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ClientEarth legal analysis

Possible actions at EU level to restrict certain type of CDM projects: HFC-23 destruction projects

ClientEarth has been asked to provide a legal opinion about the possible actions that the EU could adopt before and from 2013 regarding measures to restrict the use of certified emission reduction units (CERs) generated from certain types of projects, namely the HFC-23 offsetting projects under the Clean Development Mechanism (CDM).

The current legal opinion analyses relevant provisions of the UN Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol to the UNFCCC as well as the Montreal Protocol on substances that deplete the ozone layer, as International Agreements that are part of EU law and it is needed to clarify whether they have been breached. Critical to this issue is the assessment of Articles 11a(9), 11a(2) to (5) and 11b) of Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community (ETS Directive 2003/87/EC). These provisions purport for a range of measures the EU could adopt to restrict the use of specific credits from certain project types. In addition, the briefing looks into further options under the ACP-EC Partnership Agreement, known as the Cotonou Agreement.

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1. Executive summary of options for action

Under Clean Development Mechanism (CDM), states and operators have the choice to offset domestic emissions by investing in emissions reduction projects in developing countries or acquiring at the international market emission reduction credits generated from this type of projects. EU Member States are the major market for carbon credits generated by HFC-23 (trifluoromethane) destruction projects used to offset GHG emissions under the CDMs system linked to UNFCCC implementation.

HFC-23 is an unwanted by-product from the production of HCFC-22 which is a refrigerant gas to be phased out under the Montreal Protocol on substances that deplete the ozone layer (Montreal Protocol). The destruction of HFC-23 is much cheaper than the price of the CERs generated by them according to the carbon price per tonne of emission and thus companies have decided to produced higher quantities of HCFC-22 in order to extract the economic profit that destroying HFC-23 reports due to the CDM, increasing the level of greenhouse gas (GHG) emissions, contrary to the ultimate objective of the UNFCCC, the Kyoto Protocol, the ETS Directive 2003/87/EC and the Montreal Protocol.

The requirements under the UNFCCC and the Kyoto Protocol are applicable under EU law and therefore projects not complying with them should be considered in breach of EU law. HFC-23 projects infringe the Kyoto Protocol requirements to ensure reduction of GHG emissions and to achieve sustainable development in the countries benefiting from the project activity. It requires CDM projects to be supplemental to domestic action and to ensure emission reductions additional to those occurring without the CDM project activity. In addition HFC-23 projects go against the objective and spirit of the Montreal Protocol to reduce emissions from the Annex C substances.

The European Commission has the competence under article 17 of the Treaty on the European Union (TEU) to state what the EU law requires and to act accordingly. Under article 17 TEU the Commission could declare that HFC-23 projects breach EU law requirements on CDM and therefore should be considered invalid. The HFC-23 projects would therefore be neither eligible for use in the EU scheme nor for registration during the period 2008-2012. The European Commission would need to adopt a formal decision while making such a declaration on this type of projects' ineligibility in order to ensure it is legally binding to Member States and that it complies with the requirement of legal certainty required by the ETS Directive 2003/87/EC.

The Commission can adopt a decision at any time (e.g. in 2010) declaring unlawful HFC-23 offsetting projects and therefore non valid at EU level. This decision would imply that EU Member States would not be able to co-finance this type of projects or use CERs generated from them with the aim to offset domestic emission. It would be applicable from the date of its adoption and therefore would affect HFC-23 projects from the date of the decision's adoption. Such a decision would be legally binding.

The European Commission has indicated its intention to restrict the use of CERs generated from HFC-23 destruction projects.

The EU ETS Directive 2003/87/EC (Article 11a(9) as amended in 2009) enables the EU to adopt measures imposing restrictions applicable from January 2013 on the use of specific CERs generated through certain types of CDM projects. These measures could have specific effects before 2013 if they relate to the rules governing the process for exchanging CERs into EU allowances over Phase 3, established under Article 11a(2-4).

