

**MIDWESTERN GREENHOUSE GAS REDUCTION ACCORD
DRAFT RECOMMENDATIONS OF THE ADVISORY GROUP**

INTRODUCTION

On November 15, 2007, the Governors of Illinois, Iowa, Kansas, Michigan, Minnesota and Wisconsin, and the Premier of Manitoba entered into the Midwestern Greenhouse Gas Reduction Accord (the "Accord"). The Accord calls for the establishment of "targets for GHG emission reductions and timeframes consistent with states' targets" and the development of a regional cap-and-trade program design. In early 2008, the Governors and Premier convened an Advisory Group consisting of a diverse group of individuals representing varied interests from across the region, including representatives from state and provincial governments, business, energy and environmental advocacy groups, and academia.

The Advisory Group was charged with making recommendations for the establishment of targets for emissions reductions in the region, and for the design of a regional cap-and-trade program. After lengthy deliberation and consideration of the various options for the participating jurisdictions, the Advisory Group has arrived at the recommendations contained below.

DESIGN PRINCIPLES

In setting the regional reduction target and designing the cap-and-trade program, the Advisory Group considered the following design principles:

- Ensure that the system is equitable, administratively simple for government and private participants, minimizes administrative costs, and has a clear compliance path;
- Cover as many sources as is practical, while encouraging emissions reductions beyond the capped sources and sectors;
- Assure a transparent and robust data gathering and accounting system that will measure and report emissions accurately and consistently across all sectors and throughout the region;
- Distribution of allowance value should support the goals of the program, including compensating for disparities and impacts caused by the program;

- Enable linkage to systems in other jurisdictions with similarly rigorous accounting in order to create economies of scale and to increase market efficiencies, diversity and liquidity, while reducing costs;
- Maximize economic, employment, energy diversity, environmental and public health benefits, while minimizing any transitional job losses and energy and other cost impacts;
- Reduce the potential for emissions leakage, including the shifting of economic activity to non-covered sources and to non-participating jurisdictions;
- Stimulate investment, especially in low-carbon technologies, and reward innovations that will lead to near and long-term, permanent greenhouse gas reductions;
- Credit qualified past and present actions to reduce GHG emissions;
- Require any offsets to be real, surplus/additional, verifiable, permanent and enforceable, and appropriately address additionality and permanence;
- Allow flexibility for participating jurisdictions to meet specific policy needs and objectives, while maintaining regional program uniformity;
- Demonstrate leadership toward, and enable incorporation into and harmonization with, any future federal program, while ensuring the capability of the regional program to stand on its own, if necessary. (Revised significantly from Accord); and
- Reduce the potential for and scale of unintended economic consequences of the policy, while maintaining an appropriate price signal.

THE RECOMMENDATIONS

1.0 EMISSIONS REDUCTION TARGET.

1.1 Reduction Targets: The Advisory Group recommends the following emissions reduction targets for the participating jurisdictions.

1.1.1 2020 Target. [15, 20, or 25 percent] below 2005 levels by 2020

1.1.2 2050 Target. [60-80 percent] below 2005 levels by 2050.

1.1.3 The Advisory Group also recommends that the targets be revisited and adjusted from time to time based on future scientific findings, technology developments, and program results, and recommends the establishment of a mechanism to conduct this review.

2.0 PROGRAM SCOPE

- 2.1 Sectors and Fuels. The Advisory Group recommends that the program cover the following sectors:
- 2.1.1 Electricity generation [and imports]
 - 2.1.2 Industrial combustion sources
 - 2.1.3 [Industrial process sources to the extent credible measurement & monitoring protocols exist or can be developed prior to inclusion]
 - 2.1.4 [Transportation fuels]
 - 2.1.5 [Fuels serving residential, commercial and industrial buildings not otherwise covered in 2.1.1 or 2.1.2 above.]
- 2.2 Greenhouse Gases. The program should cover the following greenhouse gases, as appropriate: carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride.
- 2.3 Points of Regulation. The following are the recommended points of regulation for each sector:
- 2.3.1 For electricity, [the electricity generator][the load-serving entity][the first deliverer of electricity]
 - 2.3.2 For industrial combustion emissions, the emissions sources
 - 2.3.3 [For industrial process emissions, the emissions sources.]
 - 2.3.4 [For transportation fuels, where the fuels enter the market in the participating jurisdictions; generally at the terminal rack, final blender or distributor.]
 - 2.3.5 [For residential, commercial and industrial combustion emissions not covered at 2.3.1 and 2.3.2, where the fuels enter the market in the participating jurisdictions; generally at the terminal rack, final blender or distributor.]
- 2.4 Emissions threshold for coverage. The emissions threshold for coverage at an individual covered sources:
[10,000][25,000][100,000] metric tons of carbon equivalent on an annual basis.

