

Canada's Offset Trading System, Issues and Considerations.

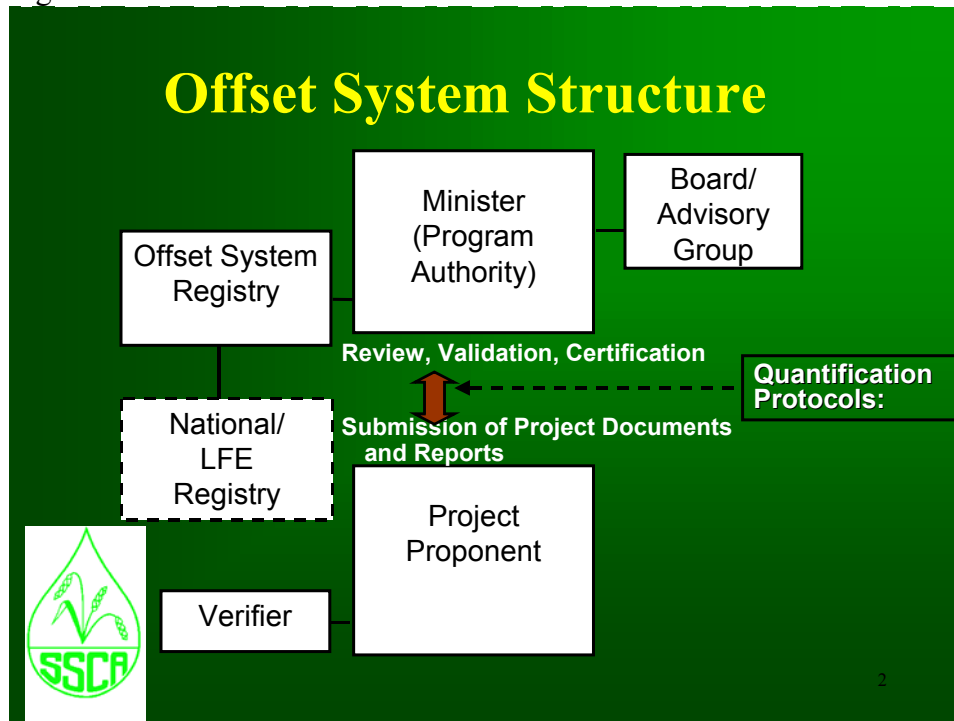
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Canada's Carbon Offset Trading System has evolved more in the last 6 months, it seems, than in the last 6 years. The system is slated to start in 2006. Its structure is highlighted in Figure 1.

The system is proposing the following features:

1. Project based system – ISO 14064-2,
2. Project start date – Jan. 1, 2000,
3. Project registration – beginning in 2006,
4. Project re-registration – after 8 years,
5. Domestic only system,
6. Large Final Emitters have Price Assurance Mechanism available,
7. Regional removal factors.

Figure 1.



Project Based System – 14064-2

- Canada has separated its Offset System from direct connection with Kyoto obligations.
- This gives flexibility to the system in the types of projects initiated, relaxes some data requirements and will serve to encourage more projects.
- Implications arising include not all projects will contribute to meeting Canada's Kyoto obligation and credits may have limited tradability internationally.

Project Start Date – January 1, 2000

- Date established to give some reward to projects initiated in anticipation of a carbon trading system.
- An implication for the long-term zero-tiller is that they will be limited to participating in the trading system following default protocols (further discussed later).

Project Registration – Beginning in 2006

- The Kyoto protocol allows for the counting of emission reductions/removals during the 2008-2012 period only.
- Allowing registrations beginning in 2006 is again a (limited) reward for projects started early.
- Credits can be generated and traded once certified.
- Credits can be saved and “converted” to international credits for use 2008-2012.
- For zero-tillers, carbon sequestered prior to 2006 will be utilized by Canada in meeting Kyoto obligations.

Project Re-registration – after 8 years

- Projects will be reviewed and new baseline activities may be assessed.
- Potential exists that the management practice of Direct Seeding becomes the new standard practice. New carbon credit generation may stop or the removal factor reduced.

Domestic Offset System

- Created in part because of desire for greater flexibility in establishing environmental projects and quickly.
- Also limited because Canada feels it will fall significantly short of its Kyoto obligations and it does not want carbon credits leaving the country.
- Has an implication on the efficiency of carbon market price discovery:
 - i. Captive sellers market,
 - ii. Buyers have access to international supply,
 - iii. Buyers are the Climate Fund (Government) and Large Final Emitters (LFE),
 - iv. LFEs have access to price capped credits through Price Assurance Mechanism.

Price Assurance Mechanism

- Mechanism available to LFEs is still under final stages of development.
- It will significantly limit the cost of meeting Kyoto obligations for LFEs.
- PAM credit costs will be capped at \$15/t CO₂e.
- This creates an artificial price ceiling for the domestic trading system.
- The carbon price could move above this but the psychological barrier has been established.

Regional Removal Factors

- Researchers finalizing initial coefficients to be integrated into the offset trading system. Data reflects regional climate and soil zone variables.
- The coefficient will be adjusted to account for Business-as-usual (BAU) activity creating the “Removal Factor”.
- This process steps away from science and allows politics an avenue to enter the system.
- Removal Factors have not yet been determined.

At the Farm, Protocols and Liabilities.

As Canada gets the ball rolling on its Offset Trading System, Farmers and landowners are going to hear more about contracts for “selling carbon”. There will be two types of protocols and each will generate one of two types of liability. Protocols will either be:

1. Default Protocol,
2. Custom Protocol.

Liability considerations will come from the creation of:

1. Offset credits (permanent),
2. Temporary credits.

Default Protocol

- Activity-based approach
 - Zero till
 - Forage conversion
- Regional removal factors
 - Incorporates 2000 baseline
 - Farmers who initiated direct seeding prior to 2000 are limited to participating in the offset system under the default protocol.
- Activity baseline measurement not required.

Custom Protocol

- Can either:
 - Measure carbon stock changes
 - Activity-based coefficients
- Baseline measurement required.

Additional protocol details may include the following:

1. Limits on seeder seedbed utilization,
2. Cropping intensity requirements (frequency of chemfallow allowed),
3. Crop residue management restrictions (straw baling, burning, grazing, etc.),
4. Access rights for third party verifiers,
5. Farmer reporting requirements.

Liability considerations as determined by credit type:

Offset (Permanent) Credits

- Permanent credits with maintenance liability
- Higher sale value (\$5-15/t CO₂e or higher)
- Marketing ease
- Liability a major issue
 - Liability period – yet to be determined (10-30 years)
 - Reversals – replacement costs?
 - Possibly requires an encumbrance on the title

Temporary Credits

- Storage of one tonne for one year
 - Similar concept to leasing
- Accumulate over time
- Less value up front (suggestions of \$0.30-3.00/t/yr)
 - Value of sink increases over time
- Market not well defined
- No liability for maintenance
- Potential accumulation period to be determined, range 10-30 years

Conclusion

The Offset Trading System design is nearing completion. From the perspective of the SSCA, there are still significant issues to be addressed if the system is to incent the potential that exists in Agriculture to aid Canada in meeting its Kyoto obligations. The SSCA will continue to lobby in the interests of Farmers.

In the mean time, carbon projects will be registered in 2006. Farmers/landowners will be approached by Project Proponents (Aggregators) to sign contracts. As offers come forward, the Farmer should carefully review the following:

1. Contract value,
2. Protocol flexibility (land management constraints),
3. Carbon sink maintenance liability.