The Commission is empowered to adopt through Comitology a decision establishing a total restriction on the use of credits from HFC-23 destruction projects. This decision should also state that the use of credits generated from HFC-23 destruction projects to be exchanged for EU allowances under paragraphs 1 to 4 of article 11a should be in accordance with the total restriction measure from the date of 6 months from the adoption of the decision. Therefore, 6 months after the decision is taken, HFC-23 destruction projects could be considered ineligible in the EU system under article 11a(2) and their registration under article 11a(3) would be banned in the ETS. That decision would not allow EU Member States investments in HFC-23 projects. This decision would ensure consistency and implementation of the first sentence of Article 11a(9). Indeed if CERs from projects during phase 2 but ban from 2013 were eligible and registered and allowed to be swapped with allowances in 2013, this would be against the principal decision that credits from this type of projects could not be used from January 2013.

The Cotonou agreement is the appropriate legal framework to implement certain decisions by the EU such as a total restriction in the use of CERs from HFC-23 destruction projects. The EU could insert certain conditions on the basis of climate change objectives in the relationships with ACP countries. This would allow the EU to reinforce its leadership role on climate change and broaden the implementation of climate change commitments outside the EU. Through the implementation of the Cotonou Agreement the EU could ensure that specific projects that are considered not-eligible or invalid by the EU due to its breach with EU law and their climate change impact are also excluded from all bilateral agreements with ACP countries signed on the basis of the current Partnership Agreement.

2. Background

The environmental organisation CDM Watch has provided evidence[1] to the UN Management Board and to the European Commission on the environmental/climate change impact generated by the recognition of HFC-23 destruction projects as valid offsetting projects under the Clean Development Mechanism (CDM). However no decision has still been made by the international body in charge of managing the CDM system.

At the EU level, the Council of the EU set out clearly in its Conclusions of 21 October 2009 that it "considers that no new CDM projects involving HFC-23 emission reductions from HCFC-22 production should be available and that other initiatives for HFC-23 destruction should be found, while existing CDM projects should be honoured." Recently the European Commission announced that future measures were being studied to impose restrictions to certain types of CDM projects[2]. Later on, the statement issued by Commissionaire Hedegaard

[1] http://www.cdm-watch.org/wordpress/wp-content/uploads/2010/06/hfc-23_press-release_gaming-and-abuse-of-cdm1.pdf or http://www.cdm-watch.org/?p=1209

[2] Commission Communication 26 May 2010 "Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage"

on 25 August 2010[3] confirmed that the Commission has formally started the process for developing a proposal for qualitative restriction on credits from industrial-gas projects in the post 2012 EU ETS.

This document aims at setting the legal framework for potential action from the European Union to restrict the use of CERs generated from HFC-23 destruction projects before 2013 and from that date onwards.

3. **HFC-23 offset projects**[4]

The Clean Development Mechanism (CDM) is one of the flexible mechanisms established by the UN Framework Convention on Climate Change (UNFCCC) and its Kyoto Protocol to enable States to achieve their permissible emission quota as cost-effectively as possible. Under this system, states and operators have the choice to offset domestic emissions by investing in emission reduction projects in developing countries or acquiring in the international market emission reduction credits generated from this type of projects.

EU Member States are the major market for carbon credits generated by HFC-23 (trifluoromethane) destruction projects used to offset GHG emissions under the CDMs system linked to UNFCCC implementation.

Every CDM project is registered with the UN Executive Board and must be based on an "approved methodology". Therefore each CER is associated with a given project methodology. The UN Executive Board has the capacity to determine whether specific CDM projects should be validated to generate CERs that can be used to offset emissions in other countries.

HFC-23 is an unwanted by-product from the production of HCFC-22 which is a refrigerant gas to be phased out under the Montreal Protocol on substances that deplete the ozone layer (Montreal Protocol). HFC-23 is a greenhouse gas with a Global Warming Potential of 11,700. Therefore, its destruction can potentially generate substantial numbers of offset credits. The number of CERs generated by a HFC-23 destruction project corresponds to an equal number of tonnes emitted. Since the destruction of HFC-23 is much cheaper than the price of the CERs generated by them according to the carbon price per tonne of emission, the companies producing HCFC-22 have generated a profit from the destruction of HFC-23 that is five times higher than the benefits from selling HCFC-22. Thus companies have produced unnecessary HCFC-22 in order to extract the economic profit that destroying HFC-23 reports. In other words, manufacturers are producing the gas in higher quantities than they would under normal market conditions in order to benefit from the profits generated by the CDM system.

