PROPOSAL FOR SCALING VOLUNTARY CARBON MARKETS AND AVOIDING DOUBLE COUNTING POST-2020

Verra proposal for stakeholder input regarding the range of options for avoiding double counting between Article 6 of the Paris Agreement and voluntary markets

1 BACKGROUND

Verra is seeking input on a revised proposal to ensure that Verified Carbon Units (VCUs) continue to provide credible options for future carbon markets, especially given varying accounting requirements for emission reduction/removal units in different markets.

Verra has actively participated in and led a number of discussions to ensure the accounting integrity of emission reduction/removal units under different markets, both in the context of the Paris Agreement (PA) and voluntary markets. This includes discussions under ICROA, a working group convened by the ClimateWorks Foundation that developed a guidance document for avoiding double counting under CORSIA, and a working group led by the Gold Standard Foundation that set out options for avoiding double counting within the voluntary carbon markets post-2020. In addition, between May and July 2018, Verra conducted a public consultation on the creation of a Domestic Climate Contribution (DCC) meant to address some of the early concerns around double counting.

There are three primary issues that have been debated:

1) How to account for emission reductions and removals in a way that avoids double counting;
2) How the associated carbon units currently are, and will be, used by corporates and others seeking to claim carbon neutrality, net-zero, or other similar claims; and
3) How to ensure voluntary markets continue to drive finance to catalyze and generate additional emission reductions and removals.

Our conclusion from these discussions is that a range of options are needed. Carbon markets are diversifying and experiencing several trends that will have direct implications for whether and how double counting risks arise, and each market may have unique requirements.

Emerging Trends

In terms of trends, first, carbon markets have demonstrated that they are a powerful vehicle for delivering finance to activities that reduce or remove carbon from the atmosphere. The growth in projects and credits transacted in voluntary carbon markets underscore the fact that they have become an integral component of comprehensive corporate climate strategies; beyond complementing efforts to reduce emissions directly, carbon credits provide a transparent and robust tool for demonstrating increased ambition which helps address the systemic risks climate change poses to many businesses.

Second, new compliance markets are starting to take shape. For example, the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) has been formally launched and credits under the VCS Program have been recognized by the International Civil Aviation Organization (ICAO) Council as eligible to be used under the scheme.[1] Carbon taxes with offset options, as implemented in Colombia and South Africa, are also gaining ground, with other countries considering similar policy measures.

Third, even where markets are not being developed, there are new climate regulations that are starting to be implemented around the world. As countries implement new regulations and establish new programs and policies, the scope for voluntary action will decrease, and GHG programs need to be mindful of these changes in order to ensure approved projects remain additional,[2] thereby ensuring carbon reductions and removals remain over-and-above business-as-usual and regulatory requirements.

Fourth, there is a broadening of the programs and infrastructure that will serve these new markets. Gone are the days when a single greenhouse gas (GHG) program, such as the UNFCCC's Clean Development Mechanism (CDM), provided the support for an entire market. The more recent evolution of markets points to a different model, whereby more than one program can support individual markets, either by meeting a certain set of criteria (e.g., CORSIA, Colombia), or being written into regulations (e.g., South Africa, where the CDM, Gold Standard and the VCS Program are officially recognized).

A final trend relates to the specific requirements each market is likely to demand. New markets that are already established have different requirements, starting with geographic location (i.e., projects seeking to supply credits under Colombia's and South Africa's carbon tax programs need to be located in those countries, respectively) and branching out into further detail, such as CORSIA's start date and vintage requirements as well as CORSIA's delineation of specific project types that are eligible. This means that GHG programs must adapt to meet the varying requirements in each market.

[1] https://www.icao.int/environmental-protection/CORSIA/Documents/ICAO_Document_09.pdf

[2] Similar to how the VCS is no longer crediting grid-connected renewable energy projects in non-Least Developed Countries.

Different Markets

The various markets that are evolving will need to determine whether they are operating within the accounting framework of the Paris Agreement or not, and this decision has significant implications for the requirements each market may impose.

Paris-Compliant (Article 6) Markets

All markets that are operating in the context of the Paris Agreement (PA) will need to take into account the fact that all countries under the PA effectively have emission reductions targets, as defined in their Nationally-determined Contributions (NDCs). To address concerns about double counting, the PA includes the concept of Corresponding Adjustments (CAs), an accounting approach designed to ensure that emission reductions are counted only once in the context of the PA. Therefore, the architecture of the PA ensures that, insofar as there is any cross-country trading of emission reductions or removals that will count towards one of the country's NDCs, they will need to have CAs to avoid double counting. Specifically, if a country wishes to import any emission reductions or removals and count them towards its NDC, such reductions or removals will need to carry with them a CA to ensure the host country does not count them as well. CAs effectively subtract emissions from the importing country's emissions inventory and add an equivalent number of tCO_2e back into the host country's emissions inventory, thereby ensuring the integrity of the accounting under the PA. In short, CAs are meant to ensure that the sum of all country emissions add up to the overall objective set out in the PA, and it is these totals that will be used during the global stock-take to determine whether more action is needed.

