Prayas (Energy Group) comments on identified methodologies for adoption in the offset mechanism under CCTS

On 23rd January 2025, the Bureau of Energy Efficiency (BEE) published a document with methodologies for 12 sub-sectors in 6 sectors for adoption in the offset mechanism under the Indian CCTS, and sought comments on the same. Please find the comments from Prayas (Energy Group) below for your consideration. BEE gave just seven days to comment on a 220-page document. We believe that such a hurried process is not really conducive to receiving rich feedback and is unlikely to serve the purpose of public consultations well.

Our comments below focus on the broader objectives of the Indian CCTS and how the current proposal can be improved to meet them, particularly given the experience from the PAT scheme which forms the basis for the proposed CCTS.

1. **Clarity of market design:** The BEE has not yet finalized various critical aspects of the proposed ICM such as whether there would be floor and ceiling prices, how they would be determined, and whether there would be a market stabilisation fund and any details thereof. It is critical that the market design be finalized based on extensive consultations before the market is rolled out trading under the compliance or offset mechanism.

   Therefore, we recommend that the offset mechanism in the CCTS be kept in abeyance until there is such clarity on market design.

2. **Need for offset mechanism:** Based on past experience with PAT, there is a serious concern that there will be an oversupply of CCCs in the ICM even with just a compliance market. Introducing the offset mechanism before (or along with) introducing the compliance market will only make the problem worse – resulting in very low carbon prices that do not reflect the true cost of decarbonisation. This concern is greater because experience with PAT also shows that enforcement has been very lax since defaulting entities have not been punished in any way thus far. Indeed, in the latest PAT round, obligated entities that have to purchase ESCerts have not even registered themselves with the exchanges.

   The introduction of the offset mechanism at this stage is inopportune and it is better introduced after the compliance market matures and enables efficient price discovery etc.

3. **Stringent additionality mechanism:** Determining “additionality” is a key component in deciding how many CCCs to allot to any entity. The principle behind allotting CCCs for the offset mechanism is to recognise efforts beyond what the entity should anyway have undertaken. Therefore, any legal obligations of an entity – such as meeting its RPO/RCO as per the EC Act or its energy intensity target under the PAT scheme – should definitely not count towards additionality and hence should not be eligible for any CCCs.

   CCC allotment for the offset mechanism based on the additionality criterion should ensure that entities are allotted offset CCCs only for excess achievement over meeting their legal obligations

4. **Overlaps between compliance and offset mechanism:** It is not clear if the current framing of the CCTS disallows the same entity from being registered as both an obligated entity (to meet compliance targets) and as a non-obligated entity (to participate in the offset scheme). Hence, it is not clear if an entity that meets its compliance targets can also claim CCCs under the offset mechanism for avoiding or reducing GHG emissions. This is clearly not desirable as it will result in undue benefits to such entities and result in potential double counting of GHG emission savings. Thus, it should either be ensured that an obligated entity cannot be registered as a non-obligated entity or that an obligated entity is not eligible for allotment of CCCs under the offset mechanism.

   The currently proposed scheme does not seem to prevent an obligated entity from claiming offset benefits by also being registered as a non-obligated entity. Checks to prevent such double accounting should be introduced.

5. **Fungibility of compliance and offset CCCs:** It appears from the documents available so far that there is no distinction between compliance CCCs and offset CCCs and there are no restrictions in obligated entities meeting their targets through a high share (up to 100%) of offset CCCs. However, this is not really conducive to the larger goal of the CCTS helping the decarbonisation of hard-to-abate industrial sectors of India, since their incentive to identify and invest in the best decarbonisation technologies for their sectors would be diluted. This problem would only become worse given the likelihood of over-supply of CCCs mentioned in point 2 above. Most international CCCs limit the share of offset CCCs that can be used to meet compliance targets. For instance, in EU ETS, no off-set credits are allowed after 2020 and all the compliance has to be met through EU ETS allowances. Only a small share of any obligated entity's compliance requirement should be allowed to be met through offset mechanism, if at all.

   Compliance and offset CCCs should not be fully fungible, and there should be an upper limit of what percentage of compliance CCCs can be met from offset CCCs. This requires a distinction between the two types of CCCs which currently seems absent.

6. **Fungibility of ESCerts and CCCs:** There is, as yet, no clarity on the fungibility of ESCerts that entities may already possess and CCCs. Since the ICM is modelled on the PAT scheme and it is generally expected that the PAT scheme would be phased out and migrated to the CCTS, clarity on this aspect is important. Developing an offset (or compliance) trading mechanism without this clarity can lead to confusion.

   It is suggested that the offset trading mechanism is introduced only after there is clarity about the fungibility between ESCerts and CCCs and the mechanism for it.

7. **Rationale for proposed sub-sectors:** The published draft document only lists 12 sub-sectors or schemes for adoption under the offset mechanism without giving any rationale for why they were chosen. For example, it is already well established that new renewable generation capacity is more economical than new fossil-fuel based generation capacity. Recent tender results suggest that this also true for renewable capacity bundled with storage. Given this, there is no rationale to include EN01.001 in this scheme. Similarly, modal shift of cargo from road to water or rail (TR06.001) is inherently more economical (subject to other barriers such as last mile connectivity and service levels). There is no rationale to provide offset CCC support to such sub-sectors.

BEE should publish a rationale for each sub-sector that is included. Currently, there are at least a few sectors that probably should not be part of the offset scheme.

Based on the above points, our suggestions to the draft proposal regarding methodologies for adoption of the offset mechanism can be summarised as follows:

- Certain market design elements such as the price discovery mechanism, floor and ceiling prices, and market stabilisation fund need to be defined first before any carbon market is introduced.
- The offset mechanism should only be introduced after the compliance market matures, and its operations and price discovery mechanisms stabilise – particularly since there are concerns about over-supply of CCCs based on past PAT experience.
- If the offset scheme is introduced in the near future, it should be ensured that offset CCCs are only allotted beyond any legal obligations of the market entities.
- There need to be mechanisms to ensure that an obligated entity cannot claim both compliance CCCs and offset CCCs for the same emission reduction.
- Multiple issues in the current proposal need greater clarity. These include fungibility of compliance and offset CCCs, how much of the compliance target can be met through offset CCCs and fungibility of ESCerts and offset/compliance CCCs.
- The rationale for introducing some sub-sectors in the offset scheme seems doubtful and these should be reconsidered.

We request you to consider our suggestions while finalizing the proposed scheme. We are happy to provide any clarifications that you may need.

Regards

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