These decisions of higher quantities of production have increased the level of greenhouse gas (GHG) emissions, contrary to the ultimate objective of the UNFCCC, the Kyoto Protocol and the ETS Directive 2003/87/EC.

[3] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/387&format=HTML&aged=0&language=EN&guiLanguage=en
[4] http://www.cdm-watch.org/?page_id=21 and CARBON UPDATE: A Reminder of the Rules on Using CERs/ERUs in the EU-ETS, Carbon Emissions, October 2010, Deutsche Bank

4. Legal requirements for CDM projects - the Kyoto Protocol

As stated above, the Clean Development Mechanism (CDM) enables Parties to the UNFCCC and the Kyoto Protocol to offset their own emissions by co-financing emission reduction projects elsewhere in developing countries. Under the CDM mechanism the investor from an Annex I country would co-finance a project within a non Annex I country and would therefore be allocated those emissions saved by the project as so-called 'certified emission reduction units' (CERs). Similarly Parties could offset their domestic emissions by acquiring in the international market CERs generated by those emission reduction projects in developing countries

The UNFCCC and the Kyoto Protocol require certain conditions to be met by the projects to generate emission reductions that are certified under the CDM.

The first general requirement applicable to any CDM project relates to the ultimate objective to **reduce greenhouse gas (GHG) emissions** as pursued by the Kyoto Protocol following Article 2 of the UN Framework Convention on Climate Change which states that its ultimate objective is "to achieve stabilization of GHG concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system."

Implementing this obligation derived from the above-mentioned International Agreement, Article 1 of the ETS Directive states that the Directive's objective is "…to promote reductions of GHG emissions in a cost-effective and economically efficient manner" and "…the reductions of greenhouse gas emissions to be increased so as to contribute to the levels of reductions that are considered scientifically necessary to avoid dangerous climate change". All CDM projects should therefore comply with this requirement and ensure reduction of GHG emissions.

Under the Kyoto Protocol, Article 12(2) states that the "purpose of the clean development mechanism shall be to assist Parties not included in Annex I in achieving **sustainable development** and in contributing to the **ultimate objective** of the Convention". This provision therefore should be applied to all CDM projects that would aim at achieving sustainable development in the countries benefiting from the project activity.

Article 12(5)c) calls for the "**additionality**" of projects requiring them to result in "Reductions in emissions that are additional to any that would occur in the absence of the certified project activity". In addition article 12(5)b) requires projects to provide "real, measurable and long-term benefits related to the mitigation of climate change".

The Marrakesh Accords further specify this requirement through the setting of the baseline stating that "A CDM project activity is additional if anthropogenic emissions of greenhouse gases by sources are reduced below those that would have occurred in the absence of the registered CDM project activity. The baseline for a CDM project activity is the scenario that reasonably represents the anthropogenic emissions by sources of greenhouse gases that would occur in the absence of the proposed project activity."

All CDM projects are required, therefore, to comply with the additionality criteria and bring forward emissions reductions additional to the ones that are already required by law or that would have occurred without the CDM project activity .

The Marrakesh Accords (CP.7 decision 15 No. 1) go beyond and establish the requirement of "**supplementarity**" for investor countries of CDM projects which should pursue an independent climate policy apart from the CDM measure. Countries parties to the UNFCCC are therefore required to put in place climate policies that reduce domestic emissions additional to the ones cuts through the use of CDM projects.

