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Comment Submission

For the kind attention of:

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Comments on the Draft CERC (Terms and Conditions for Purchase and Sale of Carbon Credit Certificates) Regulations, 2024

Background

The Regulatory Assistance Project (RAP) thanks the Commission for this opportunity to comment on the Draft CERC (Terms and Conditions for Purchase and Sale of Carbon Credit Certificates) Regulations, 2024.

The regulations are extremely important in light of the nascent stages of implementing a price on carbon emissions in India to unlock least cost reductions of carbon emissions.

We commend the CERC for developing these regulations and appreciate the chance to contribute RAP's insights to advance this effort.

Our interest is to contribute to CERC efforts to reform the country's electricity system, to make it more efficient, achieve important public policy goals, and to contribute to serving the public good in India. We trust that you will find our observations below to be objective, independent, and tailored to support CERC's guidance.

RAP wishes to offer some general comments and some specific comments on the draft regulations, plus some suggestions on the reforms articulated, as follows:

1. RAP lauds CERC´s effort in spelling out roles and responsibilities of different actors and thereby allowing the carbon credit trading scheme to become a reality.

- By allowing companies to trade carbon credits, the mechanism will help unlock least cost carbon abatement in India – CERC´s work allows these benefits to be realised.
- Many of RAP's comments that follow could be taken into consideration as the mechanism evolves over time – the key achievement is to implement the mechanism.

2. The financial penalty for failure to comply, which is key, might be guided by estimates of the social cost of carbon emissions.

- The financial penalty for failure to comply (not covering full carbon emissions with credits) is central for influencing the clearing price and determining carbon abatement effort. Its

formulation – the level it is set at – is not mentioned in the regulation, although it is stated that obligated and non-obligated entities 'cannot place sale bids in excess of total CCCs held in its Registry Account' and that the penalty for repeated failure (three times) is debarring.

- Setting the penalty at the right level is important. There is a case that it should link to estimates of the social cost of carbon emissions at the margin.[1]
- The financial penalty then becomes a cap price that might be achieved on the market. **This means a forbearance price may no longer be necessary or helpful. Debarment might similarly be unnecessary.**
- **To add further confidence that parties will not duck their bills when the carbon emissions associated with their energy sales exceed their credits, a bond might be required.**

3. The details of the interaction of obligated and non-obligated entities are unclear but merit attention

- **To provide additional carbon abatement, the participation of non-obligated entities should not precipitate a change in the total number of carbon credits made available.** So for example, should a big industrial consumer of electricity wish to purchase carbon credits to cover the emissions associated with its electricity consumption, and join as non-obligated entity, then for them to claim they have offset the emissions associated with their consumption, it is important that the credits they purchase lead to an equivalent reduction of credits available for the obligated sector.
- This also means that they should be tradeable between obligated and non-obligated entities. This will also support liquidity.

4. There is a strong case to auction carbon credits rather than to allocate them for free

- The process of allocation of free carbon credits – it is not stated they will be allocated for free, but the absence of reference to an auction mechanism suggests free allocation is likely – will be prone to significant lobbying as interest groups will see this as a zero-sum game. Indeed, allocating credits for free may be popular with incumbents – particularly the most carbon intensive – and help political economy in introduction of the scheme.
- However, drawbacks may be identified in advance:
    - auctioning allows sizeable carbon revenue rents to be captured, presenting a boon for the exchequer which can then be shared with the most vulnerable groups. Allocating them for free foregoes this important source of government revenue. European carbon pricing revenues in 2022 for example were EUR 30 billion.[2]
    - carbon emitters will still charge for the asset (the carbon credits) even when they are grand-fathered. Although this effect should have been anticipated, upon

[1] For instance in the European Union scheme the penalty is 100 euro per tonne of carbon emitted not covered with an allowance. This is around many estimates of the social cost of carbon emission at the margin. https://www.next-kraftwerke.com/knowledge/emissions-trading-scheme-ets#phase-iii-2013-to-2020

[2] https://www.eea.europa.eu/en/analysis/indicators/use-of-auctioning-revenues-generated#:~:text=Under%20the%20EU%20Emissions%20Trading%20System%20(EU%20ETS)%2C%20the,to%20EUR30%20billion%20in%202022.

implementation of the scheme in Europe, it turned the mood in Europe against the grand-fathering system rapidly.[3]

- grand-fathering approach disadvantages new entrants who will not be allocated free allowances.
- as such, the main lesson from the European experience is that there is no reason to leave the rents created by carbon markets to polluting companies.

- **RAP therefore suggests consideration be given to the case for auctioning rather than free allocation of credits.**

6. The need for an ambitiously tight volume of credits and for consideration to the efficient management of interactions with other policy

- The total emissions cap determined by the government is critical, and the government will need information to define it. This may be informed by Security Emissions Constrained Energy Dispatch modelling – which would show the economic value of marginal emissions at different cap levels. Such exercise could also be used to equip regulators with information that may be helpful in monitoring the evolution of the market.
- Furthermore, the cap should take into account the roll-out of renewables and progress in energy efficiency which (other factors constant) may displace carbon-intensive electricity and therefore the demand for credits. Thus, for example, the more effective is renewables policy, the weaker the demand for any given volume of carbon credits, and therefore the tighter should be the total carbon emissions cap in order to produce a robust positive carbon price and to spur on carbon abatement by entities in the carbon credit trading scheme. Interactions with the Renewable Portfolio Obligation – the flagship Government policy in driving new RES build – are therefore of particular importance.

- In 2019 Europe introduced a Market Stability Reserve mechanism[4] which withdraws credits from the system when there is oversupply. This built on learning from the early stages of the European Emissions Trading Scheme when carbon allowance prices were too low to be effective owing to the interaction with renewable energy policy. Prior to this, Britain (when still in the European Emissions Trading Scheme) used a ´carbon price adder´ to provide a floor[5] on the carbon price (the sum of the EU carbon allowance price plus the British carbon price adder). **Thus RAP suggests consideration to a form of dynamic mechanism to adjust the supply of credits. Failing that a carbon price adder might be considered.**

- **As a result, floor prices may therefore no longer be necessary**. Indeed, floor prices mask that the total emissions cap merits tightening, and may achieve little as the floor price kicks in when there is an abundance of credits and therefore few parties undertaking carbon abatement effort.

7. Making the scope as wide as possible as early as possible may help limit unintended consequences, such as discouraging electrification.

- The scheme helps to put a price on carbon in sectors, most notably power. If however the decarbonisation process in India entails the electrification of end uses – like heat, mobility, industrial processes – that currently use other forms of energy as input, then the imposition of

[3] https://link.springer.com/article/10.1007/s10657-009-9098-6

[4] https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/market-stability-reserve_en

[5] https://commonslibrary.parliament.uk/research-briefings/sn05927/

a carbon price on electricity but not these other forms of energy may disincentivise electrification that is beneficial from a societal perspective. This points to the merit of subsequent effort to widen the scope of the scheme.

We hope the comments above assist with finalization of the Draft CERC (Terms and Conditions for Purchase and Sale of Carbon Credit Certificates) Regulations, 2024.

Once more, we wish to applaud CERC for developing these critical regulations, and we lend our support to the reforms and advances articulated therein.

Thank you for this opportunity to comment. If we can be of further assistance, please do not hesitate to contact. We would be keen to collaborate with CERC on these and related matters.

Sincerely,

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