

IETA Response to the South African consultation on Draft Regulations: Carbon Offsets

This document forms the response from the International Emissions Trading Association (IETA) to the Draft Carbon Tax Bill: Publication of Proposed Regulations made in terms of Clause 20(b) of the Draft Carbon Tax Bill, 2015. We welcome the opportunity to respond to the National Treasury of the Republic of South Africa on this important topic.

Introduction

IETA is a non-profit business organisation created in June 1999 to develop a functional international framework for emissions trading that results in real and verifiable greenhouse gas reductions, while balancing economic efficiency with environmental integrity and social equity. Its membership includes more than 130 international companies from OECD and non-OECD countries, across the carbon trading industry. Several of our members have industrial operations in South African industry, and are active in providing inputs to climate change policy in South Africa.

IETA is dedicated to the establishment of market based systems for greenhouse gas emissions that are demonstrably fair, open, efficient, accountable and consistent across national boundaries. IETA has been the leading voice of the business community on the subject of carbon markets since 2000.

Background to ICROA

The International Carbon Reduction and Offset Alliance (ICROA) is a programme within IETA. It is made up of the leading carbon reduction and offset providers in the voluntary carbon market. The primary aim of ICROA is to deliver quality assurance in carbon management and offsetting, through adherence to the ICROA Code of Best Practice. This Code is compulsory for all ICROA members and outlines industry agreed standards for carbon offsetting services. By meeting these standards, our members demonstrate their commitment to the very best practices in carbon management and offsetting services. ICROA therefore represents a unified voice for the global voluntary carbon industry.

The achievements of the Voluntary Carbon Market

We welcome the inclusion of voluntary market standards – such as the Gold Standard and the Verified Carbon Standard – in the draft Carbon Offset Regulations for South Africa. These standards have been developed over many years. They come with sophisticated market architecture and a rigorous and credible set of methodologies. As a result, they generate credits that are innovative and of the highest quality.

Through the use of these standards and others, the voluntary carbon market has delivered \$4.6 billion in climate finance in the last 10 years¹. This investment has not only achieved nearly 1 billion tonnes CO₂

¹ Raising Ambition: State of the Voluntary Carbon Markets 2016. Forest Trends' Ecosystem Marketplace

savings, but it has also brought enormous benefits to the host communities of carbon offset projects. These benefits include:

- **Social benefits:** poverty alleviation, female empowerment and improved public health
- **Economic benefits:** job creation, technology transfer and market development
- **Environmental benefits:** improved air quality, conservation and biodiversity protection

Imperial College research, commissioned by ICROA in 2014, found that for every 1 tonne of CO₂ emission removed from the atmosphere through a carbon offset programme - a further value of US\$664 dollars is delivered in economic, social and environmental benefits for local communities around the world².

Carbon offsets are therefore an efficient tool to deliver both carbon emission reductions and sustainable development targets at least cost. ICROA is pleased to see the National Treasury of the Republic of South Africa has recognised their benefits and is consulting on their use as part of the carbon tax.

IETA and ICROA's assessment of the proposed draft regulations

Carbon offset limit

The explanatory note for the draft regulations states that "firms will be able to reduce their carbon tax liability by using offset credits up to a maximum of 5 or 10 per cent of their total GHG emissions, depending on the sector within which the firm operates". Given the co-benefits of carbon offset projects, as demonstrated through research by Imperial College London, and outlined above, IETA and ICROA would recommend increasing this limit. Although an increase in the usage of carbon offsets will decrease tax revenue to the National Treasury, the economic, social and environmental benefits of each carbon offset will outweigh this decrease. Additionally, it will also lower the cost burden on the firms participating in the scheme by providing flexibility for reaching compliance. Therefore, increasing the upper limit on the amount of credits each firm can use, will likely bring greater benefits to the South African economy and society as a whole.

