

The background features a hand in a white shirt pointing upwards. Overlaid on this are several circular icons: a sun, a wind turbine, a globe, a bar chart, a pie chart, a magnifying glass, a recycling symbol, a house, a building, and an airplane.

Decision-making Framework

for Carbon Offset Use by Water Corporations

October 2020



Contents

Introduction	3
A) Achieving genuine, cost-efficient emissions reductions required by the SoO-e: deciding to use offsets	4
1. Offsets use should be consistent with a comprehensive emission reduction strategy	4
B) Selecting offsets that reflect customer values and meet SoO-e requirements	5
2. Choice of offsets should be informed by customer values and preferences	5
3. Offsets must fully comply with the principles in CACNS	6
4. Offsets projects should do no harm	6
5. Offset use should be flexible to accommodate policy and regulatory change	7
C) Demonstrating accountability and compliance with SoO-e requirements	8
6. Offset use should be transparent in all respects	8

Water corporations must meet regulatory requirements for the use of carbon offsets as set out in the Statement of Obligations (Emission Reduction) (SoO-e). Within the scope of those requirements, there is a broad range of choices to be made about which offsets to purchase. This Decision-Making Framework is designed to assist water corporations to navigate those choices and to identify offsets that achieve cost-efficient emission reductions, meet the requirements of relevant policy and regulations, meet organisational and customer values, and avoid compromise to environmental and social wellbeing or organisational reputation.

With regard to offsetting emissions, the SoO-e requires:

- Genuine emissions reduction (SoO-e clause 1-2)
- Efficient emissions reduction at the lowest possible cost (SoO-e clauses 1-2 and 1-3)
- Offsets to be consistent with the Climate Active Carbon Neutral Standard (CACNS), formerly NCOS (SoO-e clauses 3-1.3 and 3-2)

Broadly, CACNS requires offsets to be consistent with internationally recognised offset integrity principles and accredited by one of five offset accreditation standards.

Additionally, the ESC's PREMO framework requires water corporations to understand and respond to customer values and preferences through the price submission process. Given the cost implications of reducing emissions, this is an essential consideration in the decision-making process for carbon offsets.

The Decision-Making Framework addresses these requirements in three steps:

- A) Achieving genuine, cost-efficient emissions reductions required by the SoO-e: deciding to use offsets
- B) Selecting offsets that meet regulatory requirements and reflect customer values
- C) Demonstrating accountability and compliance with SoO-e requirements

The Decision-Making Framework contains six Statements of Principle (in bold) supported by explanatory guidance. It has been informed by discussions with the Victorian Water Sector, with the intention of capturing sector-wide requirements, and making the Decision-Making Framework useful to any water corporation sourcing carbon offsets. It is intended that this Framework continue to evolve through collaborative efforts across the sector and in line with evolving best practice.

A) Achieving genuine, cost-efficient emissions reductions required by the SoO-e: deciding to use offsets

This step focuses on the decision to use offsets as part of an approach to reducing emissions in line with the requirements of the SoO-e. In particular, it provides guidance to identify whether and to what extent offsets are an efficient and cost-effective way to reduce emissions.

1. Offsets use should be consistent with a comprehensive emission reduction strategy

Offsets should be used as part of a long-term strategy to achieve net-zero emissions. All Victorian water corporations have committed to achieving net-zero emissions, with some committed to achieving this by 2030.

The Carbon Management Hierarchy illustrates that sustainable and cost-effective emissions reductions over the long term should be achieved by avoiding emissions where possible, reducing emissions through efficiency measures, and replacing high-emissions technology and energy sources with low-emissions alternatives. However, the hierarchy recognises that immediate replacement of infrastructure and large-scale changes to business activities may not be technically or financially viable and provides for offsets to be used as a transitional mechanism to reduce emissions.

A long-term strategy should take these issues into account to ensure that the decision to use offsets is consistent with the SoO-e requirements to reduce emissions in an efficient and cost-effective manner. The strategy should address how to reduce scope 1 emissions, such as plans to invest in research and development, new technology and facility upgrades, and map out the proposed use of carbon offsets over time.

To ensure that net-zero emissions is achieved efficiently, the long-term strategy should take into account the expectation that offset prices are projected to rise over time.

B) Selecting offsets that reflect customer values and meet SoO-e requirements

This step provides guidance for choosing which offsets to use, including accounting for customer preferences (as required by the ESC PREMO framework) and ensuring offsets genuinely reduce emissions (SoO-e section 1-2) consistent with the requirements of the CACNS (SoO-e sections 3-1.3 and 3-2). These factors determine the range of offsets that can be used by water corporations to comply with their regulatory obligations, from which the lowest-cost option can then be selected.

2. Choice of offsets should be informed by customer values and preferences

Within the range of compliant offsets available, selection of offsets should be guided by the water corporation's customer values and preferences for project type, location, and price.

Guided by the ESC PREMO framework, water corporations should take steps to understand customer preferences regarding offsets. This can include conducting market research and/or seeking feedback from customers about offset use. This can be incorporated into existing engagement or feedback processes with water corporation customers and should be periodically revisited. It may also be necessary to develop information resources and education tools to help customers become more informed about carbon offsets and how they are used by water corporations.

By engaging with customers about offsets, water corporations should seek to understand what the community values and the extent to which they prioritise co-benefits (such as biodiversity outcomes, local jobs and investment), and the extent to which location is an important feature of these co-benefits, and offset projects generally.

