8 July 2010

National Carbon Offset Standards (NCOS) Review

Introduction

The $150 million annual Voluntary Carbon Market is at a cross-roads due to policy gaps and uncertainty regarding the National Carbon Offset Standard (NCOS). This uncertainty has reduced investment in Australian projects delivering domestic carbon reduction, and if left unaddressed will delay the development of new projects. It has also created uncertainty for those involved in carbon accounting and verification, making it difficult for businesses to establish their own carbon footprint and for consumers to judge the veracity of environmental claims.

The Voluntary Carbon Markets Association urges the Federal Government to review the NCOS and undertake consultation with industry over the next few months to ensure the problems with the NCOS are resolved as soon as possible.

This paper is a consultation draft for all members of the VCMA to contribute to. It provides an overview of the problems with the NCOS that are affecting the voluntary carbon markets industry, and proposes a number of solutions and recommendations. To provide comments on this paper please email executive@vcma.org.au.

About the Voluntary Carbon Markets Association (VCMA)

The VCMA promotes and supports voluntary action on climate change through a vibrant and credible carbon market. We are an independent not-for-profit organisation established in 2008.

The VCMA represents all aspects of the voluntary market including businesses, local governments, communities and government agencies taking action on climate change and making environmental claims by purchasing carbon abatement. We also represent providers of carbon accounting, renewable energy, energy efficiency, and plantation offset services, and the educational and training organisations developing the skilled workforce essential to the future growth of the market.

We are working to ensure the voluntary market is credible and accountable so that investments made in a low carbon future deliver real, additional abatement. Our work includes research and advocacy on the latest issues that affect our members.

Why a Review is Needed

Now more than ever, voluntary action to reduce carbon emissions is needed. Leading organisations are stepping up to the challenge despite the slow progress of international climate change negotiations, and the delay in introducing a national emission-trading scheme. The voluntary carbon market needs to be strengthened and expanded to support this action.

The VCMA believes the market needs to be credible and accountable so that consumers are getting what they pay for, and so that Australian and global carbon emissions are genuinely reduced. An expanded voluntary carbon market will allow more organisations and individuals to reduce emissions, and even achieve carbon neutrality. However this can only occur if there is a credible, comprehensive and robust National standard to set the rules.

From 2008 the National Carbon Offset Standard (NCOS) was developed in the context of the proposed Carbon Pollution Reduction Scheme (CPRS). The consideration of how the NCOS would work alongside the CPRS informed the consultation process, including the views put forward by the VCMA. This development process is reflected in the current NCOS document.

Upon its release the government referred to the NCOS as a 'living document' indicating its ability to be reviewed and amended as the technical, environmental and legislative context changed. With the delay of the CPRS and the introduction of the NCOS on 1 July 2010, VCMA has identified a number of issues and problems with the current version of the NCOS, which need to be urgently addressed.

Early Approaches to Carbon Offset Standards

Over the last decade the operation of the voluntary offset market and how it interacts with consumers was the subject of significant concern for authorities and the public alike. Offsetting is a way for individuals and corporations to reduce their own impact on the environment by providing payment to third parties to abate carbon either by reducing their own emissions or by sequestering carbon from the atmosphere. The third party then passes the rights to that abatement to the first party in return for the payment. Pollution offsetting and its sibling, emissions trading, was first implemented in the United States during the nineties as a way to reduce high sulphur dioxide and nitrogen oxide (NOx) levels in the atmosphere which had lead to the problem of acid rain.

Unlike the acid rain problem, which tends to be localised, climate change caused by excessive CO2 levels in the atmosphere is a global problem both in terms of cause and effect. From an environmental point of view therefore, it matters little where and by whom the emissions abatement takes place. Paying someone in the developing world to sequester greenhouse gas emissions will have the same effect on the environment as spending money to reduce ones own emissions in the developed world.

The principle of offsetting has not always been easy to understand and has at times been subject to a lack of consumer confidence. Some of the early projects turned out to be of questionable integrity and limited effectiveness in reducing emissions. Understandably consumer advocates, the media and some environmental groups warned of the potential risk in relying on offsets and using them as a basis for claims of carbon neutrality

In the early years, industry terminology has not been well defined and even those charged with providing assurance and oversight to the public have struggled to cope with the rush of commercial offerings on the market. There have been concerns that unscrupulous business operators could take advantage of the vagaries of the language and uncertainty in the veracity of the environmental claims made.

Despite this, a large section of the public businesses and even local and state government agencies concerned with their own impact on the environment along with the perceived lack of government leadership were quick to adopt the concept of offsetting in its many forms. Some groups made efforts to develop guidelines and certification to further build credibility. The Howard government introduced the *Greenhouse Friendly* scheme to certify abatement projects that met the Kyoto accounting requirements for abatement or sequestration. It also accredited carbon neutral products, which used credits from Greenhouse Friendly projects to offsets the emissions over the life cycle of the product.

