



ICROA (International Carbon Reduction and Offset Alliance) Assessment of the Draft Defra Code of Best Practice for Carbon Offset Providers

Summary

The draft Code of Best Practice for Carbon Offset Providers (thereafter the 'Code') published by Defra on 19 February 2008 sets out the requirements for their proposed accreditation scheme to give consumers greater confidence when buying offset products.

ICROA welcomes Defra's efforts to provide clarity on the issues of quality and credibility in the offset industry. We support this aim of the Code but believe there are some fundamental design flaws, as well as numerous issues of specific content that will need to be rectified before the code is appropriate for widespread use.

The Stakeholder event held by Defra on Wednesday 26th March reinforced the fact that there are still a number of fundamental issues requiring clarification from Defra or further discussion with the industry, if the Code is to be implemented successfully. We have set out our view on these issues in the remainder of this document. We strongly urge Defra to delay the launch of the final Code until these issues have been resolved. We see a number of major risks associated with launching the Code too hastily, which together are likely to undermine the very concept (voluntary offsetting), which the Code was designed to support. Specific risks that we see include:

- Confusion around precise accreditation requirements / process lead to a lack of products/organisations seeking accreditation.
- Accreditation process takes longer than expected because issues have to be dealt with 'on the hoof' by the accreditation body as they arise – undermining credibility of the Code with providers.
- The delays set out above lead to an extended time lag between publishing the Code and actually having accredited products available for sale – reducing the impact of launch.
- The Code having to be reissued shortly after being 'finalised' to take account of issues that are not fully addressed between now and the end of April target launch date – again causing confusion in the market.
- Negative PR around the Code as journalists pick up on issues that have not been fully resolved at launch – meaning that the Code and quality mark have an uphill battle to fight in gaining market acceptance.

In short, we think there is a valuable lesson to be learned from the opening of Heathrow's Terminal 5 – don't launch publicly until your systems have been stress-tested!

As Defra is aware, ICROA is in the process of developing its general policy and the ICROA Code of Best Practice. In-depth work has already been carried out in work streams dedicated to additionality, standards, general policy, footprinting and RFI and forward accounting. ICROA is subjecting its Code of Best Practice and general policy to a rigorous process of analysis and development; including work stream processes, developing principles where applicable, and engaging in pre-launch stakeholder consultation.

Postponing the launch of the Defra Code will provide a valuable opportunity for the Defra Code and the ICROA Code to develop in parallel and allow Government guidance and industry self-regulation to support and complement each other, rather than challenge and conflict with each other. If a further period of time is taken to undertake more detailed consultation with the industry and the issues can be appropriately addressed, we believe that there is an opportunity to use this work as a template for an internationally recognised offsetting code which will ultimately help drive the success of this international market.

Members of ICROA:



General Comments on the design of the code

What is the code?

Firstly, it needs to be clear whether this is a Code of Practice, a standard or, as the drafting predominantly suggests, a quality assurance scheme. It should also be made clear whether the Code now aims to protect all buyers of offsets as opposed to just small businesses and consumers, as was the original intent.

The aims of the code

While some of the aims of the code are clear, others are less so. For example, amongst others, [the Defra website](#) still states that the Code aims to “*encourage the provision of credit types which are consistent with the Government’s policies on meeting its Kyoto obligations and strategy for supporting the development of a robust and liquid global market infrastructure for carbon trading*”.

Whilst this does not appear in the revised Code itself and appears to contradict the letter from the Secretary of State that accompanied the launch of this latest draft, we would like to re-emphasise that if it remains an aim of the Code, it is not an appropriate one, particularly if the implication is that voluntary offsets must be used to meet any country’s Kyoto obligations. The driver for most voluntary offsets is to go beyond international commitments and this option must remain open to consumers.

Fixed fee system for all “offset providers”

A significant design flaw relates to the definition of “offset providers” and the associated accreditation process. This puts the onus on companies that are, in fact, not specialist offset providers to meet what is, for them, a costly and potentially administratively burdensome Code.