- 2.5 Cap-and-Trade Reductions. The reduction to be achieved in the covered sectors should be [equal to the regional reduction target], provided the cap-and-trade program, together with the complementary policies to be undertaken in the states and province, should at least achieve the recommended reduction goal set out in 1.0 above.
 - 2.6 Complementary Policy Reductions. The recommendations on the scope of the cap-and-trade program assume that other policies will be implemented to ensure that comparable reductions will be achieved in those sectors not recommended to be part of the cap-and-trade program so that, taken together, the cap-and-trade program and the other policies will achieve the regional goal equitably across the economy.
 - 2.7 Linking. The Advisory Group recommends that the participating states and province seek to link the MGGA cap-and-trade program to the:
 - 2.7.1 Northeast Regional Greenhouse Gas Initiative covering ten northeastern and mid-Atlantic states;
 - 2.7.2 Western Climate Initiative, covering seven western U.S. states and four Canadian provinces;
 - 2.7.3 European Emissions Trading System; and
 - 2.7.4 Other mandatory greenhouse gas reduction programs as appropriate.
- 3.0 ALLOWANCES
- 3.1 State and Provincial Allowance Budgets. The Advisory Group recommends that the state and provincial allowance budgets should be established based primarily on absolute emissions in each state and province. Some portion of the state and provincial allowance budget should be apportioned based on other criteria, such as GHG emissions per capita; baseline year for allocation (i.e. adjustments to allow reward for early action); population and economic growth in the participating jurisdictions; and new sources or projected new sources.
 - 3.2 Reduction Path.
 - 3.3 Allowance Distribution. Allowances should be put toward climate-related purposes, not other purposes. Climate-related purposes include two categories: (1) accelerating transformational investment and/or (2) mitigating transitional harm:

- 3.3.1 *Accelerating Transformational Investment.* Allowance value should be distributed to accelerate:
 - 3.3.1.1 Commercial deployment of low-carbon technologies, including energy efficiency, bioenergy, bioproducts and transportation; renewable electricity; and advanced coal and carbon capture and storage. Special focus should be paid to those sectors and resources covered by the MGA platform, the recommendations of the Tier II Advisory Group, as well as other areas where funding and research gaps exists, such as combined heat & power.
 - 3.3.1.2 Change in the transportation sector, with an emphasis on promoting low-carbon biofuels, automotive retooling, rail, urban planning.
- 3.3.2 *Mitigating Transitional Economic Harm and Climate Change Impacts.* Allowance value should be distributed to:
 - 3.3.2.1 Mitigate consumer harm and energy price impacts on individuals, particularly low-income consumers, commercial entities including utilities, and industrial entities.
 - 3.3.2.2 Offset economic harm to entities in the region with a specific focus on energy-intensive industries.
 - 3.3.2.3 Ease worker, community and industry transition.
 - 3.3.2.4 Mitigate impacts to globally competitive industries, such as energy-intensive industries and those with slim profit margins.
 - 3.3.2.5 Mitigate climate change impacts on communities and natural resources/ adaptation through allowance value distribution.
- 3.3.3 *Auction and/or Allocation.* The Advisory Group recognizes that the decision on whether to auction or allocate allowances will depend on the purposes to be achieved through the allowance value or portion of the allowance value. Those objectives best achieved through direct allocation to covered entities should be so allocated. Those purposes best achieved through distribution of the revenue from an allowance auction should receive the allowance value after auction.

