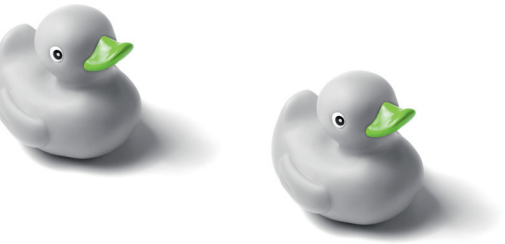

By Prue Moodie

OFFSETS ADRIFT

Carbon offsets are under scrutiny amid claims of governance failures. This presents directors with a challenge in gaining assurance whether their organisation's program is fit for purpose.

In early February 2022, federal Minister for Industry, Energy and Emissions Reduction Angus Taylor ordered a review of the quality of international offsets used by Australian companies under the government-accredited carbon neutral certification scheme, the Climate Active program. Findings are due by the end of June.

This followed growing criticism from activist groups such as Greenpeace, public policy think tank The Australia Institute and industry participants about "junk" or "sham" offsets.

In March, Australian National University Law School environmental law and policy specialist Professor Andrew Macintosh and colleagues called for a full independent inquiry into the carbon market. Releasing four research papers, they claimed there were serious governance flaws in Australia's carbon market. Labelling it "an environmental and taxpayer fraud", they outlined "systemic flaws" that were potentially wasting billions of dollars in taxpayer money and "undermining Australia's ability to meet its long-term emission reduction targets".

Macintosh is a former chair of the Emissions Reduction Assurance Committee of the Emissions Reduction Fund (ERF), charged with overseeing the Clean Energy Regulator's methodology, and was a commissioner on the 2020 Royal Commission into National Natural Disaster Arrangements.

"All of the major emission reduction methods have serious integrity issues, either in their design or the way they are being administered," he said.

Responding to the allegations, CER chair David Parker FAICD stood by the scheme, saying its methods and projects were internationally valued and that issuance of ACCUs was underpinned by its rigorous assessment processes.

"ERF is a robust offsets scheme with a high degree of integrity," said Parker. "This derives from the fact that ERF is established in legislation and is administered by the CER as an independent regulator with a raft of compliance tools at its disposal."

Parker said the CER was reviewing the papers and would progressively respond as the work is completed.

"The Australian public can have confidence in the regulator's absolute commitment to ensuring integrity and effectiveness of our schemes."

Focus on quality

So, in what has become a highly charged matter on the critical area of emissions reduction strategies, how do directors gain assurance of the integrity of their offsets programs? "The private sector should be able to rely on regulators to guarantee quality, but this is not happening," says Polly Hemming, Australia Institute adviser on climate and energy.

The three most popular activities generating carbon credits in Australia are two land-based activities (avoided deforestation and human-induced regeneration of native forests) and the capture and use of methane gas from landfill sites, says Hemming. "In the landfill gas and avoided deforestation methods, the overwhelming concern is that they are not additional."

The concept of "additionality" is paramount with any carbon offset project. It means that the revenue from selling carbon offsets must be genuinely needed by the project developer in order to proceed with the project. Commercially viable projects should not qualify for carbon offset sales. "Landfill gas capture was happening anyway," says Hemming. "The avoided deforestation method gives carbon credits to landholders to not cut down trees that they were never going to cut down. Some human-induced regeneration projects over-credit abatement. That means, they issue more carbon credits to a project than it has earned."

Sally Cook, head of strategy at consultancy Energetics, says there is a need for the government to continuously assess the integrity of the methods used to generate carbon credits, particularly, the methods and tools it provides for calculating the abatement for certain land sector methods.

John Connor, CEO of the Carbon Market Institute, has long argued offsets should be seen as a last resort, or to assist companies as they make the transition to decarbonisation, saying claims of the poor quality of Australian offsets have been sensationalised. "ACCUs are of reliably good quality because they are generated from projects that are verified against integrity standards based on best practice international standards."

However, he agrees that improved data transparency is key to ongoing confidence in the offsets regime.