The proposed Code neither offers enough assurance for large offset schemes, nor a reasonable level of cost and obligation for very small ones. There needs to be a tiered system of accreditation with varying costs, obligations and audit/verification processes to ensure that all sizes of offset provider at least have an option to be accredited at realistic cost.

What should be accredited?

Whilst the current draft is muddled, it seems that the Code intends to accredit offset products rather than organisations or credits. We would question whether this approach best serves the objective of protecting the consumer. The voluntary offset market’s ‘product’ is so diverse, ranging from full carbon neutral certification to pure forward bought tonnes from bodies wishing to support a whole project from inception, that a large proportion of consumers are currently buying products that could not be accredited.

While some of these fit with the spirit of the code and simply fall down on technicalities, others are very different propositions that are equally valuable in tackling climate change and in engaging consumers. We would therefore recommend that a less prescriptive approach would be both more workable and effective at meeting Defra's objectives.

An alternative approach

We believe that the following approach would offer more appropriate rigor, be more effective at tackling climate change and engaging consumers and ultimately be more workable which will give the scheme a much higher chance of success.

We would propose that the scheme works in a similar way to that in which pension funds are accredited. Defra would employ an appropriate body to assure consumers that the offset company is able to meet its liabilities, that the offset credit is of a sufficient quality and that the specific proposition is following a set of guidelines on areas such as calculating emissions, communicating offsets etc.

The accreditation process would be broken into three elements:

1. The offset company:

The offset company should be regarded as the organisation whose core business is the provision of warranted emissions reductions, or to be more specific, the company that cancels the credit. Any other offset provider using the current definition is effectively a reseller and would have to buy from an accredited provider (as well as passing levels 2 and 3) in order for their offset products to be accredited. The offset companies should be subject to much greater scrutiny than the current Code proposes. Something along the lines of the ICROA Code would be more appropriate. ICROA would be happy to work with Defra on developing revised criteria for an offset company.

2. The credit itself:

As with the existing scheme, this needs to be verified to an approved standard and cancelled on an appropriate registry. What constitutes an appropriate standard is addressed later in this document.

3. Guidelines on the positioning of an offset product:

The guidelines on how to develop and communicate an offset product should cover many of the areas already laid out in the Code. It is important that the guidelines should strike a balance between being prescriptive where it is necessary and general where it is not in order to allow innovation in product design alongside rigor. Examples of how a change in this balance would be beneficial include:

- Calculations – it should not be compulsory to link an offset to a specific emission. It should remain necessary to follow approved calculation methodologies for any product offsetting something specific but in instances where the products that just include a fixed offset (i.e. where no methodology existed) would not be precluded from accreditation.
- Transparency of pricing – there is no clear definition in the Code of either what this is or what is trying to achieve. We can see two main rationales for requiring a transparent price; advocates of the carbon market want a clear cost of carbon while consumers more often ask the simple question, “How much of my money goes to the project?” If transparent means ‘how much goes to the project’ – then this is virtually impossible to achieve with CERs that have been traded multiple times and is meaningless in the case of EUAs. Any attempt to give transparency of pricing must make this clear and absolutely must not give the consumer the impression that more of their money goes to the project than is really the case.
- Timing of cancellation – this is addressed in more detail later in this response but there needs to be flexibility to allow cancellation within a timeframe that is appropriate to the product offered.
- Communicating the offset – whilst the details of how to communicate offsets are not prescribed in the current Code, this requirement needs to be non-prescriptive so that providers can maximise the potential to use offsets to engage customers without having to stick to prescribed texts. Lack of prescription will allow retailers to tailor communications strategies for either their ‘business-to-business’ or ‘business-to-consumer’ purchases. Businesses generally have a much more sophisticated grasp of offset based reduction strategies, so businesses and consumers require different communications strategies.

- It should be sufficient to state that offsets are just one part of our attempts to tackle climate change and should be used as a complement to efforts to reduce emissions at source.