Eligible standards

The explanatory note for the draft regulations states that "during the initial stage of the carbon offset scheme, it is envisaged that the scheme will rely primarily on existing international carbon offset standards namely, the CDM, Verified Carbon Standard (VCS) and the Gold Standard (GS)". We welcome the inclusion of these voluntary market standards in the draft Carbon Offset Regulations for South Africa.

The draft regulation then goes on to state that "an allowance will be made to evaluate the robustness of existing domestic standards for eligibility". However, there seems to be no criteria or process in place to both ensure environmental integrity and assess which standards could be eligible in the future.

The process of establishing both criteria and a process for assessing domestic standards may take a while to complete. As such, we would recommend starting this process as soon as possible, but not requiring it to be complete before the launch of the scheme so as not to delay implementation of the

² Unlocking the hidden value of Carbon Offsetting: Imperial College London, 2014
<http://tinyurl.com/jly4ke4>

regulations. The proposed standards (i.e., CDM, VCS, GS) will be sufficient to meet the needs of the scheme when it is launched.

Scheme administration

In this section, we note the following three concerns around the administration of the scheme, along with alternative suggestions for each point:

1. The explanatory note for the draft regulations states that the DNA will be responsible for administering the carbon offset scheme and that a project is underway which includes “an initial assessment of the capacity and skills requirements to enhance the human resource capacity of the DNA”. However, there is a risk of creating a backlog if the scheme is managed by an under staffed public authority. We can advise that project issuance of credits and selection of projects should be dealt with by a third party entity;
2. The explanatory note states that one of the administrative duties of the DNA will be to “issue offset certificates, cancelling and retiring carbon credits”. However, to reduce the administrative burden on the DNA, we think the responsibility of cancellation and retirement should sit with the market participants and project owners; and
3. The explanatory note states that “The IEC is expected to work with the administrator of the scheme to develop and assess new methodologies. In line with all other international standards, there is need to incorporate a technical committee into the offset administration structure”. However, since the major certification standards have experience and developed clear processes to assess and support the development of methodologies, the DNA should outsource and advise project developers to develop new methodologies under these existing standards.

Definition

On pages 2-3 of the explanatory note, emissions offsets are defined as “an external investment that allows a firm to access GHG mitigation options at a lower cost than investment in its current operations”. The cost criteria should not be a requirement, so that the decision to purchase an offset or invest in a project is left with the taxpayer.

This definition also differs from the one on page 6 of the explanatory note which states that “Offset means a measurable avoidance, reduction or sequestration of carbon dioxide (CO₂) equivalent GHG emissions”. This definition is preferable as it does not include a cost criterion.

Eligible offsets

While the draft regulation seems to define the eligibility of issued carbon offsets from pre-2017 registered projects, the eligibility of credits from projects that are registered pre-2017, but only issue after 2017, is not clear.

Moreover, it is not clear what the rationale is for requiring carbon offsets from projects in the development pipeline as of 1st January 2017 to “be transferred from an international registry to the South African registry within 6 months of their issuance” and whether the following issuance will be

eligible as any other carbon offsets from project registered post-2016. It does not address the case where inter-registry transfer would not yet be possible.

Concern has already expressed about the potential supply of South African offsets that are available to meet potential demand. The role of crediting and rewarding early action offsets is key to incentivising new projects to be developed. Significant time, investment and business confidence is needed to continue to develop the required carbon offset project pipeline needed for South Africa. Crediting early action is necessary to incentivise active development of new projects and to reward those who have made significant investments in South Africa to date. Limiting the eligibility of early action credits to just one year of potential demand in a nascent market that will take time to develop is not enough.

Offset duration period

On page 4 of the Draft Regulations, it states that

“An offset may, after that offset is generated, only be utilised for—

- (a) in the case of a CDM project—
 - a. 7 years which period may be extended with two periods of seven years respectively on application; [.....]
- (b) in the case of A Gold Standard project—
 - a. 7 years which period may be extended with three periods of seven years respectively on application; [....]”