Development of the National Carbon Offset Standard (NCOS)

Whilst the Greenhouse Friendly program was a good start, the incoming Rudd Government correctly identified the need to create a set of common standards, establish a common language (through a proper explanation of the new social constructions) and add a level of accountability to the industry.

In its election commitment of 6 June 2007, *Credible Credits: A National Standard for Carbon Offsets*, the Government stated it "… will set up a national standard for carbon offsets to ensure consumer confidence in the rapidly growing carbon offset market."[1] It committed to

[1] Department of Climate Change, The National Carbon Offset Standard: Discussion Paper Dec 2008

develop the standard by 31 December 2008 and stated that the national carbon offset standard will:

- build on existing schemes to minimise duplication;
- provide national consistency;
- include minimum standards for offsets;
- require ongoing management where necessary to ensure integrity;
- require credits to be cancelled when used to provide an offset;
- require all products on the market to be accredited;
- include appropriate verification and validation protocols;
- take international developments into consideration; and
- include standard carbon neutral calculations.

The purpose of the Standard was to ensure consumer confidence in the voluntary carbon offsets market and the integrity of the carbon offset products they purchase.

At the time of NCOS's drafting, Australia, at the Federal level, lagged behind many other countries in its understanding of certain aspects of carbon trading and offsetting especially where national greenhouse gas (GHG) compliance caps were already in place, but at a state level and particularly within voluntary markets it was significantly advanced. Along with the Federal Government's voluntary Greenhouse Friendly scheme, the NSW state based Greenhouse Gas Abatement Scheme (GGAS) was for its time an extremely well designed model of an emissions trading scheme. Designed as a compliance mechanism it had been adopted by voluntary users who were attracted to the transparency offered by its registry and its government controlled rules. Furthermore the state based GreenPower scheme already had well defined terminology and generally rigorous system of public assurance methodologies.

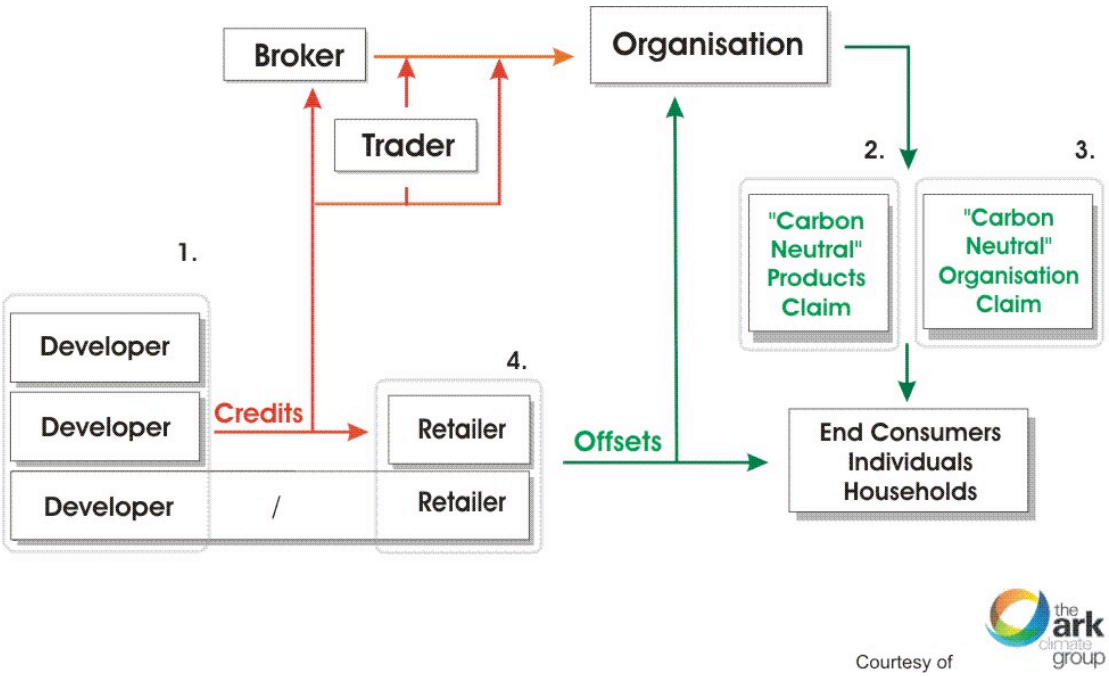
Despite this, there was still some confusion amongst the general public regarding the nature of carbon offsets, and within the offsets industry there were a range of views on the best way for the offsets market to operate. Furthermore, there had been little thought given to how compliance mechanisms should integrate with voluntary ones. Currently for example the national greenhouse factors confer upon other polluters, the benefits which flow from the contributions made by players in the voluntary market. [2]

Structure of the Voluntary Offset Market

This paper aims to contribute to thinking around how the voluntary market can best operate, and how it can interact with the present Kyoto Protocol cap and a future compliance market under a local mandatory target if an emissions trading scheme were introduced. This section provides an overview of the structure of the voluntary market, and the roles of the various actors involved.