This approach would allow a greater level of confidence in the market by setting tougher standards for the main offset providers, without squeezing out innovation and small resellers through inappropriately burdensome cost and administration. ICROA would welcome the opportunity to work in cooperation with Defra to develop this alternative approach. There is a great opportunity to harmonise the objectives and strategies of the Defra and ICROA Codes.

General Comments on the specifics of the code

There are two major flaws with the detailed content of the existing draft.

Credit type

The main issue, which was very clearly raised by the majority of respondents to the original consultation, is the **exclusion of Verified Emissions Reductions (VERs)** from the initial phase of the scheme. The arguments have already been put forward and do not need to be restated here. It should be pointed out however, that two of the key objectives laid out in the new Code – value for money and understanding climate change – are clearly better delivered using high quality VERs.

The letter from the Secretary for State that accompanied the launch of this stage of the consultation acknowledged the value of VERs and laid out some requirements for them to be included in the Code. The basic criteria that a VER must meet to be acceptable (including additionality, avoiding leakage etc.) are already met by high quality VERs such as those accredited to the Gold Standard and VCS.

The suggestion that only one widely accepted industry standard should be allowed under the Code poses a significant barrier to the inclusion of voluntary credits, as this is truly an international market with different requirements in different locations. It is also inconsistent with the approach already proposed for Kyoto based credits which can currently be accepted from three separate standards. We cannot therefore see a legitimate rationale for this requirement but believe a range of high quality VERs could be assessed and included in the Code.

We urge Defra to prioritise the discussion on this issue with great urgency because, **this is the fundamental issue** for most stakeholders concerned with the success of this code.

Timing of cancellation

Another key flaw, again expressed by many respondents to the original Code, is the requirement to cancel credits within a period of six months. There are reasonable arguments for such a time restraint, such as delivering emissions reductions within a timeframe matching the emissions to be offset, and protecting against potential financial problems with an offset provider.

These arguments, however, must be countered by the needs of the consumer. Many offset buyers demand a direct link between their money and the creation of future projects. And as the proposed Code acknowledges, consumers who are taking voluntary action want and should be entitled to the best value for money - restricting the market to ex-post credits will almost certainly raise prices and therefore unnecessarily reduce demand.

Moreover, this prescriptive approach also creates difficulties in application when the details are considered. Assuming the point of sale is the point of transaction with end consumer, the emissions that are being offset can actually happen at any point within several years either side of that sale. Also, small resellers often report sales to the offset providers at timeframes appropriate to the size of the business which can be as infrequent as annually making it impossible to meet this requirement without additional administration.

A more thorough accreditation of the offset provider as is being developed through the ICROA code would provide protection against financial and delivery risk. We therefore believe it is more appropriate to take this more thorough approach to accreditation and then have a general guideline that cancellation should be in line with the later of the emissions or offset sale plus or minus a fixed period. That period should be long enough to encourage innovation in the market (perhaps 5 years) with guidance that communication should be clear around vintage if long forward streams are sold.

As an additional point, this cancellation requirement, coupled with the limitation on credit types appears to preclude the inclusion of forestry offsets, which cannot be permanently cancelled under the Clean Development Mechanism, but can be cancelled under some VER standards.

Another issue is the '5 day period for cancelling credits from the Environment Agency Registry account'. It would be administratively impractical, time consuming and costly for cancellation to occur within 5 days of every single customers' offset being purchased. Cancellation from this registry, or retirement in appropriate VER registries, is probably best done as a bulk request covering purchases made for a given period. It would probably be more appropriate for this process to be done 6 monthly or annually.