At EU level these provisions are legally binding because the Kyoto Protocol was ratified by the EU and became part of EU Law (the acqui communautaire) through Council Decision 2002/358/EC of 25 April 2002 concerning the approval, on behalf of the European Community, of the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the joint fulfilment of commitments thereunder[5]. Obligations established in International Agreements ratified by the EU are considered EU Law regardless whether they are translated in specific provisions of EU law or not.

The ETS Directive 2003/87/EC[6] limits the use of credits from CDM projects to 50% of the EU wide reductions below the 2005 levels of the existing sectors under the EU scheme over the period from 2008 to 2020. This limitation requires therefore EU Member States to develop climate policies that ensure domestic emissions reduction others than the credits from CDM projects. Article 30(3) establishes reporting obligations to ensure that the use of CDM mechanism is supplemental to domestic action. Recital 19 of the ETS Directive 2003/87/EC as modified in 2009 refers to this principle stating that "…the use of the mechanisms should be supplemental to domestic action and domestic action will thus constitute a significant element of the effort made."

Similarly, Article 11b paragraphs (3) and (4) of the ETS Directive 2003/87/EC as amended by the linking Directive 2004/101/EC requires CERs to be issued only if an equal number of allowances is cancelled by the operator of that installation. Thus, supplementarity and avoidance of double counting are expressly required.

Financing partners are bound by the criteria and requirements of the Kyoto Protocol and the UNFCCC. It is worth noting that CDM projects financing does not rely solely on Member States and operators as the investors. CDM projects are developed bilaterally, but from an economic perspective investors are free to link up and create funds. For example the World Bank established the Prototype Carbon Fund as a private-public partnership between states and private actors.

5. The EU power to act on CDM projects in breach of EU law

This section aims at determining whether HFC-23 destruction projects under the CDM system comply with the legal requirements applied in the EU or whether they breach EU law.

[5] OJ L 130, 15.5.2002
[6] Article 11a(8, fifth para)

5.1 Breach of International Agreements requirements: the Kyoto Protocol

The CERs generated from HFC-23 destruction projects have been issued in breach of the general ultimate objective to reduce GHG emissions as stated under article 2 of the UNFCCC, the Kyoto Protocol and Article 1 of the ETS 2003/87/EC Directive. The ultimate objective of the UNFCCC as stated in its Article 2 is to achieve stabilization of GHG concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system. These projects have acted as an incentive for the production of the HCFC-22 gas increasing the level of GHG emissions. The validation of these projects under the CDM system has provoked manufacturers to produce the gas in higher quantities than they would under normal market conditions in order to benefit from the profits generated by the selling of the CERs from HFC-23 destruction projects in the carbon market. The destruction of the HFC-23 is cheaper than the carbon price per tone of emission paid for every CER generated.

In addition the HFC-23 destruction projects do not comply with the objective requiring the achievement of sustainable development in the countries where investments are financed. This requirement is set out by Article 12(2) of the Kyoto Protocol. The concept of sustainable development is defined with reference to three components: economic, environmental and social elements. The adverse environmental impact of this type of CDM projects is clear: there is an increase of GHG emissions caused by the higher production of HCFC-22 in order to sell the CERs generated from HFC-23 destruction projects at the carbon market price and provide large economic profits to the manufactures. The requirement of achieving sustainable development is not met neither in the countries where the project was financed nor elsewhere. The adverse environmental impact is not specific to the countries where investments are made but it also affects them as part of the global climate change impact. Therefore, the environmental component of this type of CDM projects is absent.

Furthermore, these projects are in breach of the additionality requirement for CDM projects set out in Article 12(5) of the Kyoto Protocol. The HCF-23 destruction projects had to be executed as part of the Montreal Protocol requirements. The emission reductions would have happened anyway in the absence of the certified project activity.

International Agreements concluded by the EU should be considered part of EU Law. According to Article 216 (2) TFEU agreements concluded by the Union are binding upon the institutions of the Union and on its Member States. In addition, Article 3(5) TEU provided that the Union shall contribute to, amongst other goals, 'the strict observance and the development of international law, including the respect of the principles of the United Nations Charter'.

