



International Carbon Action Partnership

Discussion Paper on Monitoring, Reporting, Verification, Compliance and Enforcement in Emissions Trading Systems

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This Discussion Paper was drafted by Ecofys. Other experts have made significant contributions to the paper. The conclusions and recommendations of this paper are those of Ecofys and do not necessarily represent the position of the ICAP members.

Around the world countries are implementing or planning emission trading as a cost effective way to reduce greenhouse gas emissions. As confidence and experience grow, governments are considering how to link systems to improve market liquidity and reduce abatement costs.

But how easy is it to link systems developed under different political, technical and existing legislative backgrounds? Is a tonne of greenhouse gas measured in one system the same as a tonne measured using a different method in another? And how can governments, industry, market players and the public be assured that real and comparable emission reductions are occurring?

Although there are numerous factors to consider when looking at linking two or more systems¹, one of the most fundamental questions is whether the monitoring and reporting of emissions by participants (liable entities) achieves comparable levels of quality. Good quality monitoring ensuring accounted emissions are as close as possible to actual emissions engenders trust in a system and confidence that any stated emission reductions are real.

This discussion paper provides high-level guidance for governments exploring linking opportunities. It assesses the monitoring, reporting, verification, compliance and enforcement (MRVCE) requirements (also referred to as rules) of ten emission trading systems.² MRVCE rules are implemented by regulators to ensure 'a tonne is a tonne' of greenhouse gas and units traded are equivalent. Together the rules dictate the overall 'MRVCE quality' of the emission data submitted by participants and provide information with which to judge their comparability.

In preparing this paper, key features of the MRVCE approaches used by each system were examined and compared. From these, best practices were identified and the overall comparability of different MRVCE approaches considered. Potential problems, which may pose barriers to linking, were also investigated. Finally, an approach for governments to assess MRVCE quality more thoroughly when considering linking was set out.

The research did not aim to determine which systems could or could not be linked – this requires more detailed assessment of the rules and consideration of other elements of system design (e.g. scope of activities covered, allocation rules, competition issues etc).

The research conducted found three main characteristics in MRVCE approaches for delivering consistency and quality in reporting emissions underpinned by good practices:

- ◆ *Accurate monitoring* – rules are appropriate for the nature and scale of the activity. Best practices include setting rules with specific monitoring methods for the particular activity, quantitative uncertainty requirements, uncertainty analysis, robust quality assurance and control procedures, and consistent monitoring approaches.
- ◆ *Minimal ability to interpret rules differently* and for making mistakes or purposeful misstatements. Best practices include ensuring clear and concise rules, specific monitoring for each liable entity, sufficient data reported to check errors, standardized reporting, robust verification of the reported data by competent verifiers/organisations, compliance checks and suitable penalties.

¹ I.e. allowing trading of emission units (such as carbon dioxide equivalents or emission reduction units generated through offsets) between the systems.

² Australia Carbon Pollution Reduction System; Australia, California Cap and Trade; California, European Union Emission Trading System, Japan Voluntary Emissions Trading System, New Zealand Emission Trading System, Regional Greenhouse Gas Initiative, Tokyo Cap and Trade Program, US - Acid Rain Programme: Acid Rain Program and the Western Climate Initiative. International Emission Trading under the Kyoto Protocol was not assessed.

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- ◆ *Comparable quality for offset monitoring* – where links to offset systems are desired, best practices include implementing comparable MRVCE quality and if there are concerns about comparability, limiting their use.

Although rules to achieve high level MRVCE quality are appropriate for the larger emitting liable entities, the highest achievable quality is not always necessary. Start-up phases or those with a smaller share in overall emissions can provide suitable data using a medium level of MRVCE-quality.

By comparing approaches, the research found that although MRVCE rules differ depending on the system's scope and supporting legal framework, comparable MRVCE-quality is achievable through varying combinations of rules i.e. they don't have to all be the same. Generally, specific MRVCE rules are less important than using a balanced selection of requirements to deliver appropriate MRVCE-quality for the system's purpose. Consequently, not all of the best practices identified in this study can, or should, be part of one single system. Linking can occur where the system's requirements are balanced to achieve a similar level of overall MRVCE quality.

Research revealed problems that may pose barriers to linking and possibly require changes:

- ◆ significant differences in the accuracy of monitoring approaches for the same or similar activities; and
- ◆ poorly balanced combinations of MRVCE approaches such as differing interpretations of rules, and scope for errors or misreporting.

The second step is to analyse the rules aimed at minimising scope for differing interpretations, error and misreporting as well as their practical implementation.

In both steps, expected and/or anticipated future developments should also be considered.

If these are determined to be comparable, it should be possible to link the two systems (provided other infrastructure requirements are in place).

However, where MRVCE-quality in one or both steps is not comparable, possible changes to one or both of the systems should be considered.

Lastly, if the MRVCE-quality of the two systems is not considered comparable (and changes cannot be made quickly) or the assessment is inconclusive, but linking is nevertheless desired, it may be possible to set a maximum threshold for the use of the particular units³ and/or use a transitional period to gain experience before making changes or further decisions.

In conclusion, linking systems created in different political and regulatory environments presents new challenges for governments but has the potential to reap valuable rewards for market liquidity and cost savings. This study found that there is no 'one-size-fits all' level of MRVCE-quality for ET systems. Different approaches can achieve equivalent and comparable levels of quality to enable linking without undermining the desired goals of tangible emissions reductions and trusted markets. However, a balance of best practices should be followed with each system assessed in detail for its comparability with the other and changes made where necessary. It should also be borne in mind that although a complete match in MRVCE quality is the ultimate aim, this may not be achievable or indeed necessary in practice. The desired level of MRVCE-quality in a potential linking partner is also a political decision and each situation is likely to have its own unique arrangements.

³ Although additional reasons for the threshold setting might exist, such as complementarity, price control and domestic environmental policy