

**TO: RGGI Staff Working Group**  
**cc: RGGI Stakeholder Group and Resource Panel**  
**FROM: Northeast Regional Greenhouse Gas Coalition**  
**DATE: May 18, 2004**  
**RE: Comments on RGGI Draft Discussion Piece on Offsets**

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The Northeast Regional Greenhouse Gas Coalition (GHG Coalition)<sup>1</sup> is pleased to provide you with our comments on the Regional Greenhouse Gas Initiative (RGGI) Draft Discussion Piece on Offsets dated April 12, 2004 (hereafter referred to as “RGGI offsets piece”). The GHG Coalition’s comments focus on the three questions posed in the RGGI offset paper as well as the two Appendices (Appendix A – Key Definitions and Appendix B - Potential Offset Projects). The GHG Coalition looks forward to discussing these comments in greater detail with the RGGI Staff Working Group (SWG) and the RGGI Stakeholder Group and Resource Panel.

### **Summary of Key Comments**

The key comments from the GHG Coalition contained in this memo include the following:

- Project based GHG emission reductions that meet high quality standardized criteria from sources not covered by the regional emissions cap should be eligible to create offsets for use by affected entities to demonstrate compliance with RGGI emission reduction obligations.
- Carbon offsets may provide the necessary incentive for other industry sectors to reduce GHG emissions now along with the electric generating sector. This creates a financial signal for GHG emissions and can foster linkages and market harmonization with other states and regions of the U.S. as well as other countries. Finally, offsets may ease the transition as other sectors are incorporated into the regional cap in subsequent phases of RGGI.
- Unlike traditional air pollutants, there are no technically feasible and commercially available end of pipe CO<sub>2</sub> emission control technologies that currently exist. Furthermore, some electric generating facilities are identified as “must run facilities” have limited options to reduce CO<sub>2</sub> emissions. Therefore, the flexibility that offsets provide makes them a key feature of the RGGI program.
- RGGI should seek to develop standardized criteria and a regulatory framework for carbon offsets for inclusion in the Model Rule due in April 2005. The

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<sup>1</sup> Northeast Regional GHG Coalition members include: Calpine Corporation; Consolidated Edison Company of New York; Northeast Utilities; National Energy and Gas Transmission, Inc.; Pfizer, Inc.; Public Service Enterprise Group, Inc.; Shaw’s Supermarkets; United Technologies Corporation; and Waste Management, Inc. For additional information regarding the GHG Coalition see <http://www.mjbradley.com/ghgcoalition.htm>

operational and standardized processes to quantification, monitoring, and verification may take longer to develop and should continue after the April 2005 deadline.

- The development of the operational and standardized processes to quantification, monitoring, and verification should be delegated to the Regional Greenhouse Gas Registry (RGGR) Initiative and established through a multi stakeholder process.
- RGGI and RGGR should leverage the significant body of work already completed regarding carbon offsets through the multi phase NESCAUM Greenhouse Gas Early Action Demonstration Project as well as efforts of the Climate Trust, Chicago Climate Exchange, California Climate Action Registry, UK Emission Trading Scheme, EU Emission Trading Scheme, Emission Reduction Unit Procurement Tender (ERUPT) in the Netherlands, the World Bank's Prototype Carbon Fund, and WRI/WBCSD GHG Protocol among others.

### **Detailed Comments**

The remainder of the memo outlines the GHG Coalition's detailed comments on the three questions posed in the RGGI offset piece as well as the two Appendices (Appendix A – Key Definitions and Appendix B - Potential Offset Projects).

#### **1. Should the cap-and-trade program allow for credits for GHG reductions from sources not covered by the cap?**

The GHG Coalition believes that project based GHG emission reductions that meet high quality standardized criteria from sources not covered by the regional emissions cap should be eligible to create carbon offsets for use by affected entities to demonstrate compliance with RGGI emission reduction obligations.

The benefits of including carbon offsets in RGGI are many while the reasons for not including offsets are few. The GHG Coalition believes that the concerns outlined in the RGGI offsets piece can be addressed if the offset provisions are developed in a reasonable manner. The GHG Coalition agrees with the three reasons outlined in the RGGI offsets paper for including offsets and recommend elaborating upon these benefits as follows.