> "All of the major emission reduction methods have serious integrity issues."
>
> Prof Andrew Macintosh, ANU environmental law specialist

Two streams of unease

Regulators' unease over offsets is starting to divide into two parts, says Elisa de Wit, Carbon Market Institute chair and a partner with law firm Norton Rose Fulbright. "The first part is that there'll be a lot more focus on how targets such as carbon neutral or net zero by a specified date are actually going to be implemented, and what the reliance on offsets is, in that context," she says. "The second part is, if you're going to use offsets and it's an appropriate use of offsets, what offsets are you using? Do they have credibility?"

The recent furore over Australian offset quality relates to both her points. The Australia Institute and Macintosh want more questioning of the quantity of credits being used by companies to signal environmental virtue – and they also want the government to address quality control in Australia, rather than simply pointing to doubts over international projects.

Tale of two companies

Austral Fisheries – a WA-based private company half-owned by listed Japanese fisheries and processing giant Maruha Nichiro – has an offset purchasing program that responds rapidly to price signals, incorporates projects the organisation feels passionate about, and uses in-house expertise for much of its due diligence.

Austral's journey towards offsetting its emissions began in 2016, says CEO David Carter. He emphasises that the current target is carbon neutrality, not net zero. "We run fishing boats using about nine million litres of diesel a year, so we're offsetting about 40,000 tonnes of carbon equivalent a year in arrears," he says. "That's not going to reduce significantly without a transformation of engine technology."

That 40,000 tonnes includes Scope 1, 2 and 3 emissions, says Carter, but the bulk of it is the diesel-generated Scope 1 emissions.

At the other end of the size spectrum, Telstra says it became carbon neutral in 2020, offsetting approximately 2.3 million tonnes of Scope 1, 2 and some Scope 3 greenhouse gas emissions. In 2022, says head of environment Tom Penny, Telstra estimates it will offset approximately two million tonnes of emissions to remain carbon neutral. The telco aims to cut emissions by 50 per cent by 2030 compared to its 2019 levels, but it does not use the net zero label. That's because Telstra, like Austral, has Climate Active certification.

"The Climate Active standards define the use of carbon neutral instead of net zero," says Penny.

Climate Active, described as a government-business partnership, was established to encourage Australian businesses to take voluntary climate action. It's unclear how or if Climate Active's criteria for carbon neutrality will be affected by the review of international offsets announced by the minister in February. However, Climate Active is not an arbiter of carbon credit quality. It lists standards on its website and it is up to the purchaser to satisfy itself that the project meets the standard, or to confirm that a reputable verifier has been employed to assess the project against the standard.

Credibility and responsibility

Once a company has decided on a credible strategy for reducing its greenhouse gas emissions, and knows the gap it wants to plug with offsets, how to find credible projects? One thing that has emerged from the current debate over quality is that there is no easy way to audit projects. That means there will always be questions over how much greenhouse gas a project is saving. There will also be questions about whether projects that meet the additionality test now, will continue to do so in the future.

Much of the criticism of the quality of Australian credits has centred on forestry and landfill projects. Cook believes it's not practical for companies to avoid these kinds of projects "because they are the majority of the credits on offer". But de Wit thinks companies should reconsider landfill projects, at least, because they are likely to become ineligible for generating carbon credits in Australia in a few years' time.

Either way, to assess quality, Cook says directors should ask executives to spend time studying the standard that applies to a particular carbon credit,

and to consider whether they need to supplement any due diligence done by a broker with the company's own due diligence. She also emphasises that a carbon credit purchasing program is not a set-and-forget exercise – it needs to be responsive to evolving regulations.

For example, says de Wit, there has been a rethink on wind and solar projects, even in countries heavily reliant on coal such as India and China. "There's now a view that those types of projects don't need the carbon revenue to come forward and therefore carbon credits shouldn't be able to be generated from these projects. So, over time, standards can change, which is the way the market is supposed to work."

The problem in all of this is that under the current regime, it's not clear where responsibility for quality lies. "The ecosystem is not yet mature enough to be able to get to financial statement audit quality," says Cook. "So there's probably not a single entity that companies could cite as being responsible for the quality of carbon offsets."