The following diagram represents the current market in terms of how the supply of offsets reaches the consumer. The chart is followed by an explanation and definition of terms. Blocks 1– 4 illustrate critical parts of the offset supply chain. Block 1 is where offsets/credits are created. Blocks 2 - 4. are where the market interfaces with the consumer.

[2] Under the National Greenhouse and Emissions Reporting Scheme (NGERS) a party who has made no contribution to GreenPower, will, when calculating their GHG emissions, use an emissions factor for electricity which is discounted for GreenPower paid for by voluntary consumers. As a result GreenPower buyers must calculate their emissions using the same factor as those that have made no GreenPower contribution.



Many businesses are involved in various aspects of the voluntary carbon market and it can be helpful to have a clear overview of the different roles these businesses play. The roles of the different actors involved in the supply of carbon offsets are described below.

Developers are abatement project originators that undertake capital and labour intensive work designed to reduce atmospheric carbon.

For this work they may be granted tradeable **credits** through which *the right to claim the abatement* can be sold to third parties.

Such credits can be sold to **retailers** who in turn retire them from circulation when paid for by a consumer. This retirement allows the customer to claim their purchase as an **offset** against their own emissions. Larger organisation's (with economies of scale) can directly purchase credits from project developers (or via brokers) and then retire them themselves in order to claim the environmental benefit on behalf of their own product or service.

Organisations making such claims will usually:

- measure and manage their organisational carbon footprint then offset their net emissions to claim **Organisational Carbon Neutrality** or;
- perform a Life Cycle Assessment (LCA) of a particular product in order to establish its footprint, offset those emissions and offer it as a **Carbon Neutral Product.**

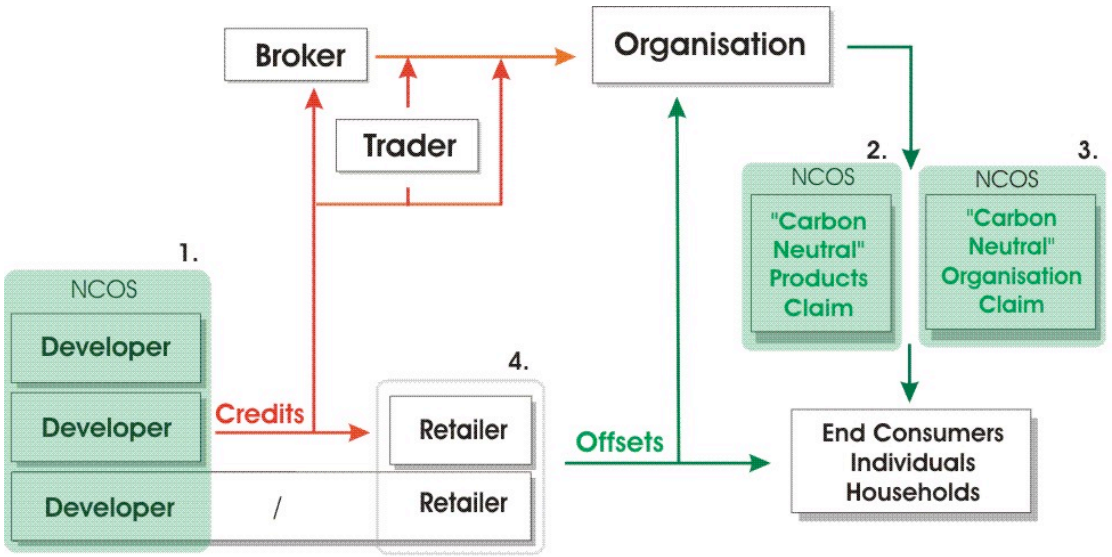
For the purposes of this paper, there is a distinction is drawn between the tradable **credit** where the buyer becomes the owner and therefore may bank and resell the credit; and an **offset** which cannot be resold either because the credit has been effectively retired or because the project developer chooses not to issue the offset in a bankable/ tradable form. A carbon credit therefore can be thought of as a form of currency, which must be surrendered in order to claim an offset and subsequent reduction in reportable emissions. [3] Evidence of surrender through a registry statement or independent audit report provides confidence for the offset buyer.

[3] This distinction does not appear in the NCOS where carbon offsets are defined as tradeable and the term carbon credit is not defined. VCMA acknowledges however that *offset* and *credit* are often used interchangeably in common usage,

In some cases a developer who chooses not to create tradable **credits** may also act as a retailer, and sells the right to claim the **offset** directly to consumers.

In some cases credits are bought and sold at a margin by **traders.**

Fig 2 indicates areas (in blue) covered by NCOS.