Although there is not yet final agreement that CAs will be required for trades occurring under the PA, Verra believes that the construct will eventually prevail, mostly because CAs are one of the critical mechanisms that ensures the integrity of trading under the context of the PA, including specific programs such as CORSIA. We therefore assume that CAs will be required for all cross-border trades occurring under the accounting framework set out by the PA.

Not all markets meant to achieve PA targets will require CAs, however. Domestic carbon tax programs like those in South Africa and Colombia, for example, do not involve the transfer of units outside the country, which means that the units used in these domestic markets will not require a CA.

Voluntary Markets

It is not yet clear whether voluntary carbon markets will need to operate under the rules set out by the PA. While some parties argue that CAs are needed for all transactions involving carbon credits regardless of origin, destination or purpose, other parties argue that voluntary carbon markets sit outside of the accounting framework established by the PA and thus do not require CAs. The purpose of this consultation is not to resolve this question, but rather to articulate how the VCS would provide options that companies can rely on when engaging with the voluntary market and thereby ensure continued financing of emission reduction and removal activities.

As one considers the options, it is clear that buyers of voluntary carbon credits have a range of preferences for the kinds of claims they want to make. For example, some buyers want to continue to claim emission reductions and removals against their own footprint or the footprint of their products. These buyers would have a choice. On the one hand, they could choose to purchase and retire credits with CAs, noting that this would preclude the credits from contributing to the host country's NDC. On the other hand, companies could choose to purchase credits without CAs, precisely because these companies want to contribute to the host country's NDC. Another alternative might entail companies directly financing units that contribute to the NDC of the host country without claiming an offset or using the unit for neutrality purposes, which is possible with carbon credits that do not carry CAs.

The above means that a range of approaches to avoiding double counting are needed, depending on the market, the use of the unit, and ultimately the claim to be made. In order to maintain the incentives currently in place, which are driving ever-greater voluntary investment, credits traded in the VCM could continue to be reported in company reports and used to reduce corporate footprints, and could also have the added benefit of supporting host countries in meeting their PA targets. Further work will be needed to provide guidance on the specific claims corporates can and should make (with respect to units that have or do not have a CA) and such guidance is likely to evolve over time.

2 PROPOSAL

Verra is therefore seeking input on a new "Article 6" label that could be applied to VCUs that meet (the eventual) Article 6 requirements, as well as altering former VCS requirements (from the Kyoto period) that dealt with double counting in Annex 1 countries.

Verra would apply a label to differentiate VCUs that are associated with Corresponding Adjustments (CAs), and potentially other requirements as set out under a future Article 6 of the Paris Agreement, such as the need for a Letter of Approval (LOA). Such units could be used (where eligible) in markets operating under the Paris Agreement (PA) or other international obligations. Additional labels will also be developed for other markets with specific requirements, such as CORSIA.

For voluntary markets, buyers would be able to select either a unit that is labelled as Article 6-compliant (or other labels, like CORSIA), or could select a VCU that does not have a CA. It will be up to the buyer to determine which unit is needed, and what claims can be made as a result, based on emerging and evolving norms and guidance on the use of such units.

Article 6 Label

Verra proposes to create a new label that could be applied to issued VCUs where any and all relevant Article 6 rules have been met (to be based on the final version of Article 6), including where a Corresponding Adjustment has been:

1) officially made by the host government; or
2) promised by the host government, in writing, by an agency with the explicit or de facto legal right to do so.

Noting that the next UNFCCC Conference of the Parties has been delayed and it will take time to finalize the rules for Article 6, and for countries to implement the necessary accounting modalities and infrastructure, Verra proposes developing two "Article 6" labels:

1) An "Article 6-compliant" label, where all relevant Article 6 rules have been met, including evidence that the host country has not included the emission reductions in its NDC accounting (e.g., where a CA has been made); and,
2) A "Pending-Article 6" label, where evidence of a host country's intent to make a CA has been provided, such as a letter specifying that the emission reductions will not be included in its NDC accounting.

Such labels would be required in order to use the unit in any market that requires an Article 6-compliant unit. It would also be required where the host country has authorized the unit to be used for specific "Other International Mitigation purposes,"[3] and could be used by any voluntary market buyer looking for such units.

Updates to Verra Registry functionality would be made, including (a) adding the option to apply an Article 6 label (and the "pending Article 6" label) to issued VCUs, and (b) new functionality to facilitate searching for labelled units.

