

The role of offsets in post-2012 climate agreements

A position paper by Enel-Endesa



Carbon offsets generally refer to emission reduction credits which can be used against CO₂ emission targets under both mandatory and voluntary schemes.

Offsets typically result from the implementation of climate change mitigation projects and are subject to an independent quality verification.

Offset mechanisms (Clean Development Mechanism - CDM and Joint Implementation - JI) were introduced by the Kyoto Protocol, which also provided for direct involvement of private entities.

Within the European Emission Trading Scheme, credits from CDM and JI can be used by private entities against their targets.

In addition the cap-and-trade system foreseen by the US Waxman-Markey and Kerry-Boxer bills and other countries' cap-and-trade systems provide for the use of offsets at both national and international level.

Enel-Endesa highlight that the positive performance of the EU ETS demonstrates that market-based solutions should be preferred to command-and-control provisions. Moreover, cap-and-trade systems, as opposed to carbon taxes, have the advantage of guaranteeing that environmental objectives are met.

In this framework, the CDM, although it requires improvements, has proven to be effective in allowing for the implementation of emission reduction projects in developing countries through the mobilization of private capital. Since its entry into force in 2005, over 1,800 projects have been registered with an associated estimated emission reduction volume of approximately 1.7 billion tons of CO₂eq by 2012. The success of CDM can largely be explained by the direct involvement of private entities, which were enabled to deliver results. In fact, approximately 85% of emission reductions are due to activities carried out by private entities. For example, Enel-Endesa has taken action since the Kyoto Protocol signature to identify and implement CDM projects. Enel-Endesa's portfolio includes several dozen projects with a potential emission reduction of nearly 200 Mt CO₂eq in the 2008-2012 period.

Enel-Endesa agree with the need to improve existing offset mechanisms, but highlight the risk that some of the proposals which have been tabled so far may become burdensome administrative processes. Enel-Endesa therefore strongly advocate that the direct involvement of private entities be maintained in any future architecture.

Potential of offsets in a "post-2012" framework

A progressive global approach requires the expansion of the current role of offsets mechanisms. Offsets in the post-2012 framework are expected to lower overall mitigation costs and facilitate international technology transfer by encouraging financial flows from developed to developing countries, while allowing the active involvement of the private sector and the adoption of simplified procedures compared to the past.

The most promising option relies on the improvement of the current CDM. Sectoral crediting, including forestry activities, is also on the agenda of international negotiations. We believe that the possible introduction of such mechanisms should be carefully considered, so that the direct initiative by private entities can continue to be offered incentives.

CDM

Notwithstanding its weaknesses, CDM has proven to be an innovative tool to promote technology transfer in emerging and developing countries. If linked to "cap-and-trade" systems, CDM-like mechanisms can therefore encourage investments in emission reductions by the private sector worldwide, effectively contributing to global sustainable development. The undergoing negotiations for a post-Kyoto 2012 represent an opportunity to design a strategy capable of overcoming the weaknesses of CDM and building on its strengths to enhance the potential of:

- improving, through technology transfer, emerging and developing countries' capability to reduce emissions;
- financing sustainable development by private capitals;
- reducing overall compliance costs;
- offering an effective tool to link different carbon trading systems, thus representing a possible bridge towards a truly global carbon market.
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In summary, based on their past experience, Enel-Endesa support the continued development and use of CDM-like mechanisms. For the future of CDM Enel-Endesa recommends the following:

1. **The CDM should be enhanced:** it requires improvements, in particular to guarantee environmental additionality and environmental integrity of projects, but has demonstrated its potential to contribute concretely to emissions reductions at global level.
2. **The private sector should continue to be directly involved:** it has proven that it is able to deliver results under appropriate regulatory frameworks.
3. **Quantitative and qualitative restrictions should be avoided:** environmental integrity should be guaranteed, but the risk of collapse of a new effective market should be avoided by not allowing for a-priori negative lists of eligible project types, especially if such lists are unilaterally established by certain countries.
4. **Retrospective application of possible new rules should be avoided:** confidence of developers and investors would disappear.

Enel-Endesa also recommend that, until new possible mechanisms have proven that they function, existing mechanisms should be kept to allow for a smooth transition to a new regime.

JI

So far, JI has not had the same success as CDM.

A very good reason is that it started later than CDM. However, Enel-Endesa believe that this mechanism could develop greater potential in the future.

Sectoral crediting

Current negotiations seem to point towards the inclusion of sectoral approaches (SA) in a possible post-Kyoto agreement. Various proposals have been tabled, some of these assume the mechanism would generate credits (sectoral crediting mechanism), others that, in addition, the credits would be eligible to be traded into the international carbon market (sectoral trading mechanism).

Enel-Endesa are looking with interest at the development of SA. In fact, if these develop in the form of a sectoral crediting and trading mechanism, they have the potential to overcome some of the criticalities of the CDM project-based approach.

However, Enel-Endesa strongly recommend that, for an effective implementation of sectoral crediting mechanisms:

- COP15 in Copenhagen, as with the Kyoto Protocol, explicitly mention that the private sector be involved;
- sovereign and counterparty risk be reduced by keeping the UN as issuer of credits;
- certainty is ensured for private actors by providing a guarantee that successful projects will receive credits even if they belong to unsuccessful sectors;
- local and international credits be fungible.

Enel-Endesa are also following the debate on initiatives to avoid deforestation (REDD) with interest. Mechanisms to recognize credits for these initiatives, if linked to international carbon markets, could attract private investments in this field, which is among those with the highest reduction potential at global level.

To that purpose, Enel-Endesa highlight the opportunity to favour the involvement of the private sector through provisions such as:

- introducing sub-national level for crediting (otherwise at national level risks may be too big to manage for private entities);
- recognizing crediting for early actions, in order to encourage the industrial sector, not used to investing in forests, to take actions and build capacity.