How NCOS Relates to this Market Structure

General

NCOS provides basic principles taken from a list of current local and international standards for calculating carbon footprints (carbon emissions, removals, enhancements, and assertions. NCOS refers to this list of standards as its "Normative Reference". [4] These standards include those published by the International Standards Organisation (ISO), the GHG Protocol published by the World Resources Institute and the Business Council for Sustainable Development, and the various guidelines published under the Australian Federal Government's National Greenhouse and Energy Reporting System (NGERS)

Tradable units which can be used for offsetting include most of the international compliance units. To its credit NCOS also recognises units from the progressive and robust Voluntary Carbon Standard and Gold Standard.

Block 1. NCOS Project Standards and Eligibility of Domestic Project Sources

Apart from naming a number of project standards in its "Normative Reference" NCOS does not stipulate any particular standard which must be used for accrediting domestic offset projects or verifying abatement. Instead it states that developers with projects in Australian may propose to have methodologies approved and specifies a number of basic criteria that domestic offsets methodologies must meet in terms of the abatement being additional, permanent, measurable, transparent, independently audited and registered.

[4] Clarification on the meaning of this terminology used in the NCOS would be helpful.

Importantly NCOS sets out what types of local abatement projects can be accredited under the standard and these are restricted to sources of abatement not counted towards Australia's Kyoto obligations. So projects that cut emissions from fossil fuel use, agriculture, organic waste management, industrial processes and land-use change and forestry within Australia are not eligible to create NCOS credits: these comprise most of the existing opportunities for Australians to cut emissions.

As will be explained later, this is a critical problem.

Block 2. NCOS Product Footprint Standards

NCOS sets out basic steps and inclusions for conducting a Life Cycle Assessment of a product referring to the International standard ISO 14040:2006 and ISO14044:2006 to provide further guidance on how to undertake a LCA.

In order to make the product carbon neutral, credits available for offsetting net product emissions, can come from any of the current international compliance units (such as those produced by projects under the Clean development Mechanism of the Kyoto Protocol) along with Voluntary Carbon Standard and Gold Standard units as well as future NCOS units from accredited domestic projects from activities not covered by the Kyoto Protocol.

Block 3. NCOS Organisation Footprint Standards

Guidelines and principles are provided within NCOS which are based upon the GHG Protocol Corporate Standard and ISO 14064 (1).

Credits usable for offsetting net organisational emissions are the same as those that can be used for *products.*

Importantly the guidelines lack any reference to use of local systems, subsidies and credits when calculating net emissions as will be explained in the "Issues" section later.

Block 4. Retailer Standards

There is no specific NCOS standard relevant to offset retailing activity at this time.
It has been suggested that a retailer could have its systems for delivering offsets accredited under the carbon neutral **products** standard, however this could be cumbersome given the standard is designed for a somewhat different type of product – typically a physical product rather than a trading service. Further it is unclear how an offset retailer would differentiate the accreditation of its service from the offsets that it sells.

Summary of Issues with the NCOS

The VCMA recognises the status of NCOS as a 'living document' capable of being updated, augmented and improved over time. It is also aware that the postponement of the CPRS has compromised some areas of the NCOS at an inopportune time. However the VCMA believes there are currently a sufficient number of critical issues, which may render NCOS as either ineffective for the purposes of reporting emissions or at least unable to fulfil its promise to "… ensure consumer confidence in the rapidly growing carbon offset market."

Furthermore, the VCMA believes that NCOS in its current form creates a disincentive for many organisations to pursue 'Carbon Neutrality' using offsets generated within Australia and will therefore suppress the potential for many Australian abatement projects and technologies. This will effectively drive investment in offset projects from Australia to other countries where the abatement is recognised – abatement leakage.

The issues that need to be addressed for the NCOS to be effective and ensure consumer confidence are:

- Robustness and broad coverage
- Clear definitions, terminology and methodology
- Transparency and accountability for treatment of GreenPower
- Eligibility and accreditation of Australian based offsets projects
- Ensuring 'additionality' of voluntary action
- Accessible, low-cost accreditation
- Removal of disincentives

The following sections provide an explanation of these issues and potential solutions.

1. Robustness and Broad Coverage

1.1 Reliance on International Standards

NCOS is a concise document, which in many cases defers to international standards for guidance. Unfortunately these standards do not cover many of the situations, which are specific to the Australian context. Australia has a multitude of varying energy efficiency incentives and carbon credit systems including the Renewable Energy Target (which uses Renewable Energy Certificates as its currency), the NSW Greenhouse Gas Abatement Scheme, Victorian Energy Efficiency Target, which may impact on the appropriateness of certain offset claims.

1.2 Treatment of Credits Sold

There is no guidance on how credits sold off to third parties may affect the net emissions of the subject (selling) organisation. Additionally it is not clear how a sale of Renewable Energy Certificates (RECs) from a solar panel installation deemed for 15 years in advance, would affect the net reportable emissions of the installation's owner in each future year?

By contrast the UK government's guidance published by the Department of Environment Food and Rural Affairs (DEFRA) [5] goes to significant lengths to cover how to calculate renewable energy purchases and sales of related certificates under various scenarios that may be encountered in the UK.