Specific comments on the content of the code

3 Accreditation

Requirements

- 1. Offset providers must pay a fee in relation to their product for it to be assessed and accredited.*
- 2. A signed declaration will be required from the primary applicant stating that they will abide by the Code.*
- 3. Accredited offsets must continue to meet the requirements of the Code throughout the accreditation period (12 months from the granting of accredited status) unless the accreditation body is informed in writing that accreditation is no longer wanted.*

Clarifications on terminology

- **What is being accredited?:** An 'offset product' is not specifically defined but appears to be the full package of the calculation methodology, the type of emissions reduction and any associated communications. There needs to be a clearer definition of 'offset product'.
- **Who applies for accreditation?** An 'offset provider' is defined as a company/organisation which sells offsets to consumers – this contradicts part of the definition in Annex 2 which says that 'an offset provider is a company whose core business is the provision of offsets, either directly to the public or as a service provider to another organisation to allow their consumers to offset'.
- **No definition of 'primary applicant'** – implies that there is a secondary applicant status, but there is no mention of this in the Code.

Problem of principle/application

- **A high proportion of offsets are sold through 'resellers' or 'agents':** many individuals buying offsets do so as part of a product such as a flight or car. If the Code is for accrediting the 'offset product' as defined above then each agent/reseller must apply for accreditation. To meet its objectives the Code must be practicably applicable for these companies whatever their size.
- **Costs are restrictive for SMEs if all resellers need to apply individually:** Fees are £4,500 for offset product registration and £2,000 for annual renewal. This renders the offering of many reseller customers uneconomical. For example, one of our members calculated that for a group of 90 of its resellers to all apply for accreditation would cost around £400,000, and less than £200,000 would be being spent on offsets. So 2/3 of the cost passed on to customers would be going to AEA. Defra consider that the fee recognises the commercial value attached to using the quality mark – is there any evidence for this?
- **Timing of accreditation.** The proposal to have all accreditation based on a calendar year will be challenging to administrate and will act as a potentially significant barrier to the majority of companies who have different operating years.

Calculating Emissions

1. *Offset providers must calculate emissions to be offset accurately, using the factors provided for in this Code.*
2. *The factors to be used shall be included in the application.*
3. *Only direct carbon emissions can be offset using accredited offsets.*
4. *Where applicable an offset provider may make an application to the accreditation body if they wish to propose a specific emission factor which is not listed in this Code. These factors must be agreed by the Accreditation body before they can be used.*
5. *Offsets will only be accredited if they calculate emissions from a particular activity or over a period of time.*

Clarifications on terminology

Problem of principle/application

- **Non-specific offsets.** This approach excludes an important and growing market for ‘non-offset’ provision of emissions reductions: e.g. providing simply a quantity of tonnes, or including emissions reductions as a ‘fund’ rather than an offset.
- **Accuracy of reporting:** For business offsets, it is unclear how much responsibility the offset provider has for ensuring accurate reporting of emissions using an appropriate methodological approach. Do they have to do the calculations themselves or is it sufficient to have a contract that states the consumer has to demonstrate use of one of the appropriate methodological approaches when reporting?
- **Direct emissions.** The term ‘direct carbon emissions’ defined by Defra as including electricity use and flying is inconsistent with ISO 14064 and GHG protocol definitions
- **Offsetting products.** Having no methodology for embedded carbon precludes many existing and potential offset schemes and so the plan for a finding a satisfactory methodology should be expedited.
- **Availability of additional EFs.** Is one application submitted per methodology, which once approved is made available to other offset providers wishing to use that methodology?
- **Costs for new EFs.** A *minimum* of £1000 per emission factor – how and at what point will this cost be defined?
- **Detailed calculations.** There are numerous questions of detail surrounding the specifics of individual calculations that are dealt with in a separate paper.

Environmental Integrity

1. *Accredited offsets must only include Kyoto compliant credits.*
2. *If an accredited offset includes credits from forestry (tCERs and ICERs) the offset provider must guarantee that the credits will be renewed or replaced once they expire.*
3. *Credits to fulfil a consumer's purchase should be bought within 6 months of the transaction.*
4. *They should be retired from the Environment Agency's registry within 5 days of purchase.*
5. *Offset providers must be able to provide evidence that this has occurred to the accreditation body.*

Clarifications on terminology

- **Point of credit purchase.** Some offsets are originated rather than purchased – how will that be evidenced?

