

# **Offset emissions trading:** **issues and options for the natural gas pipeline industry**

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# Overview

- Understanding emissions trading
- The current market
  - Regulatory carbon markets
  - Voluntary carbon markets
- Issues and options for natural gas pipelines

# Emissions Trading Basics

- Climate change
  - The atmosphere is indifferent to where GHG emissions are reduced
  - The wallet is not
- Emissions trading
  - Ensures emission reductions are made by those with lowest cost opportunities
- Two types of trading
  - Cap-and-trade
  - Project-based or offset trading

# Cap-and-trade

- Impose emissions cap on group of facilities
- Distribute allowances equal to the cap
  - Each allowance is a right to emit one ton
- Facilities must submit allowance for each ton emitted
- High cost facilities can buy allowances from low cost facilities
- Outcome: cap achieved through lowest cost distribution of reduction activities
- Examples:
  - Clean Air Act Acid Rain Program (power plants)
  - European Union Emissions Trading Scheme

# But a cap doesn't work for everyone

- Facilities without easily monitored/measured emissions
  - Landfills
  - Forests
  - Farms
  - *Methane emissions from pipelines?*
- Political issues
  - Developing countries under the Kyoto Protocol
- Options
  - No regulation
  - Direct command-and-control regulation
  - **Offset emissions trading**

# Offset trading basics

- Investor and project host
- Demonstrate that the project achieve reductions “additional” to business-as-usual:
  - Reductions not otherwise required
  - Emissions below a standard
  - Reductions are not otherwise profitable
- Third-party verification
- Investor can use verified reductions to offset its emissions
- Example:
  - Kyoto Protocol Clean Development Mechanism

# Current and future markets

- Current markets
  - Kyoto markets
    - European Union Emissions Trading Scheme
      - \$24.3 billion in 2006
    - Clean Development Mechanism
      - \$4.8 billion in 2006
  - Voluntary market
    - \$54 million in 2006
- Future markets?
  - Federal US cap-and-trade program expected to result in:
    - Primary demand of 260 mtCO<sub>2</sub> – 1.215 mtCO<sub>2</sub>/yr
    - **Transactions worth \$10billion - \$50billion in 2015**

Sources:

*The World Bank, State and Trends of the Carbon Market 2007 (May 2007)*

*New Carbon Finance, "North America and Global Carbon Market" (June 2007)*

# The global VER market

- Total global market in 2006 = 23.7 mtCO<sub>2</sub> \$91 million
- Who are the buyers?
  - Corporate social responsibility buyers
    - Meeting commitments to go “carbon neutral”
  - Pre-compliance buyers
    - Hedging future compliance risk
- The US share of the global voluntary carbon market today
  - Global over-the-counter market = 13.4 mtCO<sub>2</sub> (\$54.9 million)
    - 43% sourced in North America
  - Chicago Climate Exchange = 10.3 mtCO<sub>2</sub> (\$36.1 million)
    - Already 3.3 mtCO<sub>2</sub> transacted in July 2007
  - 68% of voluntary market customers in United States

*Sources:*

*New Carbon Finance, “North America and Global Carbon Market” (June 2007)*

*Ecosystem Marketplace & New Carbon Finance, “State of the Voluntary Carbon Markets 2007:*

*Picking Up Steam” (17 July 2007)*

# Challenges of the VER market

- Opportunities
  - For sellers
    - Monetizing reductions
  - For buyers
    - Acquiring low cost/discounted VERs
- Uncertainties
  - What is being transacted?
  - What is the right standard?
  - What constitutes delivery?
  - What establishes ownership?
  - What is the right price?

# Issues and options for natural gas pipelines

- Emission reduction project options
  - Fugitive methane reductions
  - Acid gas / CO<sub>2</sub> storage
  - Others?
- Uncertainties
  - Will pipeline emissions be subject to cap?
    - Risk: reducing emissions could reduce allocation of allowances
  - Will pipeline emissions be subject to direct regulation?
  - If available for offset projects:
    - What project types will count?
    - What standards will apply / what will constitute additionality?

# Issues and options

- For companies considering VER projects now:
  - Do tariffs affect recovery of costs, distribution of benefits?
- Advocacy:
  - Should the industry advocate for favorable offsets policy generally?
  - Should the industry advocate for a particular standard?

# Conclusions

- Emissions trading markets are here
  - And will grow
- Natural gas pipelines could have significant opportunities
- But there are substantial uncertainties
- Managing the uncertainties involves:
  - Understanding where the rules are going
  - Shaping the rules

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