1.3 Accounting for GreenPower

Similarly, within the NCOS document itself there is no mention of the co-operating state governments' GreenPower scheme, and how it should be treated when calculating net emissions– yet this is Australia's most popular form of voluntary abatement . There is only an incidental advice in the NCOS associated Q & As on the department's website and as is described later, this advice would appear to be entirely problematic.

1.4 Retirement of Credits

Of significant importance is the lack of emphasis placed on the need for retirement of credits when wishing to make an offset claim. Partly this may be due to the fact that offset **retailers** who are often responsible for the retirement of credits, are not covered under NCOS. Therefore there is no protocol required for verifying retail sales of offsets against retirements. This is in contrast to the recommended standard for verifying NCOS accredited **products.**

[5] Guidance on how to measure and report your greenhouse gas emissions - 2010 - www.defra.gov.uk

This highlights a mis-match between the priorities of policy development and the needs of the voluntary carbon market industry, as the current Australian market hosts more offset retailers than it does carbon neutral accredited products. The retailer block has possibly greater market presence and is currently a more significant interface between the market and the end consumer than are "carbon neutral" products.

1.5 Audit Arrangements for Offset Retailers

At this stage relatively few of the offset retailers in Australia are subject to any independent audit and NCOS makes no provision or attempt to regulate or oversee this part of the industry.

This is in contrast to the Australian GreenPower scheme which has well established protocols for auditing retailers. This system could be quite easily applied to NCOS approved carbon offset retailers if required.

2. Clear Definitions, Terminology and Methodologies

NCOS appears somewhat vague and imprecise with regard to various footprinting and calculation methodologies, where worked examples would be helpful to avoid misunderstanding and confusion.

NCOS also contains a number of vague and indefinite statements such as the following:

> "…. The administrative framework supporting the Standard will provide further guidance on how to apply additionality principles." [6]

To date however, no administrative framework has been published and it is unclear which additionality principles might be applied, when, and to what.

The Q& A section makes reference to GreenPower *and other renewable energy purchases*. However it is not clear what these other renewable energy purchases are. The VCMA is concerned that they could include high environmental impact renewable energy sources that are now excluded from accredited GreenPower. Since many voluntary abaters value a range of environmental factors, transparency with regard to the actual sources of the renewable energy is critical to credibility.

Further, given the breadth of products, services and projects that NCOS intends to cover, it is unclear if any thought has been given to ensuring that NCOS accredited products, services, projects and offsets will not suffer similar branding issues to those of the Greenhouse Friendly program where consumers could be easily confused with regards what is actually accredited. I.e. Will NCOS accredited products from a retailer be confused with the products of an NCOS accredited retailer and what does an NCOS accredited offset retailer sell? Can an NCOS accredited farm project which produces offsets be confused with an NCOS accredited farm which produces carbon neutral eggs.

3. The GreenPower Anomaly

GreenPower is a well established scheme supported by all Australian state governments and is currently the most popular method for purchasing third party emissions reductions. Because of its significance, it is given separate treatment within this review.

[6] NCOS, Domestic Offset Eligibility Criteria

3.1 Current Federal Government Position

While GreenPower is not mentioned in NCOS, the following statement appears in the NCOS Q & As on the departmental website[7]:.

> "GreenPower™ and other renewable energy purchases are not NCOS approved offsets because they relate to an emissions source (stationary energy) covered by the CPRS. Only abatement achieved in emissions sources not covered by the CPRS and not counted towards Australia's Kyoto Protocol target can be offsets under the NCOS.
>
> However, GreenPower™ and other renewable energy purchases can be treated as zero emission sources of electricity under the NCOS for the purpose of calculating a carbon footprint for carbon neutrality. For example, if an organisation purchases 100 per cent GreenPower™ for all its electricity requirements, then its carbon footprint will include no emissions from electricity consumption. It would then need to purchase fewer offset credits to achieve carbon neutrality.
>
> Under the Government's proposed CPRS, all purchases of GreenPower will be taken into account when tightening future caps. The Government has also committed to cancel an equivalent amount of international units to ensure that these GreenPower purchases achieve an emissions reduction beyond Australia's national targets."

The government's reasoning for not including GreenPower within NCOS is that it does not qualify as an offset under its proposed model. This important issue has wider implications and will be covered in greater detail in other VCMA papers[8]. However, by treating GreenPower as 'zero emissions electricity' the Federal Government is effectively granting it equal status as an offset for the purposes of reducing a carbon footprint.[9] Therefore the government's position is inconsistent.

3.2 How should GreenPower be treated?

GreenPower differs from traditional offsets in that its currency (RECs) is denominated in megawatt-hours of electricity (MWh), and it is not subject to a number of accreditation screens that apply to other forms of third party abatement. However this is not to say that GreenPower would not pass those screens if they were applied given that it is audited and supervised by a government panel. The MWh denomination is a technical difference that can and is easily resolved by applying the grid emissions factor, i.e. the amount of greenhouse gas generated per MWh of electricity consumed. Buying one MWh of GreenPower therefore avoids the emissions from that amount of conventional electricity (typically around a tonne).