Price-conscious

International offsets can cost as little as $10 per metric ton, compared to the ACCU price, which was trading a little below $30 in mid-March, having fallen from above $55 in February. Cook says the market for offsets is not a transparent market with easy price and volume discovery. She warns that extremely low-cost offsets should be viewed with caution.

But as the price of ACCUs rose throughout 2021, Austral became alarmed by the surge and started looking at overseas options. "We've used brokers for some of our offsets," says Carter. "They found international wind and solar projects. We've also got some credits generated from a project where they're using low-friction anti-fouling on large shipping boats to make the hull more hydrodynamic."

Rhys Arangio, senior manager of environment and policy at Austral, says he does due diligence on the projects suggested by the broker, to make sure they are eligible offset units as noted in the Climate Active Carbon Neutral Standard. The company also uses an experienced third-party consultant to help set the strategy.

Austral has another offset purchasing program –this one more of a passion project and not covered by Climate Active's standards. In addition to its 40,000 offsets annually, Austral buys about 20,000 biodiverse reforestation carbon offsets because

it believes in the project and trusts the project manager, Carbon Neutral. "For many years we've been supporting a project to regenerate broken farmland near Perenjori, 3.5 hours north-east of Perth by car," says Carter. "You go up there in summer and it's just hard, eroded red dirt – and baking. Then you cross the road to where the projects have been running for about seven years and the difference is extraordinary – 40 different plant species collected from the local area, and birds and other critters."

These 20,000 offsets cannot be used to offset Austral's emissions under the Climate Active program because they are not verified against one of the standards. Consequently, they were cheaper for Austral to buy than ACCUs.

Future pricing

Things have changed since then. The market for Australian carbon credits received a jolt when Minister Taylor announced a change to CER sale rules in March. The change will allow parties – such as project developers – with fixed contracts with the regulator, to exit their fixed contract and sell on the private market. "Sellers of credits will be able to essentially pay an exit fee to get out of their contracts with the CER, so they can sell their credits at the higher spot price rather than at the lower price of that originally bid in the auctions," says de Wit.

Says Arangio, "If this change does bring down the price longer-term, that would be good for us as emitters. We would prefer to buy Australian units where possible, but there is a balance between project and price."

Penny thinks that releasing the project managers from government contracts will enable voluntary purchasers to get access to more Australian credits. International credits aren't necessarily of lesser integrity than Australia's, he says, "but the extra point in Australia is that companies often pay a higher price for credits based on co-benefits, such as benefits to Aboriginal communities."

One of the offsets in Telstra's program, for example, pays for managed burns on Indigenous land in northern Australia early in the season, which avoids higher emissions from out-of-control fires later on, and directs investment into those communities.

Ultimately, companies must make their own decisions about offsets. While the search for quality can seem like a minefield, applying the concept of additionality makes it easier to understand. ■

CHECKLIST

Energetics' Sally Cook says offsets must represent actual emissions reductions. At a minimum, they need to be:

1. CREDIBLE
Look for standards that require evidence of the emissions reduction before they issue an offset certificate.

2. ADDITIONAL
Emissions reductions beyond what would have been achieved through business-as-usual.

3. DATED
Emissions reductions need to have been achieved in recent years. For example, Climate Active requires offsets to have a vintage of 2012 or later. Pre- and post-2021 vintages have become a key distinction in the Paris Agreement's rules for offsets markets for some offset types.

4. ENDURING
So that a land-based offset is replaced, for example, in the event of fire.

5. VERIFIED
By an independent auditor.

6. NOT DOUBLE-COUNTED
They need to be recorded in a registry that allows them to be surrendered when the emissions reduction is claimed.

Beyond the minimum criteria purchasers can look for co-benefits:

Project location
Location can be leveraged to provide local community benefits.

•

Socioeconomic and environmental benefits
Such as employment, poverty alleviation, biodiversity and air quality. Many offset projects make narrative claims about the co-benefits they can produce, but some standards can also certify co-benefits.