Submission to consultation on the intended proposal to introduce further qualitative restrictions on the use of CERs for compliance with the European Union Emissions Trading Scheme

3 November 2010

1 Background

1.1 The European Union Emissions Trading Scheme ("**EU ETS**") is a European Union wide carbon dioxide cap-and-trade system under which installations with compliance obligations must surrender allowances to match their reportable emissions of carbon dioxide over the relevant compliance year. Under the rules of the EU ETS, most types of Certified Emission Reductions ("**CERs**") CERs that may not be used are those from LULUCF, nuclear, and Large Scale Hydro projects where there is no compliance with the WCD criteria. In addition, CERs previously surrendered for compliance in the EU may not be used for compliance again. can be used by an installation to comply with its obligations (up to a certain limit of reportable emissions).

1.2 On 25 August 2010, Connie Hedegaard, European Commissioner for Climate Action issued a statement saying "*I have asked my services to prepare a proposal for a measure to introduce further quality restrictions on the use of credits from industrial gas projects in the post-2012 EU ETS*". An EU Commission proposal is expected by the end of November.

1.3 DG Climat has opened a consultation to gather stakeholder views on qualitative restrictions.

1.4 Mexico benefits from more than a hundred Clean Development Mechanism ("**CDM**") projects. Of the roughly 2.9 million CERs issued in respect of Mexican projects in 2008, around 2.1 million were issued in respect of one project, an industrial gas project.

1.5 This submission highlights international impacts of restricting the use of industrial gas CERs in the EU ETS.

2 Qualitative restrictions would fail to recognise the importance of large CDM projects to developing country GDP

2.1 Large projects tend to generate large numbers of CERs. The majority of host governments for these projects place a levy or tax of some form on the activities of these projects. As a result, a large project can have a significant uplifting effect on the GDP of the state or country in which the project is located. Mexico is a good example. Benefitting from many projects, Mexico nonetheless has one project that was responsible for more than 70% of the issued CERs for Mexico in 2008. This is an industrial gas project. To the extent that restrictions in the EU limit the market for CERs from this project, the CERs can be expected to become heavily discounted, diminishing the benefit of the project to Mexico as a whole.

2.2 It is important to ensure that the EU Commission and Member States are aware of the dynamic of "key" projects and we believe that the EU Commission and Member States should consider the particular dynamics of host countries that rely heavily on one or two industrial gas projects for CDM-related development finance, notwithstanding that such a country may host many projects.

3 Qualitative restrictions would fail to re-direct the CDM towards LDCs.

3.1 We understand the EU goal of trying to ***redirect*** the CDM to incentivise investment in Least Developed Countries ("**LDCs**").

3.2 However, it appears to us that the strategy of the EU of limiting the use of CERs from industrial gas projects for compliance with the EU ETS would not serve to support those aims. It is unlikely that companies required to comply with EU ETS obligations would instead invest capital in CDM projects in LDCs (or in other project types/host countries from which CERs may still be used in the EU ETS) in order to obtain CERs in order to meet their compliance needs. As a result, qualitative restrictions would not further the EU's goal of ***redirecting*** the CDM to benefit LDCs.

3.3 Instead, it appears to us that the above stated EU aims would be better achieved by supporting the overhaul of the CDM into a financial mechanism capable of overcoming the barriers to investment in LDCs and other less popular CDM host countries and by continuing the important CDM capacity building work of the EU and Member States.

4 Qualitative restrictions are the wrong way of resolving problems in the CDM

4.1 We recognise the EU's concern about the ability of the rules of the CDM to ensure that CERs represent real and additional emissions reductions from projects that promote sustainable development. However, we believe that restricting use of industrial gas CERs will hinder that goal, not further it.

4.2 We take this view because the CDM relies on private investment for its success. In the event that use of CERs from industrial gas projects in the EU ETS is excluded in Phase III EU ETS, the carbon markets will be seriously undermined by fragmentation. EU aims of redirecting the CDM would become even more difficult because the investment in the CDM as an EU ETS compliance tool will be greatly diminished.

4.3 We believe that the EU Commission should take seriously investors' increasing concerns that the CDM no longer constitutes a viable investment strategy. At the current time there is already a serious crisis of trust in the CDM Executive Board's decision-making process. As the CDM is dependent on private sector investment, further actions that undermine market certainty may cause investment in the CDM to collapse altogether. This would be disastrous for all Kyoto parties.

5 Conclusion

5.1 We recognise the EU's right to decide how to seek to incentivise progress to a global low-carbon economy but urge the EU Commission and its Member States to refrain from adopting qualitative restrictions for Phase III of the EU ETS for the time being and to conduct an impact assessment of qualitative restrictions on CDM host countries and on the stability of the private sector carbon market.

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