



MEMORANDUM

To: Members of Working Group on Early Offsets Supply
From: Nicholas Institute (Lydia Olander, Brian Murray, David Cooley, and Jan Mazurek)
Re: Summary of discussion from the first call and questions for the next call
Date: 9/2/2009

We would like to thank all of you that were able to join the first call of the Working Group on Early Offsets Supply. We found the discussion to be very helpful, and it raised a number of questions to be examined further. The discussions from the first call, and the questions raised, are summarized below.

The premise of our questions and discussion is that having a sufficient quantity of offsets in early years--200-300 million domestic tons and 1 billion international tons according to EPA modeling--will help reduce costs and is important for the political viability of a climate policy. The overall sense of the conversation from our first call is that more clarity is needed in the legislation if it is important to generate investment to produce offsets in the early years of the program.

Summary of discussions from the first call

Uncertainty in Timing for Offset Investment

There was general agreement that the 3 year crediting period under Waxman-Markey does not grant enough investment certainty to foster significant investment in offsets before federal rules are in place. There was a broad sense that investors would need a minimum guaranteed crediting period of 7-10 years to see a return on investment for most offset projects. For forestry projects, however, the minimum crediting period would need to be much higher, at around 30 years.

The point was raised that it could be difficult to switch existing projects (those developed under other protocols) to the federal protocol once it is developed. Therefore, extending the guaranteed crediting period beyond the 3 years specified in Waxman-Markey is seen as critical in encouraging investment in early offsets supply.



Offset Eligibility Uncertainty

There was some discussion about whether or not a “positive list” of eligible activities or protocols needed to be specified in the legislation. Waxman-Markey allows offsets to be generated immediately under state or tribal registries that meet certain requirements, and it also allows for the inclusion of additional protocols approved by the Administrator. The time it would take for the Administrator to approve additional protocols is uncertain, but could be 18-24 months, or more, after enactment, based on similar experience with Agency rulemaking.

While a positive list of protocols is one way to provide certainty, it could open the floodgates to allow all protocols regardless of quality. So the alternative approach taken in Waxman-Markey of including state and tribal registries, which provides a list of immediately eligible protocols under RGGI and CAR, as well as opportunities to expand the list with EPA and/or USDA approval, was in general preferred by those on the call. Nevertheless, the existing protocols do not cover certain potentially important offsets pools, such as REDD or CDM. We intend to raise this issue in the next call (see below).

A number of people on the call also raised concerns that the performance standards mandated for certain uncapped sources in the Waxman-Markey bill reduced the pool for early offsets. This is a topic we will discuss on our next call.

A couple of participants also raised the idea that the government could produce offsets through federally sponsored activities in the interim, such as enhancements to the CRP program or activities on federal forest or range lands, and that these offsets could then be sold into the market.

Cost Containment Uncertainty

Our memo prepared prior to the call raised a series of questions about whether the failure for offsets to materialize should be grounds for increasing the number of allowances contained in or released from the strategic reserve mechanism specified in Waxman-Markey. Unfortunately, we did not have much time to discuss this issue, and there was some confusion over the questions we were raising. We will return to this topic in the next call.

Questions for discussion in the next call

Cost Containment Uncertainty

The strategic reserve is intended to contain costs in the event that allowance prices rise too quickly. Under Waxman-Markey, the reserve will have 2.5 billion credits initially, although only 250 million credits per year will be released in the first years of the program.



If sufficient levels of offsets are not available, due to investment uncertainty and other expectations do not materialize (efficiencies where they were expected or deployment of CCS), the cost of allowances could increase substantially, and the reserve could be triggered. Given that the reserve to begin with is established to cover possible adverse outcomes such as the failure of offsets to materialize, are any further adjustments needed if indeed the offsets do not materialize?

Questions for the working group:

(1) If sufficient levels of offsets do not materialize, should the amount of credits released from the reserve be increased? Should the total size of the reserve be increased?

(2) Should this be specified in the legislation, or should authority be given to the Administrator to release more reserve credits, if the offsets supply determined to be to low?

Options for including additional pools of credits in early offsets projects

While the protocols from state and tribal registries will enable the crediting of many types of offsets projects, there are still some additional pools that either are not covered by the existing registries (CAR and RGGI), or are excluded by other parts of the Waxman-Markey bill.

Reliance solely on these registries would not allow investment in REDD, agricultural soil sequestration, or international projects. Forest management is not yet included in these registries but if CAR moves forward, this may change soon.

The performance standards for uncapped sources from Title VIII could also affect the supply of offsets by regulating emissions reductions from certain uncapped methane sources, such as landfills and coal mines¹. If performance standards regulate uncapped sources that would otherwise be allowed to produce offsets, the standards could impact offsets supply. The magnitude of the impacts, however, will depend on how the standards are set. Regulated reductions would not be eligible for offsets, but reductions beyond performance standard requirements could be eligible. Options for addressing the potential effects of performance standards on early offsets supply include delaying the start date of the standards or limiting their stringency in the short term.

¹ The Nicholas Institute has recently issued a policy memo on the effects of performance standards on offsets under the Waxman-Markey bill.

<http://www.nicholas.duke.edu/institute/performance.memo.pdf>



Questions for the working group:

(1) Is it possible that some of the missing pools – forest management, soil carbon – will be included in CAR or RGGI soon enough to overcome the early investment uncertainty problem?

(2) What would be the benefits and concerns about pushing back the start date on the performance standards or limiting their stringency in the short term? What would the overall impact on greenhouse gas emissions be?

(3) Waxman-Markey requires bilateral or multilateral agreements before international credits can be used which means that uncertainty around which international offsets would qualify would remain for at least a couple years after enactment. What are some ideas for how to allow some international offsets in the interim years to foster investment without sacrificing integrity? Since CDM is already a functioning system with existing oversight, could these be deemed eligible in the legislation? Is it possible that CAR could develop a REDD protocol for international tons that would be eligible? Other?

