration rather than specified in legislation. However, protocol uncertainty creates investment uncertainty for offset development. This could cause problems for the capped sectors which may need to draw on large quantities of offsets to contain compliance costs, especially in the first years of the program.

HR 2454 includes provisions to address the need for some certainty in offset provisions, such as a list of eligible forestry and agricultural activities and recognition of post 2009 projects through state, regional or equivalent registries, but investors find them insufficient.

Topics for Discussion

Uncertainty in Timing for Offset Investment

There is a time limitation under HR 2454; offsets can only be generated under existing offsets protocols by activities occurring between January 1, 2009 and three years after the enactment of the bill. This may not provide sufficient investment certainty and length of contract to make early offset projects viable. Investors need to know that projects they invest in now—projects that may take a year or more to initiate and five or more years before becoming profitable—will be viable throughout that period. If the federal protocol is not ready by then and there are not sufficient guarantees for interim protocols, there could potentially be little investment in offsets supply.

These limitations could be addressed either by (1) guaranteeing a contract period that is sufficient for investors or (2) by clearly outlining a way that interim protocols will be merged with federal standards when they are developed instead of a 3 year limitation.



Questions for the working group:

Are there other ideas? What would be the best approach?

Offset Eligibility Uncertainty

HR 2454 provides a list of agricultural and forestry activities that are eligible to generate offsets, but does not do the same for activities in other sectors. It also allows offsets from activities occurring after Jan. 1, 2009 that are registered under state, regional or voluntary offset registries to provide offset credits, although protocols from voluntary registries must also be of at least equal stringency as those established under state law, as determined by the Administrator, to be eligible. Registries must also have publicly available protocols and methodologies that have undergone a public comment or peer-review process, and the protocols must require third-party verification.

Questions for the working group:

Does an eligible activities list combined with recognition of offsets in registries of sufficient rigor provide enough certainty to generate investment in offsets projects through 2012 if the timing issue above is corrected?

If not, do we need specific protocols or methodologies identified as eligible? If so, when do these get identified? Can we wait for EPA/USDA to do this after enactment or need an initial list in the legislation?

Cost Containment Uncertainty

Given the uncertainty around the volume of offsets generated in the early years, the cost containment mechanisms proposed in HR 2454 may not be sufficient to address burdensome costs be sufficient to cover shortfalls in offsets over this period.

In HR 2454, the strategic carbon reserve is filled with a small percentage of the cumulative allowance allocation out to 2050, and it can be further expanded by the use of international offset credits from reduced deforestation additional to those used in the international offsets programs. The strategic reserve will initially contain 2.5 billion tons of credits, but the amount released from the reserve in any given year cannot exceed 5% of the total emissions allowances established for that year, until 2016, or 10% in any year thereafter.

If sufficient levels of offsets are not available for release in a given year to adequately contain costs, the annual limit on the release of reserve allowances could be increased or authority could be given to the Administrator to release additional



credits from the reserve. The total size of the reserve could also be increased to ensure a sufficient number of credits.

Questions for the working group:

Should (a) the size of the reserve, (b) the annual limit on credits released from the reserve, or both be increased if there is a shortfall in the availability of offsets? If so, when should the limit be increased? In the legislation? After the program starts when the Administrator determines that the current supply of offsets is insufficient? Another way?

The working group may draw on existing research to inform its discussions, but it may also motivate new research from the Nicholas Institute or other partners to help clarify the options. We expect the first call will direct the next steps of our research and help us identify questions for the next call.