The fact that GreenPower creates a reduction in emissions, which come from a Kyoto counted source is however a problem for carbon accounting. Other international jurisdictions that have offset standards do not recognise third party abatement from within a Kyoto counted (or local ETS covered) sector simply because the abatement is already counted by the Federal Government towards its own compliance targets. This issue is discussed later, as it has wide implications for other forms of offsets. The VCMA has campaigned strongly to address this problem, with limited success to date.

Regardless, the government justifies its inconsistent position by saying that buying GreenPower is the same as buying a solar panel and placing it on your roof. Therefore while it does not qualify as an offset it can be thought of as a direct investment in a piece of renewable energy infrastructure.

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[7] http://www.climatechange.gov.au/en/government/initiatives/national-carbon-offset-standard/for-consumers.aspx

[8] VCMA GreenPower paper - forthcoming

[9] Although under NCOS applicable only to reducing one's electricity emissions.

This is an ironic analogy given that NCOS provides no guidance on how to account for the sale of RECs from solar panels. NCOS thus creates the anomalous situation where if the purchasers of a solar panels who generate 50% of their power from the panel's installation, can claim the RECs from the panels, sell the RECs, then purchase them back as GreenPower with the money they had just received from selling them, they can then make the claim that their remaining 50% grid electricity is "emissions free"! In other words 50% of their claim for carbon neutral electricity comes from nothing but a financial merry-go-round.

In any case the VCMA rejects the GreenPower equals solar panels analogy. Significantly, so do other comparable overseas schemes.

3.3 International Approaches

The UK DEFRA guidance allows for two forms of reportable emissions reduction from renewable energy. Firstly, energy from renewable facilities that are owned by, and connected directly to the subject organisation's supply. Secondly Green Tariff supply which is a grid-based electricity product backed by the commensurate removal of international units, namely Certified Emission Reductions (CERs). The DEFRA guidance therefore makes a distinction between abatement created by ones own capital infrastructure which can be used to reduce ones carbon footprint, and any third party abatement (offset) which can only be used for such a purpose if it is backed by a reduction in global emissions through the removal of an international permit..

Similarly the Regional Greenhouse Gas Initiative (RGGI) in the US (a state based compliance scheme) has a system where the relevant authority sets aside compliance permits from the scheme at the beginning of each year in anticipation of green power sales and retires the actual used amount at the end of each accounting year.

In both the US RGGI and the UK Green Tariff program, it is only the number of compliance units retired that is used to establish the GHG reduction value of the renewable energy purchased and support any green claim. [10]

3.4 Potential Solution

When the Australian government made the commitment in November 2009 to retire international units in response to GreenPower sales from 2010 onwards it was seen as a recognition of the need for compliance units to be surrendered in order to justify the environmental claim that GreenPower is a zero emissions electricity source. This move would have brought Australia into line with the principle established by similar schemes in other jurisdictions. It had the effect of re-incentivising potential buyers of GreenPower who had been withholding their purchases due to the lack of additionality.

At the recent Voluntary Carbon Markets Association National Conference, Minister Combet outlined the Federal Government's current position as follows:

> "A critical role for the Government is to work in partnership with you by maintaining or establishing the policy settings you need to make the voluntary market work effectively. A number of these policy settings flowed from the CPRS and particularly from the agreement negotiated with the Opposition in November last year. The Government established a framework that ensured that all purchases of GreenPower would be additional by ensuring that abatement from GreenPower is recognised in cap setting for the CPRS. The Government also committed to a new mechanism to recognise action that households take on energy efficiency in setting further CPRS caps, to be backed by the cancellation of Kyoto units."[11]

[10] Significantly in both cases the number of compliance units retired is based on the average grid emissions factor at the point of consumption.

[11] The Hon Greg Combet AM MP, Minister Assisting the Minister for Climate Change and Energy Efficiency, Address to the Voluntary Carbon Markets Association 10 June 2010.

This commitment recognises the need and capacity for government to cancel international units to ensure that voluntary action such as GreenPower actually reduces greenhouse emissions rather than merely lowering the cost of abatement under mandatory targets. The same logic can be applied to any verifiable voluntary action, intended to reduce global emissions.

Unfortunately the government has yet to confirm the calculation methodology to be used in determining the number and timing of international units to be retired in response to GreenPower purchases.

This calculation methodology is critical if NCOS is to be seen as having a credible and robust accounting methodology. The actual value of the abatement in terms of the number of Kyoto units and the timing of unit removal must be known in order that footprint assessors can correctly assign an emissions reduction,

4. Eligibility and Accreditation for Australian Based Offsets Projects

4.1 Importance of NCOS Accreditation for Australian Based Projects

Eligibility and accreditation under the NCOS is essential for Australian based abatement projects. The voluntary market, and the effectiveness of the NCOS have become even more important given the delay of the CPRS.