Where customers express a preference for local projects (for example, in their service area), there will be a smaller set of offset projects available, usually at higher prices than those available from a wider market. Customers may be prepared to pay a higher price for local benefits such as an improved local environment from revegetation, catchment protection, and local employment. Where there is evidence of this preference, and having particular regard to price impacts on vulnerable customers, a water corporation may prioritise higher cost offsets to satisfy this preference.

3. Offsets must fully comply with the principles in CACNS

The CACNS sets out seven offset integrity principles based on international standards that it uses to determine offset eligibility under the standard. Each of the principles must be met to ensure the integrity and effectiveness of carbon offsets.

Adherence to the integrity principles can only be assured by project level scrutiny, not just by purchasing any accredited offsets. The CACNS provides that offset buyers should undertake their own due diligence on offset projects.

Water corporations should undertake due diligence regarding all projects from which offsets are to be purchased. To do this effectively may require capacity development to build the skills and knowledge within the organisation to scrutinise projects. Additionally, it is important to ensure there is sufficient time built into procurement processes and workloads to permit thorough due diligence.

Compliance with CACNS also requires that offsets are accredited under one of five different accreditation standards. These standards use different methodologies and cover a wide range of project types for projects from diverse geographic regions with widely varying prices. There is evidence of varying credibility, environmental integrity and co-benefits amongst the range of accreditation standards, methodologies and projects. Water corporations should also investigate the accreditation standard under which offsets are accredited.

4. Offsets projects should do no harm

Some offset projects have been found to cause environmental and social harm, and factors such as a lack of transparency mean this continues to be a real and present risk. Scrutiny is required at the project level to screen out projects that have a credible risk of causing harm to people or the environment.

Investing in such projects carries serious reputational risks for Victorian water corporations and could undermine community, customer and stakeholder confidence in the use of offsets and efforts to reduce emissions. Water corporations should exclude projects causing or likely to cause environmental and social harms from consideration.

In addition to doing no harm, water corporations have indicated their strong interest in generating positive outcomes for their customers, community, service area and catchment. This interest reflects the corporations' understanding of customer values and preferences and should continue to be explored through engagement with customers (see Statement of Principle 2 above). When weighing up the range of factors to be considered in an offset purchasing decision, it is appropriate to consider potential benefits of offset projects to the local community and environment, aligned with customer preferences, as this can provide a greater return on investment for the water corporation and its customers.

5. Offset use should be flexible to accommodate policy and regulatory change

The use of offsets should be flexible to adapt to policy and regulatory change and avoid locking into an offset strategy that may be 'regulated out'. As compliance frameworks are strengthened at the international, national, and state level, some types of offsets may become stranded assets, unable to be used to offset emissions. This risk is especially significant with regard to low-quality offsets but may also affect specific types of projects that become attractive investments in themselves and are therefore no longer additional (such as renewable energy). Failure to anticipate this risk and maintain access to a diverse portfolio of high-quality offsets may substantially increase the cost of offsets and undermine their efficiency, in contravention of the SoO-e requirements.

Offsets sit within complex regulatory and policy frameworks that are subject to change. Allowable offsets under the Commonwealth Government's CACNS have changed in the past and may change again.

One way of anticipating and minimising the impact of regulatory change is to select good quality offsets to accommodate the possibility that regulatory requirements become more stringent in the future. Water corporations should consider whether the offsets they purchase are likely to be eligible for use under the Commonwealth Safeguard Mechanism (which caps emissions from large greenhouse gas emitting facilities) should the Safeguard Mechanism be changed to apply to them and require emissions reductions.

Water corporations should seek to maintain access to a diverse portfolio of offsets to minimise the risk of becoming 'locked in' to offsets that cease to be eligible following regulatory changes. Water corporations should also regularly review their approach to procuring offsets and their offset portfolio to ensure it reflects current best practice and is optimally positioned to respond to any anticipated regulatory change.

Maintaining diversity and flexibility in an offset portfolio is an acceptable reason to consider higher-priced offsets if necessary as it reduces the risk of stranded investments in the medium to long term.



C) Demonstrating accountability and compliance with SoO-e requirements

This step ensures that regulatory compliance is clearly demonstrated and recorded, providing confidence to regulators, customers and the public that water corporations are meeting their obligations under the SoO-e.

6. Offset use should be transparent in all respects

Offset purchases and use should be subject to full and detailed public disclosure, including the role of offsets in an organisation's emission reduction strategy, the rationale for choosing offset certification standards, methodologies and projects, and steps taken to verify offset integrity. Water corporations should disclose the details of projects and should provide information about the full range of offsets included in their portfolio. Broad summaries are not enough to demonstrate transparency.

Water corporations should make this information available on their website, as well as including details in annual reports and other published documents.

Offset reporting must be consistent with CACNS guidance. Minimum requirements include:

- a description of the project generating the offset unit
- the type of unit (e.g. Australian Carbon Credit Unit (ACCU), Certified Emission Reduction (CER), Verified Emission Reduction (VER), Verified Carbon Unit (VCU))
- the serial numbers of the units
- the vintage of the units (e.g. 2015)
- the date of retirement/cancellation
- a working hyperlink to the record of cancellation in the public registry.





VicWater

FOR FURTHER INFORMATION CONTACT VICWATER

L2 466 Lt Lonsdale St Melbourne Vic 3000

www.vicwater.org.au