This is also accompanied by text in the explanatory note which “specifies the crediting period for which generated offsets will be valid”. The reference to crediting periods and the validity of offsets is confusing. In the majority of cases, offset credits are valid indefinitely until they are permanently retired. On the other hand, a crediting period is time-bound, but the duration is set by the standard in question. It is possible the terms ‘offset crediting periods’ and ‘offset validity periods’ are being mixed up, and therefore greater clarity on this topic is needed.

Eligible projects

Projects such as fuel switching in transportation, improved rice management, wastewater treatment and afforestation, reforestation and REDD+ should be considered for inclusion on the indicative positive list.

Finally, the draft regulation goes on to state that to be eligible, new project types must “meet the required criteria”. However, it is unclear what these criteria are and therefore greater clarity is required.

Communication

In order to avoid the difficulties experienced by the CDM and its executive board, we recommend that clear and transparent channels of communication between the DNA, project developers and taxpayers are established. We recommend that a regular forum be established for the regulator to meet with stakeholders, such as project developers, taxpayers, verifiers and other professionals. Such a forum could assess progress, consider issues and develop solutions. This would help provide transparency to the market and manage expectations.

Procedure for claiming allowance

The explanatory note states that "offset developers or entities responsible under the carbon tax will have to request credits to be cancelled in the international registry and then transferred into SA registry". However, cancelling the credits should be done by the market participants and project owners and once the credits are cancelled they cannot technically be transferred to another registry. Moreover, it seems to be inconsistent with the paragraph that states that the DNA would "issue offset certificates, cancelling and retiring carbon credits".

Procedure for obtaining certificates

In this section, we note the following three concerns around the procedure for obtaining certificates:

1. The explanatory note states that "the project developers apply for an Extended Letter of Approval (ELoA) from the DNA to confirm domestic eligibility approval before a project is undertaken" but it does not define whether this means the project construction start date or the project commissioning date. Therefore, it would be helpful to have further clarity over when it will be possible to apply for an ELoA, and how long it's expected to take to issue one.
2. The draft regulation states that "the DNA would assess each request for transfer against the domestic eligibility criteria and would either accept the transfer and issue corresponding domestic carbon offset into the nominated account of the transferee in the domestic offset registry or reject the transfer". However, this seems to be inconsistent with the statement that international offsets may not be transferable to a domestic registry. Additionally, we are concerned this is an additional level of unnecessary complexity, given that projects will already have an ELoA confirming domestic eligibility. Instead, this could be an automated task carried out by the registry.

Compliance timetable

Neither the draft regulations nor the explanatory note set out a timetable for compliance and when carbon offsets need to be surrendered. This is very important aspect of the scheme and therefore needs to be set out clearly to all participants.

Summary and conclusion

IETA and ICROA welcomes the opportunity to respond to the National Treasury of the Republic of South Africa on this important topic. The carbon offset market has developed over the last 10 years, and is now a highly effective tool to achieve emissions reductions, whilst delivering numerous additional benefits to the host communities of carbon offset projects. An industry has grown up to develop projects and deliver benefits. This industry is complimented by a sophisticated marketplace with the appropriate systems and architecture – such as standard organisations, certification bodies and registries – in place to allow it to function effectively.

It is now critical that the rules for the offset mechanism be established quickly to provide the necessary business certainty. We encourage the Department of Environment and National Treasury to provide clarity as soon as possible in relation to both the overall compliance obligations of the scheme, and the carbon offset regulations. This will give participants maximum visibility over their future demand

requirements, and it will also give offset project developers a clear pathway to develop both methodologies and projects suitable for use under the South African Carbon Tax.

We are pleased the National Treasury has recognised the role carbon offsets can play and is including this tool in their national legislation. We would be happy to offer further assistance to the National Treasury in the development of the regulations on this topic should the need arise. Please do not hesitate to contact us should you have comments or questions on the views expressed above.

Sincerely,



Dirk Forrister

President and CEO, IETA