It is appropriate therefore that this critique of NCOS also includes comment on the manner in which voluntary abatement is treated in Australia and how abatement projects allowed under NCOS can either stimulate or dampen innovative abatement initiatives and technological enterprise.

Previous VCMA documents (see www.vcma.org.au) have explained the benefit of broadening the ambit of eligible abatement sources.

4.2 Current Status of Australian Based Offsets in the NCOS

Currently under NCOS only those sources not covered by Australia's obligation under its Kyoto Protocol commitments are eligible for creating offsets. According to NCOS these are limited to:

- *Forest management (forests established before 1990);*
- *Revegetation (establishment of woody biomass that does not meet forest criteria); and*
- *Cropland and grazing land management (net greenhouse gas emissions from soil, crops and vegetation).*

Emission sources not counted toward our International Target will be subject to outcomes in international negotiations and, similar to domestic arrangements, are likely to change over time.[12] *So a project developed when an abatement activity is not part of an international agreement could, in future, fall within that agreement, and be excluded from NCOS. This is a serious risk for project developers, as explained below.*

4.3 Problems with the Current Approach

These criteria for eligibility are highly problematic. They exclude many forms of highly effective abatement options which, with the right approach, could drive investment and

[12] National Carbon Offset Standard, Generation of Domestic Offsets.

employment in highly valued technological areas. Furthermore the Federal Government's approach has the potential to create a classic Catch 22 situation for any prospective project developer in areas to which NCOS applies.

The problem is in the last paragraph quoted above. There are reasons why these sources are not included in Australia's Kyoto obligation. In part it is because the baselines and the methodologies for measuring carbon input and output associated with these activities have been contentious or difficult to establish. NCOS however puts the onus for establishing appropriate methodologies onto the project developer. The problem is of course that once an acceptable methodology is agreed internationally the abatement activity can be included in international agreements. The source then becomes fair game to be included in future international negotiations, and likely to be included in Australia's international commitments, thereby making it ineligible as an offset under NCOS which excludes activities included in international agreements).

The perverse outcome of this will be that the project developer will have wasted all of its development costs and efforts possibly before any credits can be sold. This is a similar situation to that faced by many offset developers who currently find themselves holding large investments in Greenhouse Friendly forestry and other offsets that are now deemed ineligible due to the ratification of Kyoto.

The solution to this however is not difficult and is perhaps made even easier now that the CPRS is in a holding pattern.

5. The Voluntary Action Anomaly

5.1 Voluntary Action and Mandatory Government Obligations

Any abatement from a source which is counted towards Australia's Kyoto target reduces the impost upon the Federal Government to make good on its international commitments[13]. The government's international targets and commitments are based on expectations of business as usual, modified by changes over time brought about by local regulatory change and carbon price / tax (dis)incentives. If the Federal Government gets its compliance settings right the country should end up just making its target. [14]

Action is often taken voluntarily by individuals and corporations expressly for the purpose of reducing greenhouse gases in the environment and mitigating climate change beyond government commitments. Voluntary offset programs will not achieve such an effect if they are counted towards achieving the Federal Government's compliance target. Whilst such actions will reduce the impost upon the general economy, because it saves the government from having to impose stronger regulatory action, the level of overall emissions will not change as achievement of the cap is guaranteed by the government anyway.[15]

Any voluntary program where the abatement is appropriated by the Federal Government to meet mandatory obligations is likely to fail once contributors become aware of the futility of their actions. There is also a case to argue that such action by Government would be unethical. Therefore, for such projects to proceed consumers must be guaranteed that the resulting abatement is not used to simply reduce the impost upon the economy in general and thereby reduce the pressure on other polluters to take action.

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[13] At present, this means meeting its Kyoto target for the period 2008-2012 to average 108% of Australia's 1990 emissions.

[14] so that it meets its international obligation without having to pay extra to buy international permits, but avoids any additional cost associated with undershooting' the target.

[15] So if an individual, business or government agency takes abatement action voluntarily within Australia (that is, not in response to regulations or pricing signals), this additional abatement will simply leave more permits available to other emitters, as the cap is not adjusted downwards to reflect the additional abatement.

5.2 Importance of Protecting Consumer and Business Investment in Offsetting

Abatement from offset projects must therefore be additional to any mandatory commitments in order to qualify as legitimate offsets.

Where the project occurs within a Kyoto counted sector, the Federal Government can achieve this with a commitment to retire any international units that are freed up by the project so that the offset is additional to its international obligations.

Without such a commitment, the investment by consumers and businesses to reduce their own carbon emissions by purchasing offsets is undermined. Similar to the arrangements protecting the tax deductibility of donations to registered charities, the Federal Government needs to provide protection to ensure voluntary investment in carbon offsets actually delivers the expected carbon abatement. It can do this by ensuring voluntary action is counted in addition to any mandated national or international targets.