The UNFCCC and Kyoto Protocol have been ratified by the EU and are part of EU law. Council Decision 94/69/EC, adopted to ratify the UNFCCC, and Council Decision 2002/358/EC concerning the approval, on behalf of the European Community, of the Kyoto Protocol to the UNFCCC and the joint fulfillment of commitments thereunder, are the legal basis under which obligations under these International Agreements become part of the EU Law.

The European Court of Justice has repeatedly recognized the value of International Agreements signed by the EU as high ranking EU legislation. In the case IATA and ELFAA v Department of Transport (C-344/04) the Court states:

"Article 300(7) TEC provides that 'agreements concluded under the conditions set out in this Article shall be binding on the institutions of the Community and on Member States'. In accordance with the Court's case-law, those agreements prevail over provisions of secondary Community legislation (Case C-61/94 *Commission* v *Germany* [1996] ECR I-3989, paragraph 52, and Case C-286/02 *Bellio F.lli* [2004] ECR I-3465, paragraph 33)."

The requirements under the UNFCCC and the Kyoto Protocol are applicable under EU law and therefore projects not complying with them should be considered in breach of EU law. HFC-23 projects infringe obligations under EU law and CERs generated from them should not be used by Member States to offset their emissions. The European Commission should ensure implementation of EU law by Member States operating in the CDM market or financing CDM projects.

5.2 Breach of International Agreements requirements: the Montreal Protocol

HFC-23 projects are subject to compliance with the **Montreal Protocol** on substances that deplete the ozone layer, since it is a by-product of HCFC-22, a Hydrochlorofluorocarbon listed in Annex C of the Montreal Protocol as an ozone depleting substance in addition to its greenhouse gas character.

The Montreal Protocol has been ratified by the European Union through the Council Decision 88/540/EEC concerning the conclusion of the Vienna Convention for the protection of the ozone layer and the Montreal Protocol on substances that deplete the ozone layer[7]. It is therefore part of the EU Law as described in previous section 5.1.

Article 2F of the Montreal Protocol was modified, in 2007 by the nineteenth meeting of the Parties, regarding substances in Annex C. It requires Parties to freeze, at the baseline level, the consumption and production of all Annex C substances by 2013.
It also requires Parties other than developing countries to complete the phase out of production and consumption by 2020 on the basis of the following reduction steps: 75% by 2010; 90% by 2015 while allowing 0.5% for servicing the period 2020-2030.

HFC-23 destruction projects have increased HFCF emissions in breach of the gradual phase out obligation required by the Montreal Protocol.

Even thought the steps applied to developing countries are different[8], the EU Member States should not be allowed to finance offsetting emissions projects that are contrary to the EU obligation to reduce in more than 75% the consumption and production of HCFC-22 gas which is an ozone depleting gas as well as a powerful GHG. Similarly EU Member States should not be allowed to acquire CERs and offset domestic emissions that come from projects in contradiction to the EU obligation of phasing out under the Montreal Protocol.

[7] OJ L 297, 31.10.88

[8] 10% by 2015; 35% by 2020; 67.5% by 2025 while allowing for servicing an annual average of 2.5% during the period 2030-2040.

Under Article 21(3) of the Treaty of the European Union and article 7 of the Treaty on the Functioning of the European Union, the EU External policies should respect the principle of consistency between internal and external policies. According to Article 21(3) TEU, the Union is under a duty to 'ensure consistency between the different areas of its external action and between these and its other policies.'

The internal obligation of EU Member States and the EU itself to gradually phase out the production and consumption of HCFC-22 should also be applied in relation to the EU's and Member States' external actions including interventions in the international market for emission credits such as the CERs generated from CDM projects or simply funding these type of projects.

The EU Member States have an internal obligation to phase out HFCF gases. Therefore, even if it might be difficult to determine the impact of specific projects in the quantitative reduction target applied to the relevant developing countries, the EU should not allow Member States to finance projects or use CERs from projects that go against the reduction objective of the Montreal Protocol even if projects are outside the EU borders.

In addition, EU Member States actions of financing this type of CDM projects or using CERs from them would go against the general spirit of the Montreal Protocol to reduce emissions from the Annex C substances.