- 3.3.4 *Regional Distribution of Allowance Value, or by Jurisdiction.* The Advisory Group recommends a hybrid approach for the distribution of allowance value across the region. Some decisions over allowance distribution should be left to each jurisdiction, while other decisions should be harmonized across participating jurisdictions. The Advisory Group recommends that the hybrid approach seek to achieve the maximum achievable level of harmonization and consistency across participating jurisdictions in order to help minimize inter-jurisdictional economic competitiveness issues and ensure the most level playing field.
- 3.4 Compliance Period. The Advisory Group recommends that each compliance period should be no longer than 3 years in length.
- 3.5 Banking. The Advisory Group recommends that the cap-and-trade program should allow unlimited banking of allowances and offsets. Allowances or offsets received or purchased in one year, therefore, can be banked and used in any subsequent year of the program, even across compliance periods.
- 3.6 Borrowing. The Advisory Group recommends that limited borrowing should be allowed, provided borrowed allowances should be paid back with some “interest”.
- 3.7 Early Action Credit. The Advisory Group recommends that early action should be recognized in the cap-and-trade program. Two types of early action credit are recommended:
- 3.7.1 *Early reduction by covered entities.* Covered entities should be able to earn early reduction allowances in addition to the starting allowance budget by reducing emissions at covered facilities. The cut-off date for these early reduction allowances should be as close to the start of the program as possible.
- 3.7.2 *Other early action.* The Advisory Group also recommends that to the extent participating jurisdictions wish to reward early action that does not qualify for allowances under 3.7.1, those reductions should be awarded allowances out of (and not in addition to) the jurisdiction’s allowance budget.
- 3.8 New Entrants. The Advisory Group recommends that new covered entity entrants to the cap-and-trade program should be treated similarly across all participating jurisdictions to the maximum extent possible.

4.0 OFFSETS

- 4.1 Offsets Program. The Advisory Group recommends that the states and province develop an offsets component as part of the cap-and-trade program.
- 4.2 Offsets Requirements. Offsets must be real, additional, verifiable, permanent, and enforceable so that they do not compromise the integrity of the cap-and-trade program:
 - 4.2.1 *Real*. Offsets must represent actual emission reductions and not artifacts of incomplete or inaccurate accounting. The effects of a project on GHG emissions must be comprehensively accounted for, and “leakage” in emissions must be factored into the quantification of emission reductions. Conservative assumptions should be used where there are uncertainties in quantifying emission reductions or removals.
 - 4.2.2 *Additional*. The reductions resulting from offset projects must be shown to be “in addition to” reductions that would have occurred without the incentive provided by offset credit. To be eligible for offsets, offset projects cannot be required by law or regulations, and must exceed baseline criteria. The baseline criteria must use standardized criteria (including but not limited to, performance standards, financial feasibility criteria, market penetration, and project start date) that serve to exclude “business as usual” projects from eligibility.
 - 4.2.3 *Verifiable*. Offsets must result from projects or programs whose performance can be readily monitored and verified, and whose effects can be measured with reasonable precision and certainty.
 - 4.2.4 *Permanent*. Emission reductions or removals must be backed by guarantees if they can be reversed, i.e., re-emitted to the atmosphere. For emission reductions or sequestration activities that can be reversed, adequate safeguards should be established to minimize the risk of reversal, or a mechanism should be provided for the replacement of those tons.
 - 4.2.5 *Enforceable*. Offsets must be consistent with regulations and administrative rules that define their creation, provide for transparency, and meet defined standards of ownership to avoid double counting.