5.3 Proposed solution

A national scheme which enshrines this commitment by government would allow any number of potential Australian abatement projects to proceed regardless of whether they were in the covered sector or not. Significantly developers of projects within currently eligible sectors could be assured that even if their activities eventually came under a counted or locally covered sector they would continue to remain eligible.

Such a scheme would have no negative impact upon the economy or additional cost to the tax payer because the international units retired would be limited to those freed up as a result of the abatement project itself, and the project would not have happened without the commitment to retire international units.

Such a scheme would however significantly drive innovation and business activity within Australia in areas where experience and expertise in such projects is becoming increasingly valued.

The impediment to such projects to date has been trying to establish baseline and additionality criteria where there is already a carbon price. Ironically now that the CPRS has been delayed with no alternative compliance based carbon price on the horizon, the baseline calculation becomes much easier.

6. Accessible, Low-cost Accreditation

The NCOS appears to anticipate that organisations will always take a long term view of their carbon neutrality. Similar to other protocols NCOS require the establishment of an Emissions Management Plan, which includes the keeping of records, publication of periodical reports and (one assumes) compliance verification statements.

Experience has shown that a number of organisations, having firstly gone down the track of becoming Carbon Neutral for one year, have discontinued participation due to the cost and effort relative to the perceived benefits.

Often this is due to the cost of having internal staff trained up to become competent in interpreting standards which they only refer to once a year. When this staff member leaves or is reassigned, more training of others is required. Record keeping and time for other staff to become familiar with data formats is another cost and time burden.

All of this creates a significant disincentive for organisations to take the NCOS path. Respondents to the government's NGER system on the other hand have the advantage of OSCAR, an online calculator and database which not only ensure a standardised approach but reduces the need for much interpretation, and provides a convenient store of company data for future referral and comparison of performance and benchmarking.

The provision of a similar online system for NCOS reporting would significantly reduce costs for would be participants.

7. Removal of Disincentives

A further disincentive created by NCOS and currently voiced by some companies is the lack of flexibility with regard to varying degrees of statement of environmental performance. That is, one is either Carbon Neutral or one is not. Many organisations may wish to cut emissions without going Carbon Neutral but under NCOS there appears little incentive for doing so. This is of particular concern where large scope 3 emissions (emissions from activities beyond the direct control of the organisation) are concerned. Organisations may however be prepared to take action in return for recognition of incremental improvement.

At the very least NCOS should provide recognition for organisations that have significantly reduced their emissions regardless of whether or not they wish to spend money on offsets.

Recommendations

To address the issues raised in this paper, it is recommended that the Federal Government take the following actions:

1. Develop cogent and detailed guidance on the treatment of abatement credit sales and subsidies which is in line with principles currently being established in other jurisdictions.

2. Commit to set aside and retire AAUs or other international (Kyoto) units in response to GreenPower (or any other verified voluntary renewable energy credits) sales.

3. Remove the contribution of GreenPower from the National Greenhouse Accounts factors.

4. Develop an NCOS accredited web based calculator and data base for voluntary reporting

5. Expand eligible local projects to include those currently within Kyoto counted sectors. Voluntary credits (and potentially compliance credits) created from these projects would be made “additional” by the removal of AAUs or other international (Kyoto) units freed up in response to the project’s verified abatement.

6. Introduce transitional arrangements granting NCOS recognition for existing Greenhouse Friendly projects with a corresponding removal of AAUs or other international (Kyoto) units.

7. Introduce a fixed minimum term for new projects (in currently un-counted sectors) to remain eligible under NCOS in the case that future changes to legislation affect counted or covered sectors. This will require commitment from government to set aside and retire AAUs or other international (Kyoto) units under such circumstances.

8. Establish a task force to assess NCOS terminology and naming procedures in order avoid customer confusion with generic terminology.

Conclusion

As a result of the issues outlined in this paper, the NCOS is unlikely to achieve its stated objective of ensuring consumer confidence in the voluntary carbon offsets market and the integrity of the carbon offset products.

Potential for the creation of domestic offsets and offsets projects within Australia is very low given the restrictive nature of NCOS towards allowable projects.

Integration between voluntary and compliance systems is poor leading to the benefits of voluntary actions being of greater assistance to other polluters rather than to the voluntary player or to the environment.

Accessibility to NCOS Carbon Neutral accreditation is also poor given the potential costs involved. The overall impact of NCOS as it is now framed will be to drive voluntary abatement activity and investment offshore – creating abatement leakage, and depriving Australia of the development of the kinds of businesses that would contribute to development of a low carbon economy – the exact opposite of what we need.

The VCMA looks forward to engaging in further industry consultation with the Federal Government over coming months to further develop the solutions needed to ensure the NCOS is effective in reaching it's policy objectives.

Comments Invited

This paper has been prepared as a consultation draft for members. If you would like to make a comment on this paper please send an email to Kate Noble, Executive Officer, Voluntary Carbon Markets Association at executive@vcma.org.au

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