- i.) By incorporating offsets into RGGI, market forces can be tapped into which will promote innovation and least cost compliance with the regional cap. Most stakeholders are familiar with this market innovation concept and environmental regulation mostly recently illustrated in the NOx cap and trade programs and the development of emission control technologies. However, it is important to remember that CO<sub>2</sub> emissions are different in very fundamental ways from air pollutants such as SO<sub>2</sub> and NOx. Most importantly, unlike traditional air pollutants, there are no technically feasible and commercially available end of pipe CO<sub>2</sub> emission control technologies that currently exist. Therefore, onsite emission reductions will be very challenging to obtain. In addition, while the geographic location of SO<sub>2</sub> and NOx emission reductions have significant

environmental impacts, the geographic location of CO<sub>2</sub> emission reductions do not.

- ii.) The incorporation of offsets from other sectors not covered by the cap encourages GHG emission reductions from sectors in addition to the electric generating sector. This establishes a market incentive for obtaining the least cost GHG emission reductions from both within as well as outside the RGGI region (i.e., in other states, regions or countries). Furthermore, by incorporating offsets, RGGI creates a market signal for GHG emissions that will ease the transition as other sectors are incorporated into the regional cap in subsequent phases of RGGI.
- iii.) The availability of offsets is likely to be a critical element for individual states deciding whether or not to participate in RGGI. Once the RGGI SWG finalizes the Model Rule in April 2005, states will then have to undertake their individual public hearing and review processes to adopt and implement the Model Rule. This will require support from various stakeholder groups. It is highly likely that in order to receive the necessary industry support (from not only the electric generating sector but from other sectors as well), carbon offsets will have to play a significant role to minimize the costs to the individual states and the larger regional economy.

#### ***Concerns With Offsets***

Those who advocate against the use of carbon offsets contend that a regulatory program that incorporates them would be administratively burdensome and complex. Those who advocate against the use of offsets also contend that the process of ensuring that the offsets are highly credible and deliver real environmental benefit is too difficult. The GHG Coalition strongly disagrees with this reasoning. The GHG Coalition believes if the regulatory framework for offset creation is designed in a thoughtful, straightforward and reasonable manner, these concerns will be addressed. The GHG Coalition believes that a conservative, standardized approach to addressing specific categories of emission reduction projects will result in a reasonably straightforward and cost effective offset component to RGGI.

#### ***An Issue of Timing***

Furthermore, the GHG Coalition contends that many of these concerns are not entirely related to the issues surrounding offsets but are related to the RGGI schedule (i.e., Model Rule by April 2005) and competition with other programmatic issues that must be addressed.

The GHG Coalition recommends that clear decisions about the regulatory framework and criteria for carbon offsets be included in the RGGI Model Rule. However, it is reasonable to expect that the standardized approaches to quantification, monitoring, and verification will take longer to develop and agree upon and this dialogue may likely continue after the Model Rule is finalized.

## **2. If offsets are to be included, which offsets?**

The GHG Coalition believes that carbon offsets should be allowed to be utilized for compliance purposes if the offsets meet the established regulatory criteria regardless of geographic location, strategy (technology) type or type of GHG emissions reduced (CO<sub>2</sub>, CH<sub>4</sub>, N<sub>2</sub>O, HFCs, PFCs, SF<sub>6</sub>).

### ***Geographic Limitations***

The GHG Coalition understands the concerns regarding limiting the geographic scope of offset projects to include the following:

- i.) enforceability of projects located outside the state/region its used for compliance and
- ii.) the co-benefits (i.e., economic, environmental, health, air quality, water quality, biodiversity etc.) of emission reductions that occur within a RGGI state or region.

However, placing geographic limits on the offset market would likely result in increased offset prices due to the limited scope from which projects may originate. The GHG Coalition suggests that the enforceability of the required emission reductions should focus on those entities affected by the RGGI program and not the offset project. Therefore, the affected entity will address any potential default by the offset provider through contractual means with the offset provider and will be ultimately responsible for demonstrating compliance with RGGI requirements.

With regards to the co-benefits, the GHG Coalition acknowledges that some offset projects result in co-benefits in the region in which it is implemented. To address this issue, the GHG Coalition suggests developing an incentive for undertaking offset projects in the RGGI region.