On this basis the European Commission should ensure the Montreal Protocol enforcement and should not allow EU Member States finance in countries outside the EU, projects that do not comply with the internal legislation.

5.3 The EU competence to act on CDM projects in breach of EU law

The European Commission has the competence under article 17 of the Treaty on the European Union (TEU) to state what the EU law requires and to act accordingly. The European Commission therefore has the competence to declare that the HFC-23 projects infringe obligations under EU law.

Under article 17 TEU the Commission could declare that HFC-23 projects breach EU law requirements on CDM and therefore should be considered invalid. The HFC-23 projects do not comply with these international provisions that are part of EU law and have a higher ranking in EU Law than secondary legislation provisions. As described in section 4 the European Court of Justice stated in the *IATA and ELFAA v Department of Transport* [9] case that:

> "Article 300(7) TEC provides that 'agreements concluded under the conditions set out in this Article shall be binding on the institutions of the Community and on Member States'.
> In accordance with the Court's case-law, those agreements prevail over provisions of secondary Community legislation (Case C-61/94 *Commission* v *Germany* [1996] ECR I-3989, paragraph 52, and Case C-286/02 *Bellio F.lli* [2004] ECR I-3465, paragraph 33)."

[9] Case C-344/04, *IATA and ELFAA v Department of Transport*

On this basis, the Commission is entitled to declare that HFC-23 projects breach EU law requirements on CDM and therefore are neither eligible for use in the EU scheme nor for registration during the period 2008-2012. The European Commission would need to adopt a formal decision while making such a declaration on this type of projects' ineligibility in order to ensure it is legally binding to Member States and that it complies with the requirement of legal certainty required by the ETS Directive 2003/87/EC. Indeed, recital 29 of Directive 2009/29/EC amending Directive 2003/87/EC refers to the predictability needed by operators, which need to be provided with certainty about the possibility to use CERs after 2012 which they were allowed to use in the period 2008 to 2012 from project types which were eligible for use in the Community Scheme during the period from 2008 to 2012. However, the same recital 29 requires the respect of the environmental requirements by all CDM projects for their credits to be used by operators and states:
"It is important that credits from projects used by operators represent real, verifiable, additional and permanent emission reductions and have clear sustainable development benefits and no significant negative environmental or social impacts. A procedure should be established which allows for the exclusion of certain project types."

The Commission's enforcement power under Article 17 TEU justifies such a Commission decision as the projects breach EU law requirements. The European Commission decision would ensure the legal certainty amongst Member States and operators which would be able to apply it and recognize that HFC-23 destruction projects are unlawful according to EU law and therefore non-eligible nor up for registration in the EU scheme from the date of the Commission decision. Similarly from that date, HFC-23 destruction projects could not be co-financed by EU Member States during the period between the decision and 2012 and CERs generated from HFC-23 destruction projects could not be used up to 2012 or swapped for allowances from 2013 under article 11a(2 and 3). Similarly Article 30(3) of the ETS Directive 2003/87/EC as revised in 2009 enables the Commission to make legislative or other proposals, in light of its report under Article 5 of Decision No 280/2004/EC, to ensure that the use of the CDM mechanism is supplemental to domestic action within the EU.

There is nothing that prevents the European Commission from declaring through a decision, adopted for example in 2010, that certain type of projects are unlawful because they breach EU law on CDM (as stated above) and therefore are invalid in the EU system and non-eligible for co-financing by EU Member States or for use of their CERs in exchange of allowances under the ETS.

The Commission can adopt a decision at any time (e.g. in 2010) declaring unlawful HFC-23 offsetting projects and therefore non valid at EU level. This decision would imply that EU Member States would not be able to co-finance this type of projects or use CERs generated from them with the aim to offset domestic emission. It would be applicable from the date of its adoption and therefore would affect HFC-23 projects from the date of the decision's adoption. Such a decision would be legally binding.

