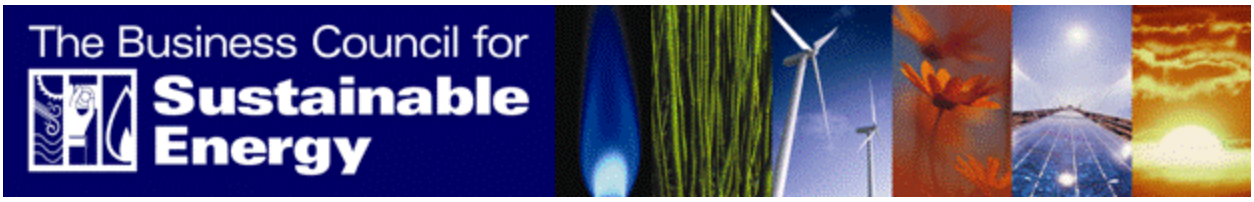

Written Testimony of the Business Council for Sustainable Energy

Submitted to the Agriculture, Nutrition and Forestry Committee Subcommittee on Rural Revitalization, Conservation, Forestry and Credit

Hearing on Creating Jobs with Climate Solutions: How Agriculture and Forestry can Help Lower Costs in a Low-Carbon Economy

Wednesday, May 21, 2:30 p.m.
328 Russell Senate Office Building

Chairman Stabenow:

The Business Council for Sustainable Energy appreciates the opportunity to submit the following testimony for the Subcommittee hearing on Creating Jobs with Climate Solutions: How Agriculture and Forestry Can Help Lower Costs in a Low Carbon Economy.

The Business Council for Sustainable Energy is a broad-based coalition that represents companies and trade associations in the energy efficiency, renewable energy and natural gas industries. Members include power developers, equipment manufacturers, independent generators, retailers, green power marketers, and gas and electric utilities, as well as several of the primary trade associations in the renewable energy, energy efficiency and natural gas industries.

The Council and its members have been working consistently with state, federal and international policymakers on market-based measures to reduce greenhouse gas emissions since its inception in the early 1990s. The coalition supports the establishment of market-based programs for clean energy technology innovation and deployment, economic efficiency and enhanced energy security.

The Business Council supports the inclusion of a robust offset program in federal climate legislation, including S.2191, the Lieberman-Warner Climate Security Act, currently pending in the Senate. A robust offset program provides incentives for deployment of greenhouse gas emission reduction projects and activities outside capped sectors, including projects in the agriculture and forestry sectors of the economy.

A robust offset program would expand the reach of the program and minimize overall compliance costs for the economy as a whole. In its recent analysis of S.2191, the Environmental Protection Agency supported this conclusion. For example, EPA's analysis concluded that if no international or domestic offsets of any kind were allowed, allowance prices would increase by 92% compared to S.2191 as written. Allowing the unlimited use of domestic offsets alone can reduce the prices of allowances by 26% compared to S.2191 as written, and allowing the unlimited use of domestic offset allowances and international credits can reduce allowance prices by 71% compared to S.2191 as written.

Considering the value of the cost containment benefits of offsets, the Council recommends designing a program that promotes broad use of offset allowances to achieve compliance under a federal climate change program.

A Robust Offset Program can Help the U.S. More Quickly and Cost-Effectively Reduce Greenhouse Gas Emissions

The ability for entities to generate and purchase offset allowances is an essential feature of a market-based approach to reducing greenhouse gas (GHG) emissions. Under a compliance offset program, covered entities are permitted to help meet their obligation to reduce GHG emissions by purchasing offset allowances generated from projects or activities that fall outside the scope of an emissions cap. This flexibility provides covered entities with the ability to achieve needed emission reductions at the lowest cost. While the Council encourages covered entities to undertake internal emission reduction activities such as deploying renewable energy and energy efficiency to the greatest extent possible, our members recognize offset purchases as an important complementary tool to help covered entities manage compliance costs, widen the scope of environmental benefits and lower economic costs for energy consumers.

By creating the market opportunity to generate offset allowances and by providing covered entities with the ability to purchase offsets, the U.S. can more quickly and cost-effectively reduce GHG emissions across a broad spectrum of the economy. In addition, an offset program promotes the deployment of valuable existing clean technologies that reduce emissions, and facilitates additional and positive environmental, social, and economic benefits.