### ***Standardized Offset Criteria and Protocols***

The GHG Coalition suggests that the development of standardized offset criteria and the regulatory framework for inclusion of carbon offsets in RGGI be addressed by the RGGI SWG and included in the Model Rule. The overall regulatory framework and offset criteria is critical to establish a standardized approach from state to state so that one cohesive offset market emerges for the region.

The GHG Coalition suggests that the development of standardized approaches to quantification, monitoring, and verification be delegated to the Northeast Regional Greenhouse Gas Registry (RGGR) Initiative and established through a multi stakeholder process. Standardized approaches to quantifying emission reductions from project activities should be established to ensure that the emission reductions from these efforts are highly credible and deliver real GHG emission reductions. Furthermore, standardized monitoring and verification protocols must be developed to ensure real reductions and to prevent gaming.

### ***Leveraging Existing Work***

The standardized criteria and quantification protocols should build on existing programs including carbon offset efforts undertaken by non-profit organizations and other countries and organizations to date. Some of these efforts include the following: Climate Trust, Chicago Climate Exchange, California Climate Action Registry, UK Emission Trading Scheme, EU Emission Trading Scheme, Emission Reduction Unit Procurement Tender (ERUPT) in the Netherlands, the World Bank's Prototype Carbon Fund, and WRI/WBCSD GHG Protocol among others.

The NESCAUM Greenhouse Gas Early Action Demonstration Project can also serve a valuable role in this process.<sup>2</sup> In this multi year project, fourteen companies, environmental groups and non-governmental organizations from the U.S. and Canada collaborated with the Northeast states to review GHG reduction actions undertaken by project participants and to explore practical issues surrounding the measurement and potential crediting and trading of these reductions. All private sector participants in this project implemented GHG reduction strategies and quantifying the benefits of those actions according to a standardized criteria document or "Checklist" (see NESCAUM web site for Checklist). Through this process, project proponents demonstrated the availability of cost-effective and quantifiable GHG reduction opportunities in a host of industrial, residential, and transportation applications.

### ***Linkages with Other Programs***

Finally, the GHG Coalition suggests that RGGI pursue linkages and harmonization with emerging registries and emission trading programs in the U.S. and others are the world such as the European Union. The GHG Coalition believes this to be an important first step towards a global GHG emissions trading market with one common currency.

For example, the California Climate Action Registry is beginning to develop project specific emission reduction protocols and reporting for the forestry sector and will likely begin to evaluate project emission reduction protocols for other sectors in the near future.

Also, given the recent developments in the European Commission Linking Directive regarding the explicit support of state and regional efforts in the U.S. to reduce GHG emissions, the RGGI SWG should evaluate potential linkages with the EU Emission Trading Scheme. It is evident that emission trading may occur at this point with the EU ETS – although only one way – from the EU ETS to RGGI. This provides linkages to the flexibility mechanisms of the Kyoto Protocol (both Joint Implementation and the Clean Development Mechanism) as well as high quality emission reductions that meet the requirements of the EU ETS.

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<sup>2</sup> For more information see <http://www.nescaum.org/Greenhouse/index.html>

### **3. If offsets are to be included, how will they be included in the program?**

The GHG Coalition believes a reasonable approach to including offsets in RGGI involves a greater understanding of the overall objectives of offsets and the other policy mechanisms that have been utilized within cap and trade programs to date to achieve environmental objectives.

The question in the RGGI offset piece asks the following “should offsets be allowed in addition to the cap”. The GHG Coalition does not agree that carbon offsets are in “addition to the cap” nor do offsets “inflate” the cap as some contend. Offsets are emission reductions as defined by specific criteria while the regional cap is based on total CO<sub>2</sub> emissions from electric generators. Therefore, the cap does not get added to or expanded when offsets are utilized, the affected sources comply with the cap at least cost.

It is important to reiterate the overall objective of the incorporation of offsets. The concept of offsets is as follows: the emission reductions achieved by one entity (not covered by the cap) “offset” or net out the emission increase by another entity (subject to the cap) on a ton for ton basis so the emission cap is achieved and the environmental benefit is realized.

The RGGI cap will require emission reductions from a specific baseline. The quantity of allowances allocated to affected sources will reflect that emission reduction in absolute terms. Therefore, emission reductions must occur somewhere to meet the cap. In order to inflate the cap, offset projects would have to increase emissions as opposed to decreasing emissions.