- 4.3 Offsets Component Architecture. The offset program should establish initial offset project categories and evaluation criteria. The following mechanism should be used to establish this initial list, and to incorporate additional categories and evaluation criteria over time.
- 4.3.1 Category evaluation and protocol development should be spearheaded by strong technical and scientific advisory committees.
- 4.3.1.1 Technical Committees would be established for each offset category being considered by signatory states and provinces. Technical Committees would be comprised of subject matter experts and would be tasked with drafting offset project protocols. The Technical Committees should report their findings to the Scientific Committee.
- 4.3.1.2 The Scientific Committee is a standing body of scientists and experts with an in-depth understanding of climate science and offset program principles and implementation challenges. The Scientific Committee can accept, reject, or suggest modifications to the Technical Committees.
- 4.3.1.3 In developing those protocols, the Technical and Scientific Committees should consider the Offset Program Design Principles, Carbon Offset Requirements, and other guidelines agreed to by the signatory states and provinces.
- 4.3.2 In the interest of promoting transparency, protocols approved by the scientific committee should be made available for public comment.
- 4.3.3 Agency Heads of participating states and provinces would collectively consider, through a collaborative process, those public comments when deciding whether or not to adopt a protocol throughout the region.
- 4.3.4 At any time, anyone may propose protocols for new types of projects to the regional organization, for consideration pursuant to the procedures in 4.4.
- 4.4 Limits on Use of Offsets. The use of offsets should be constrained to 10 to 50 percent of the emission reductions to be achieved by the program when compared to business as usual projections.

Modeling results should inform the determination of usage constraints, and any determinations regarding the need and price of triggers that would expand usage limits.

4.5 Geographical Location of Offsets.

4.5.1 Initially, the geographic scope should be constrained to MGA GHG Accord signatory jurisdictions and those states and provinces that have entered into an MOU with the MGA GHG Accord signatory jurisdictions.

4.5.1.1 At a minimum that MOU should require the state or province to carry out certain administrative tasks related to evaluation of offset projects.

4.5.1.2 States and provinces not apart of the MGA GHG Accord could also be required to have a GHG regulatory program of comparable or greater stringency than that established by the MGA GHG Accord.

4.5.2 As the program evolves, states and provinces should consider incorporating the Clean Development Mechanism (CDM) and Joint Implementation (JI) programs.

4.5.3 Any determination about whether to allow offset credits from other regulatory offset programs should follow the procedures for adding offset project categories. Therefore, such decisions should be made by Agency Heads, and only after thorough consideration by the Technical and Scientific Committees and public comment.

4.6 Offsets Types. Initial project categories should be identified and prioritized for protocol development under section 4.3 to the extent that they meet the following criteria:

4.6.1 Offsets easily and credibly meet the Offset Program Design Principles and Carbon Offset Requirements;

4.6.2 The extent to which offsets can incentivize new technologies or new practices;

4.6.3 The likelihood of a project category being regulated under a Midwestern cap-and-trade program, or by complementary policies developed through the Greenhouse Gas Accord process;

4.6.4 The likelihood of a project category being regulated under a federal cap-and-trade program;

4.6.5 Stakeholder support for project categories;

- 4.6.6 Quantity of cost-effective reduction opportunities;
- 4.6.7 Environmental and economic co-benefits;
- 4.6.8 Protocols already exist that employ standardized benchmark criteria for evaluating project categories; and,
- 4.6.9 Anticipated administrative simplicity for project developers and state regulators.
- 4.7 Offsets Methodologies. Protocols for quantification of emission reductions/removals and for project monitoring should be as standardized to the extent possible, while ensuring accuracy. Ideally, there should only be one approved protocol for each type of project, but additional protocols may be adopted if warranted
- 4.8 Offsets Program Administration.
 - 4.8.1 To maximize certainty for project developers, a two-step review process should be adopted. The first step – a consistency determination – provides for preliminary review before project commencement. The second step – monitoring and verification – is the application for offset allowances equal to the actual emissions reductions or sequestrations demonstrated to have occurred at the project location.
 - 4.8.2 Applications for consistency determinations and applications for monitoring and verification must be verified by accredited, independent, third-party verifiers.
 - 4.8.3 Third-party verified applications must be reviewed by states, provinces, or the centralized administrative body.
 - 4.8.4 To ensure rigor, periodic auditing should be performed by states, provinces, or the centralized administrative body.
 - 4.8.5 It is critical that the regional offset program be consistently implemented from jurisdiction to jurisdiction.
- 5.0 MANDATORY EMISSIONS REPORTING
 - 5.1 Start Date.
 - 5.2 Entities and Facilities Subject to Reporting.
- 6.0 ECONOMIC ANALYSIS
 - 6.1 Modeling: Insights not Numbers.
 - 6.2 The Reference or “Business as Usual” Case.

- 6.3 Insights on the Program.
- 6.4 Summary of Insights.