The Commission therefore could challenge Member States if it had failed to fulfill its obligation under the International agreement which has become part of EU law. This Commission act would be based on Article 258 of the TFEU which enables it to bring the matter before the Court of Justice of the EU. In addition, Article 11b(5) of the ETS 2003/87/EC Directive requires Member States to ensure that participation of private or public

entities authorized by the State is consistent with the guidelines, modalities and procedures adopted pursuant to the UNFCCC and the Kyoto Protocol. Member States could therefore be made responsible if CDM projects financed by them are not in compliance with requirements under the UNFCCC and the Kyoto Protocol.

Since the UNFCCC Management Board has not yet taken a decision on the CDM Watch information regarding the validity of HFC-23 destruction projects under the CDM system, the European Commission can take the decision on the basis of the implementation of the UNFCCC and the Kyoto Protocol provisions as part of EU Law.

6. The EU power to impose restrictions on the use of credits from certain type of projects under the ETS Directive

Article 11a(9) of the ETS Directive 2003/87/EC enables the Commission to apply measures to restrict the use of specific credits from project types from the 1st of January 2013. The implementation of restrictions from 2013 would require that CERs from phase 2 are not allowed to be swap for EU allowances from 2013. Therefore for consistency, the Commission should ensure that these credits cannot be swap for allowances in 2013. This can be done by setting through the CDM restriction measure act the date in phase 2 from which CERs from this type of projects cannot be generated or registered so that they can be swap for allowances from 2013 as allowed under article 11a(2 and 3). According to Article 11a(9) second para, this date could be six months from the adoption of the measure.

Sections 3 to 5 show that HFC-23 destruction projects do not comply with EU law. This section therefore analyses what actions could the EU take under the ETS Directive 2003/87/EC to restrict this type of CDM projects.

The Kyoto Protocol allows for the introduction of restrictions to certain type of projects. At an EU level, since the first phase of the EU ETS, the EU has established restrictions to certain type of CDM projects through 2004/101/EC Directive amending the ETS 2003/87/EC. In line with the Kyoto Protocol, Article 11b(6) of the ETS 2003/87/EC Directive requires that the hydroelectric power production project activities with generating capacity exceeding 20 MW, comply with relevant international criteria and guidelines, including those contained in the World Commission on Dams November 2000 Report. Additional restrictions could therefore be adopted by legislative measure through ordinary legislative procedure in the future, as considered in section 6 below.

In addition, Article 1 of Directive 2004/101/EC[10] applying the provisions of the Kyoto Protocol introduced an Article 11a(3) in the ETS Directive 2003/87/EC states: "All CERs and ERUs that are issued and may be used in accordance with the UNFCCC and the Kyoto Protocol and subsequent decisions adopted thereunder may be used in the Community scheme:

a) Except that, in recognition of the fact that, in accordance with the UNFCCC and the Kyoto Protocol and subsequent decisions adopted thereunder, Member States are to refrain from using CERs and ERUs generated from nuclear facilities to meet their commitments pursuant to article 3(1) of the Kyoto Protocol and in accordance with decision

[10] OJ L 338/18 13.11.2004

2002/358/EC, operators are to refrain from using CERs and ERUs generated from such facilities in the Community scheme during the period referred to in article 11(1) and the first five year period referred to in Article 11(2).

and

b) Except for CERs and ERUs from land use, land use change and forestry activities."

The above mentioned provisions are legal limitations to the use of certain type of CDM projects. CERs issued from other type of projects than the ones referred to by Article 11a(3) of the ETS Directive 2003/87/EC may be used by Member States and operators. However the use of may under article 11a(3) introduced by article 1 of Directive 2004/101/EC can be interpreted in 2 different ways: the first one as offering a possibility to use CERS from all other project types that are in accordance with the UNFCCC and the Kyoto Protocol without limitation and a second one giving some further discretion power to the Member States or the EU as Parties to the UNFCCC to decide on further limitations.