Problem of principle/application

- **Kyoto compliant credits.** This is still a fundamentally flawed proposition and high quality VERs should be included from the outset. It is essential that the dialogue on how VERs can be included in the code commences immediately and that there is a genuine intention on the part of all parties to find a practical and expedient means of doing so.
- **Cancellation within 6 months.** This timescale creates significant administrative difficulty with little real benefit and should be changed to within five years of the later of the emissions or the sale. This period should be reviewed as the market grows and matures.
- **Forestry credits.** How long does the obligation remain on the offset provider and AEA as the accrediting body? What provisions are there in the event the offset provider goes into liquidation?
- **EA Registry.** The EA registry presently only holds EU ETS allowances until the ITL provides a link to the UNFCCC.
- **Evidence.** Providing the necessary level of detail of evidence will be challenging for small resellers.

Consumer Information

1. *Offset providers will provide general information about climate change and the importance of reducing a carbon footprint to consumers.*
2. *Offset providers will provide explanatory information to consumers about the role of offsetting in contributing to tackling climate change.*
3. *Clear and transparent pricing should as a minimum be provided at the point of sale.*

Clarifications on terminology

- **Offsetting service.** What is meant by the “offsetting service” as opposed to the credits? Presumably this is to include any additional charges over and above the price of credits being bought (e.g. transaction cost, marketing and consultancy fees).

Problem of principle/application

- **Reduce before you offset.** What criteria will be used to assess whether the offset product passes the requirement that its customers ‘should be encouraged to avoid and reduce their emissions prior to offsetting’? Will there be communication guidelines? How do you define when a consumer has reduced sufficiently to justify offsetting?
- **Guidelines on how to communicate offsets.** Who defines the content of this advice? What is the role of offsetting? Will the accrediting agency have to approve all text? Will example text be made available or communication guidelines again? This requirement needs to be non-prescriptive so that providers can maximise the potential to use offsets to engage without having to stick to prescribed texts. It should be sufficient to state that offsets are just one part of our attempts to tackle climate change and should only be done alongside efforts to reduce our own emissions
- **Transparent pricing.** What is the aim of this approach? If it is to give consumers a clear understanding of how much of their money is invested in the projects, it fails to achieve this. If it is to signal a clear price for carbon to drive behavioural change then this must be absolutely explicit. It should be made clear that this is a market price and not an assessment of how much money actually goes to the project.

Quality Mark

1. *Only accredited offsets can display the quality mark.*
2. *The quality mark will be copyrighted and only those offset providers licensed to use it can do so.*
3. *The terms of the licensing agreement covering the use of the Quality mark shall be adhered to.*
4. *Sellers of accredited offsets must follow the guidelines for how and where to use the quality mark.*
5. *An offset provider will distinguish the accredited offsets from any offsets it may sell which are not accredited.*

Clarifications on terminology

- **Accredited offsets.** There is confusion again here in terms of whether offsets or products are being accredited – this requires clarification.

Problem of principle/application

- **Defra PR and Marketing Strategy.** Defra PR and Marketing campaign needs to be extensive enough, for consumers to understand the significance of the quality mark; is the proposed Defra strategy sufficient?

Role of the Accreditation Body

1. *The Accreditation Body will manage a web-based application process.*
2. *Queries about the Code and the accreditation process should be sent to the Accreditation Body.*
3. *Compliance with the Code will be regulated by the Accreditation Body.
(Auditing offset providers representing at least 5% of the total accredited offsets sold seems low if it is only 5%. How high is the target for this?)*
4. *Complaints against an accredited offset should be sent to the Accreditation Body.*
5. *Complaints regarding an accreditation decision should be sent to the Accreditation Body and may be dealt with by an industry panel.*

Clarifications on terminology

Problem of principle/application

- Given that audit is paid for out of accreditation fees and audit costs are relatively fixed per audit exercise (provider), there is an incentive here for AEA to focus on 1 or 2 large providers to meet the 5% audit target rather than a larger number of smaller providers. Is this what is intended?