Voluntary Market Options

As noted above, voluntary market buyers have different goals and therefore need a range of options, based on the kinds of claims they wish to make. Buyers may or may not prefer or need a unit labelled as Article 6 compliant. Many voluntary market transactions (such as those purchased for carbon neutrality claims, while also contributing to the emission reductions/removals accrue to the host country; as well as those intended to "finance reductions" in the host country) may not require a Corresponding Adjustment, and thus will not require a label. This means that it is important for voluntary GHG programs, like the VCS Program, to continue to allow the issuance of credits (VCUs) without a CA, while providing transparency on the Verra registry with respect to the status of a given unit (e.g., with respect to whether it has or does not have a CA). Doing so will facilitate differentiation by transparently listing the characteristics of each unit.

Buyers should follow what will undoubtedly be an evolving set of good practice guidance on voluntary markets, for example from ICROA, Science-Based Targets, WRI's GHG Protocol, and others, as appropriate. Verra will develop labels, as needed, to denote units that have met specific requirements of emerging and evolving markets.

[3] CMA draft 11 on Article 6.2, Section D.16 states, "D. Other international mitigation purposes
16. Where a participating Party authorizes mitigation outcomes for other international mitigation purposes, it shall apply a corresponding adjustment, consistent with this guidance, for first transfer, whether or not the mitigation outcomes have been internationally transferred."

Changes to VCS Requirements

To facilitate these various options, Verra proposes revising the language on double counting in the VCS Standard as follows (note, text in red denotes a change to existing VCS program rules as noted in the VCS Standard):

3.19 Participation under Other GHG Standards[4] Programs

… [no other edits made to 3.19]

3.20 Other Forms of Credit

Concept

In order to maintain atmospheric integrity, ~~GHG emission reductions/removals that are issued as VCUs cannot also be issued as other types of GHG credits or claimed as other forms of environmental credit~~ project proponents shall demonstrate that emission reductions or removals from projects that will be used in ~~emission reductions or removals are not also used under~~ other emission trading programs meet the requirements of such programs (such as CORSIA or the Colombian domestic market), including avoiding double counting. ~~other mechanisms that include GHG allowance trading, or as other forms of environmental credit.~~

Requirements

~~Emission Trading Programs and Other Binding Limits~~

~~3.20.1 Where projects reduce GHG emissions from activities that are included in emissions trading program or any other mechanism that includes GHG allowance trading, evidence shall be provided that the GHG emission reductions or removals generated by the project have not and will not be otherwise counted or used under the program or mechanism. Such evidence may include:~~

~~1) A letter from the program operator, designated national authority or other relevant regulatory authority that emissions allowances (or other GHG credits used in the program) equivalent to the reductions or removals generated by the project have been cancelled from the program or national cap, as applicable.~~

~~2) Evidence of the purchase and cancellation of GHG allowances equivalent to the GHG emissions reductions or removals generated by the project related to the program or national cap.~~

~~3) Evidence from the program operator, designated national authority or other relevant regulatory authority stating that the specific GHG emission reductions or removals generated by the project or type of project are not within the scope of the program or national cap.~~

Paris Agreement Targets and Other Emission Trading Programs

3.20.1 Where VCUs will be used for purposes of reporting under the accounting rules set out by the Paris Agreement or other emission trading programs (such as CORSIA) that will be operating under the accounting framework of the PA, they must meet any and all relevant requirements of

[4] This section 3.19 refers to other GHG Standards Programs such as Gold Standard or CDM.

that market, including any that relate to preventing double counting (such as a Corresponding Adjustment under Article 6 of the Paris Agreement). Evidence shall be provided that the GHG emission reductions or removals generated by the project and used for such purposes have met (or will meet) all relevant requirements. Such evidence will be used to support the labelling of VCUs that meet specific market requirements.

Requirements for projects to secure a label, for example for CORSIA or Article 6 of the Paris Agreement, are [will be] set out on the Verra website. Labels are placed on the relevant VCUs in the Verra Registry.

3.20.2 Units used for voluntary purposes do not require a label, but labelled units may be used for voluntary market transactions, where desired. Note, this would apply to all voluntary transactions, globally, including within or between Annex 1 countries (unless otherwise regulated by those countries). This would drive additional finance to unregulated sectors and to activities that go beyond regulation.

3 REQUEST FOR INPUT

Verra requests input on the following considerations:

1) Do the label titles "Article 6-Compliant" and "Pending Article 6" make sense? Or, should these labels have different names?
2) Do you think carbon credits (VCUs) being used to meet corporate voluntary GHG commitments (e.g., "net-zero" or "carbon neutrality") should require a corresponding adjustment to be made by the project's host country? Please explain your rationale.
3) How readily do you anticipate host countries will be willing and able to make such adjustments and by when? What incentives are there (could there be) for countries to make such adjustments, given they will have to then find and finance other reductions to meet the NDC?
4) If countries may be unwilling or unable to make such adjustments, at least in the near term, would you support allowing corporates to continue to use such (non-adjusted) credits for a period of time if that is needed to maintain and grow voluntary climate action and finance? How could that be designed in a way that also incentivizes and supports country readiness to provide adjustments?
5) Do you feel requiring corresponding adjustments for such voluntary commitments will help or hinder climate change mitigation efforts and why?