GUEST COMMENTARY

Offset investments in an uncertain regulatory environment

By Nicholas Martin, Chief Technical Officer, American Carbon Registry

There has been much discussion of late about the diminishing chances of passage of a GHG cap-and-trade bill. Conventional wisdom now leans against passage in 2010, and as a result, pre-compliance entities face a daunting array of scenarios. Congress could pass an energy bill with a national RES and energy efficiency and clean energy incentives. The future could be economy-wide cap-and-trade along the lines of the House and Senate bills, but not until 2011 or later; or power sector-only cap-and-trade as an interim measure. Without federal action, state and regional climate programmes will be re-energised. Finally, EPA regulation of mobile and stationary sources under the Clean Air Act is now inevitable unless Congress acts, with unanswered questions about whether this can include offsets and other market mechanisms.

Entities expecting to be regulated are thus understandably uncertain how best to prepare. Is there anything a pre-compliance buyer should do with no regrets? Here are some suggestions.

- Invest early in offsets. Offsets will play a significant role, both to contain costs for capped entities and consumers, and to create benefits for US farms and forests. The House and Senate bills allowed up to 2 billion tonnes/year of domestic and international offsets. Compare this to a total supply to date of around 350 million tonnes in the Clean Development Mechanism, 82 million on the Chicago Climate Exchange, 30 million on the American Carbon Registry, around 10 million on Voluntary Carbon Standard registries, and 2.5 million on the Climate Action Reserve – and it is clear that offset demand will significantly exceed supply. Entities investing in compliance-quality offsets and banking them for later compliance will have a significant price advantage.

- Trust, but verify and register. While there are still significant volumes of voluntary offsets – variable in quality and not always verified and registered – it is clear that compliance offsets will need to be based on publicly vetted and peer-reviewed methodologies, independently verified, and serialised on a recognised registry. Language in the Waxman-Markey, Kerry-Boxer, and Stabenow bills suggests that the safest pre-compliance offset bets are the American Carbon Registry, Climate Action Reserve, Voluntary Carbon Standard, and possibly Chicago Climate Exchange – programmes using transparent processes and methodologies to ensure that offsets are real, additional to business as usual, permanent, net of leakage, and used only once. Also worth consulting are the publications of the Offset Quality Initiative.

- Check the list. The Waxman-Markey, Kerry-Boxer, and Stabenow bills included lists of project types for which EPA and/or USDA must develop guidance. Within those lists, consider whether certain types are more scalable and cost-effective, or better understood and thus likely to have approved methodologies sooner. Are certain types are more vulnerable than others to regulatory changes that would mandate reductions and thus make them ineligible for offsets? Consider which eligible types are available within your service territory or customer area, thus providing additional public relations and regulatory benefits. Consider which types on the federal lists are also recognised by the regional programmes – California, RGGI, WCI, Midwest GHG Reduction Accord – in case these remain the only compliance systems for several years.

- Keep an eye on EPA and USDA. Both agencies are working, even absent new legislation, to develop guidance for numerous offset types. A delayed cap-and-trade start gives the agencies some breathing room, but considering the lengthy public processes required, there is scarcely enough time. Pre-compliance buyers should track which project types are first in the queue, and recognise that the agencies will need to build strongly on existing high-quality voluntary offset protocols and methodologies.

- Do not ignore international opportunities. With the Copenhagen conference's CDM reforms, sector-based crediting, and additional emphasis on Reducing Emissions from Deforestation and Degradation, international offset supply may increase dramatically – and is specifically allocated substantial volumes in draft legislation.

- Always be innovating. Ongoing innovation – in new project types, offset methodologies, performance standard approaches and sector-based crediting – is crucial to expand supply and will be important in any regulatory framework that finally emerges. The American Carbon Registry is, for example, currently developing new methodologies for improved forest management, reducing fugitive natural gas emissions, N2O reduction, carbon capture & storage, methane capture and other areas designed to be scalable for significant reductions. We are also working to co-found voluntary carbon programmes in key developing countries – China's Panda Standard and others – that will help these countries meet their reduction goals but could also provide high-quality offsets into US compliance markets.