As with other aspects of market-based initiatives to address climate change, the details and structure of a federal compliance offset program will play a critical role in determining successful implementation, as well as achieving desired GHG emission reductions. The Council believes that ensuring the environmental integrity of offset allowances is essential in order to meet desired emission reduction levels. Real and additional offsets must be the standard for program integrity. Independent, third-party monitoring and verification requirements are also necessary to ensure that GHG emission reductions are delivered.

Council Recommendations for Design of an Offset Program

Leveraging the experience of our members in renewable and low-carbon energy generation, clean energy technology, and project development, the Council has suggested a number of modifications to the following provisions that pertain to offset allowances under S.2191. We offer them here, before the Senate Subcommittee on Rural Revitalization, Conservation, Forestry and Credit, as you contemplate the impact of the legislative provisions on the agriculture and forestry community.

Of note, as a diverse business coalition, not all Council members endorse or take positions on the set of proposals listed below.

1. **Approved, verifiable offset allowance purchases made prior to enactment of S.2191 should be eligible for early action credit**

S.2191 should be amended to allow covered entities that have purchased approved, verifiable offset allowances to be eligible for early action credit under Title III, section 3202, which pertains to the allocation and distribution of allowances.

Rewarding the efforts of covered entities that purchase offset allowances prior to implementation of a mandatory federal program sends clear market signals to facilitate development of projects that reduce GHG emissions. It also provides an incentive for covered entities to reduce emissions as soon as possible, even *before* implementation of a mandatory program.

To recognize early action, Section 3202 contains provisions to allocate allowances to covered entities which have made voluntary reductions in GHG emissions under established voluntary programs outlined in the legislation. The Council supports this early action allowance allocation, or early action credit; however, we believe this section needs to be expanded. Specifically, the Council believes that, in addition to allocating allowances to entities that have made voluntary reductions entity-wide, Section 3202 should be amended to state that covered entities which have purchased and retired offset allowances under a voluntary offset program deemed eligible by the Administrator should also be eligible for early action credit.

To provide certainty about which offset allowances may qualify for early action credit, the Council believes Section 3202 should be further amended to direct the Administrator to consider offset allowances purchased and credibly retired under existing voluntary offset programs outlined in Section 2408(b)(1).

2. Approved offset projects should be eligible to generate offset allowances for a guaranteed crediting period

Approved projects should be given the flexibility to generate offset allowances for either a defined 10-year period on the basis of a fixed, ex-ante baseline and initial additionality assessment, or for a 7-year crediting period with the option to apply for renewal. In the case of forestry offset allowances, projects should be credited for, at minimum, a 30-year period. Approved projects should accrue offset allowances on an annual basis. This accrual should occur at the end of each year that a project undergoes successful, independent verification of its performance.

The Clean Development Mechanism (CDM) under the Kyoto Protocol maintains a workable approach in which offset projects are allowed to generate credits for a multi-year, yet limited period of time. Similar crediting approaches have been adopted under the Regional Greenhouse Gas Initiative and the California Climate Action Registry. Based on these existing approaches in regulatory and voluntary offset programs, the Council believes that Section 2405, which pertains to offset verification and issuance of allowances, should be amended to clarify that approved offset projects be allowed to generate offset allowances on the basis of a multi-year crediting period. The Council recommends that project sponsors be allowed to choose either a one-time 10-year crediting period, or to choose a 7-year crediting period, after which they may re-apply to the Administrator for crediting. In the case of forestry offsets, projects should be credited for, at minimum, a 30-year period.

A 10-year crediting period is critical to some projects to enhance project revenue and enable project developers to secure valuable debt financing for projects, while a 7-year, renewable crediting period may be more workable for other types of projects. In the case of forestry, a longer crediting period reflects the nature of these projects as requiring an extended investment of time in order to generate long-lasting emission reduction benefits.

3. Review and approval of an offset project's additionality and emissions baseline should only occur once per crediting period

Section 2405 should be amended to clarify that, while an offset project should be monitored annually over the course of a crediting period by an independent, third-party verifier to ensure that the project meets required standards of performance, the assessment of additionality and determination of an emissions baseline should only occur once per crediting period. The assessment of additionality and determination of an emissions baseline should occur at the time a project is assessed for approval.

To meet GHG emission reduction requirements, offset allowances must be generated by projects outside of the cap that adhere to rigorous standards that ensure that the emission reductions achieved are real, independently verified, permanent, enforceable, transparent, and additional. The terms "additional" and "additionality," as defined in section 4(1) of the Bill, relate to the extent to which reductions in GHG emissions, or increases in sequestration, are not legally required and are incremental to business-as-usual practices.