#### ***Set Asides and Offsets***

The GHG Coalition does not agree with equating offsets and the mechanism of so called “set asides” under the cap. While it may be an appealing option for individual RGGI states to dedicate a portion of their state CO<sub>2</sub> emission budget to a set aside pool of CO<sub>2</sub> allowances, similar to efforts of some states in the NOx SIP Call, this is clearly distinct from carbon offsets. Implying that the two are the same invites confusion.

The set aside consists of carving out a portion of the state CO<sub>2</sub> budget (i.e., 5%) and making that portion available to project developers to provide an incentive to undertake emission reduction projects (i.e., energy efficiency or renewable projects). If no projects are brought forward for consideration, then the allowances in the set aside usually get allocated back to the affected sources. Once the project developer demonstrates that the project reduces emissions according to a protocol developed by the state, the state would then award allowances to the proponent. It would then be necessary for the developer to sell those allowances to extract the financial value he or she was after in the first place. So, in essence, the allowance set aside is carved out of the state CO<sub>2</sub> budget in order to achieve specific technology objectives with the allowances ultimately returning to the affected sources.

#### ***Electric System Constraints***

The GHG Coalition understands the objective of achieving CO<sub>2</sub> emission reductions on site at electric generating facilities in the RGGI states. Given the current limitations regarding reducing CO<sub>2</sub> emissions onsite, the GHG Coalition believes flexibility is

necessary to achieve emission reductions either on site and/or offsite. The GHG Coalition agrees that some reductions should occur on site at the electric generating facilities, however, either requiring a certain percentage reduction on site or limiting the use of offsets by a certain amount may not be feasible in the near term. For example, some electric generating facilities identified as “must run facilities” have limited options to reduce CO<sub>2</sub> emissions. Therefore, the flexibility that offsets provide makes them a key feature of the RGGI program.

### ***Offset Administration and Implementation***

The GHG Coalition is aware of at least three possible scenarios for the implementation of the offset portion of RGGI:

1. case by case evaluation by individual states;
2. evaluation by a regional body consisting of environmental, industry, non profit, industry and government stakeholders, and
3. evaluation by a non profit organization that is charged with overseeing the offset registration and review.

The GHG Coalition believes that there are pros and cons to each one of these options but that the certified offsets should ultimately be registered in the regional registry being developed by the Regional Greenhouse Gas Registry Initiative. The GHG Coalition suggests that the RGGI SWG, RGGR and interested stakeholders from the environmental, industry, government and non-profit communities incorporate these process and administration issues into discussions on standardized offset criteria. The GHG Coalition believes that whatever mechanism is ultimately decided upon for the review, certification and registration of offsets, it should be standardized across the RGGI program.

### ***Appendix A – Key Definitions***

The GHG Coalition agrees that it is important to identify definitions for the key terms identified in Appendix A. However, the resolution of these definitions is likely to be part of the multi stakeholder process of discussing the broader offset issue. Furthermore, it is important to note that some of these key terms have more than one definition depending on the regulatory program and country in question. Finally, the GHG Coalition suggests adding the following key terms to the definitions list: regulatory additionality, financial/economic additionality, environmental additionality, enforceability, verification, certification, and registration.

### ***Appendix B – Potential Offset Projects***

The GHG Coalition believes that this list is a good starting point for identifying offset projects that are available for consideration under RGGI with the following suggestions. Under “Direct Emission Reductions”, the GHG Coalition suggests that the RGGI SWG think more broadly about emission reduction projects in this area and not limit them to only these specific categories as long as the standard criteria is followed. Direct emission reductions include emission reductions at stationary sources, mobile sources, fugitive sources, as well as sources of process emissions. In particular, the GHG Coalition suggests expanding 1.a. to not only include methane emissions but also any other GHG

from large stationary sources or facilities in other industry sectors. The GHG Coalition also suggests adding combined heat and power (CHP) applications for all industry sectors and GHG emission reductions from mobile sources such as vehicle fleets. The GHG Coalition also suggests expanding I.d. to include reductions at utility sources of methane such as those that occur during the transmission, storage and distribution of natural gas and expanding II. to include geological sequestration as well as biological sequestration.