The Council supports the need to periodically review and update approved offset project types, and the methodologies for determining the project baseline and method of calculating emissions reductions. This is important to ensure that offset allowances continue to be generated from activities that would not have happened under a business-as-usual scenario. There are a variety of factors that can be used to determine the additionality of offsets, such as performance standards and "tests" set forth in the World Resources Institute's Greenhouse Gas Protocol for Project Accounting and the United Nations Framework Convention on Climate Change's Tool for the Demonstration and Assessment of Additionality (Version 03). As per the current language of S.2191, the Council supports implementation of pre-approved standards (performance and/or project-based, as appropriate) for projects and activities that promote certainty for offset project developers, as well as administrative efficiency and transparency within the regulatory system.

To foster development of offset projects, investors must have the confidence that approved projects will be eligible to generate offset allowances for a multi-year period and that an additionality determination made at the time of approval *remain* valid for that period. There will be a significant deterrent to investment in, and the development of offset projects, if, in the course of annual emission reduction verifications, a project may also be subject to being invalidated as the result of a baseline re-assessment. Project developers and covered entities will be deterred from investing in projects that annually run the risk of being disqualified for offset allowance generation, since these many of these projects rely partially upon the revenue from the sale of offset allowances over time to be financially attractive.

The rationale behind the approach of assessing additionality once in the course of a fixed crediting period is that over the course of an offset program, as projects are developed and new practices emerge over time, the additionality of certain project types or activities may change. For example, governments may enact new laws requiring practices that were not previously required. And as technology emerges and business-as-usual practices evolve, project types that were once qualified to be additional may no longer be additional. This is a sign of progress within an offset program, and it is balanced by the fact that offset projects are bound by a limited crediting period. This approach ensures that approved offset projects can benefit from the confidence that offset allowance generation is possible over a guaranteed time period, and ensures that the environmental integrity of the program is preserved, as well.

The Council believes that the current language in Section 2405, which pertains to offset verification and the issuance of allowances, should be amended to clarify that, while offset projects should be monitored annually by an independent, third-party verifier to ensure delivery of real emission reductions, the assessment of additionality and determination of an emissions baseline will only occur once per crediting period. Such additionality and baseline determination should take place at the time an offset project is reviewed for approval.

4. Covered facilities should be eligible to generate offset allowances from the implementation of projects or activities that reduce emissions from uncovered sources

Section 2403 of S.2191 should be amended to specify that projects or activities implemented to reduce GHG emissions from uncovered sources within a covered entity be eligible for offset allowance generation.

Section 2403 outlines various project types eligible to generate offset allowances. While the Council supports this provision, additional clarification is required to ensure that eligible project types that reduce emissions from any uncovered sources within a covered facility – sources that are not included as part of a covered facility's emissions inventory – are eligible to generate offset allowances. Without the ability for covered entities to generate offset allowances from these uncovered sources, these emissions – such as fugitive emissions from natural gas pipelines – will go unmitigated. In addition, by allowing covered entities to generate offset allowances from uncovered sources, the market will benefit from the learning experience associated with such project and technology implementation, and may help to make it more feasible to include such sources of emissions in covered facilities' emissions inventories at a later date.

5. Verified, high-quality international offset allowances should be eligible for recognition within an offset program, regardless of the location they are generated

S.2191 should be amended to allow covered entities to use international offset allowances or credits, such as those recognized under the CDM of the Kyoto Protocol, toward their GHG emission reduction compliance requirement.

The Council commends the authors of S. 2191 for allowing covered entities to use "international emission allowances" from a foreign greenhouse gas emissions trading market that has been certified by the Administrator. Council members believe that a federal market-based approach to addressing climate change should be linked to other domestic and international market-based programs that incorporate an offset program, provided they are deemed to be of high-quality and environmental integrity. Addressing climate change is a global challenge and emission reduction activities that occur within and outside U.S. boundaries generate equally valuable environmental benefits.

As currently drafted, S.2191 under Section 2502 (b)(1) requires that international offset allowances be "issued by a foreign country pursuant to a governmental program that imposes mandatory absolute tonnage limits on greenhouse gas emissions". As drafted, this provision would exclude the use of Certified Emission Reduction (CER) credits issued under the CDM. CERs are generated in developing countries that do not have mandatory tonnage caps on GHG emissions. CER credits are universally recognized as high-quality offset credits that represent real, additional, verifiable and permanent emission reductions and which also help to promote sustainable economic and environmental development in countries throughout the world.

Having access to CER credits generated under CDM will play a significant role in reducing compliance costs for covered entities, which will help contain costs for the U.S. economy as a whole. While allowing the use of CERs for compliance purposes should not be construed as a substitute for engaging developing countries in emission reduction commitments, such effort will continue to build the market for emission reductions throughout the world, and will serve as a bridge to engaging developing countries in making future reduction commitments. In addition, many projects developed under the CDM employ technologies and equipment manufactured in the U.S. The CDM market serves as a valuable international business market for U.S. companies, while at the same time facilitating transfer and deployment of clean technologies around the world.

6. The flexibility for covered entities to use offset allowances to meet compliance obligations should be maximized

Offset allowances play a valuable role in containing costs of a GHG emission reduction program. To ensure maximum flexibility in the design of the program and facilitate cost-containment, Section 2402 and Section 2501 should be revised to allow covered entities to utilize offsets domestically and/or internationally, to the extent and proportion they deem most suitable.

A robust offset program provides incentives for deployment of GHG emission reduction projects and activities outside capped sectors, expanding the reach of the program and minimizing overall compliance costs for the economy as a whole. Recent analyses, including from the Environmental Protection Agency (EPA), support this conclusion. For example, EPA's analysis concluded that if no international or domestic offsets of any kind were allowed, allowance prices would increase by 92% compared to S.2191 as written. Allowing the unlimited use of domestic offsets alone can reduce the prices of allowances by 26% compared to S.2191 as written, and allowing the unlimited use of domestic offset allowances and international credits can reduce allowance prices by 71% compared to S.2191 as written.

Considering the value of the cost containment benefits of offsets, the Council recommends designing a program that promotes broad use of offset allowances to achieve compliance under a federal climate change program. S.2191 currently allows covered entities to meet up to 15% of their compliance obligation with domestic offset allowances (Section 2402), and up to another 15% with international emission allowances (Section 2501). While our members have differing views on the overall percentage

of offset allowances that covered entities should be allowed to use, Council members believe that covered entities should have the flexibility to decide how to design their offset portfolio, whatever percentage Congress ultimately allows. In other words, capped entities should have the flexibility to choose whether, and in what proportion, offset allowances are purchased from domestic and/or international sources, provided such offset allowances meet high-quality standards established by the Administrator. The Council also believes international offsets should include both international emission allowances and project-based credits such CERs. Compliance costs will be contained to the greatest extent possible if covered entities are provided with maximum flexibility to choose how to design their portfolio of offset allowances.

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Independent of federal action on S.2191, Congress should promote market certainty by immediately authorizing the development of the rules, oversight, and accounting mechanisms of a federal compliance GHG offset program.

S.2191 effectively sets forth a framework whereby the Administrator and USDA will promulgate rules and procedures establishing a compliance carbon offset program upon enactment of the legislation. While the Council recognizes that development of such a program will take time, the U.S. economy would benefit greatly if this work could proceed as soon as possible – even independently of the passage of climate change legislation.

Since offset projects can take years to design and develop, covered entities and consumers will benefit if the federal government can begin establishing the rules, oversight and accounting mechanisms of an offset program. The federal government can learn and build upon significant work accomplished to date internationally under the CDM; under the federal EPA Climate Leaders Program; from regional programs such as the Regional Greenhouse Gas Initiative and the Western Climate Initiative; and from state programs such as the California Climate Action Registry.

Regulatory uncertainty is one of the largest obstacles to new investments in low-carbon and clean energy technology projects. Companies want to develop new offset projects, but are deterred by uncertainty with respect to the types of projects and methodologies that will be recognized under a future federal compliance program. Companies that expect to be regulated under a future climate change program want to begin to support offset project development by purchasing offset allowances, but want the assurance that their purchases made today will be recognized in some manner under a future federal program.

Developing the rules, accounting and oversight mechanisms of an offset program that could be incorporated into a federal climate change regime is not contingent upon passing cap-and-trade legislation such as S.2191. The U.S. could get a significant head-start on reducing GHG emissions from sectors outside of a future cap by initiating a process to formally begin designing the structure and rules of an offset program. The Council would be pleased to leverage the vast experience of its members on offset issues and work with members of Congress to further develop this concept.

For more information about the Council, please visit: www.bcse.org