It is acknowledged that, as presented above, the existing limitations have been introduced expressly by articles in the ETS Directive 2003/87/EC in order to reflect decisions under the Kyoto Protocol. Further restrictions could be taken by legislative act adopted through ordinary legislative procedure (ex-codecision). However these provisions require that CERs are issued in accordance with the UNFCCC and the Kyoto Protocol. This is the basic requirement that needs to be monitored and would justify action to ensure enforcement and implementation of EU legislation. As stated in the previous section, we conclude that the EU can take a decision declaring HFC-23 projects unlawful under EU law and initiate corresponding enforcement actions.

In addition, the EU ETS Directive 2003/87/EC (as amended in 2009) provides the power to adopt measures imposing restrictions applicable from January 2013 on the use of specific CERs generated through certain types of CDM projects. These measures could have an effect before 2013 if they relate to the rules governing the process for exchanging CERs generated in phase 2 across to phase 3 (banking) as anticipated under Article 11a(2-4).

Article 11a(9) CDM restriction measures

Under the ETS Directive 2003/87/EC, Article 11a(9) empowers the EU to apply measures from January 2013 that would restrict the use of credits that have been generated from certain project types.
Article 11a(9) paragraph 1 provides as follows:

"From 1 January 2013, measures may be applied to restrict the use of specific credits from project types.

These measures should be adopted through the Comitology regulatory procedure with scrutiny (as set out in Article 23(3) of the ETS Directive). The initiative to adopt such a measure could be taken by the Commission (on its right of initiative) but Member States can also request it and the Commission is therefore obliged to consider submitting to the Committee a draft of the measures to be taken.

The EU could therefore adopt measures to restrict the use of credits from certain type of projects from 2013. However the EU ETS Directive 2003/87/EC does not establish any criteria for what type of projects could be subject to restrictions. ClientEarth has highlighted in previous sections that projects that are not in accordance with the UNFCCC and the Kyoto Protocol (as required by Article 11a(3) of the ETS Directive 2003/87/EC as amended by Directive 2004/101/EC) could certainly be subject to restrictions.

The language of article 11a(9) refers to measures being applied from 2013. However, it does not prevent the measures from being *adopted* earlier than January 2013 or the measures prohibiting banking of certain types of phase 2 credits from January 2013 onwards. Thus, the measures would only be applicable from 2013 but could be adopted earlier and should prevent use of certain phase 2 credits during phase 3.

However under the second paragraph of Article 11a(9) the restriction measures adopted could potentially be applied before.

Article 11a(2) – projects should not be eligible for use under phase 2 – CERs from restricted type of projects cannot be swap with EUAs from 2013

Article 11a(9) para2 states: "Those measures shall also set the date from which the use of credits under paragraphs 1 to 4 shall be in accordance with these measures." This date can be 6 months from the adoption of the measure or any other date set.

Under this provision, the EU is required to include in the CER restriction measures specific provisions setting up the date from which the use of credits under Article 11a(2) should be in accordance with the restriction measure. Article 11 a(2) refers to the exchange of CERs issued in respect of emission reductions up until 2012 from projects which were eligible for use during the period 2008-2012 for EU allowances valid from 2013 onwards. Article 11a(2) states:

> "…operators may request the competent authority to issue allowances to them valid from 2013 onwards in exchange of CERs and ERUs issued in respect of emission reductions up until 2012 from project types which were eligible for use in the Community scheme during the period from 2008 to 2012."

In other words, the exchange of CERs for EUAs under Article 11a(2) should be in accordance with the Article 11a(9) measures to restrict the use of credits from certain type of projects. Therefore if certain type of projects were ban from 2013 through a decision in 2010, the EU could declare that 6 months after the adoption of such decision, the credits generated from those types of projects from 6 months of the date of the decision's adoption could not be swapped for allowances valid from 2013. In practice the type of projects under restriction would not be able to generate CERs as operators would know that they would not be allowed for exchange of EU allowances from 2013.

The wording of Article 11a(2) refers to eligible projects in the EU during the period 2008 to 2012. The reference to project types eligible for use in the EU scheme allow to argue that the EU can determine at any time what type of projects are eligible for use during the period 2008 to 2012. This power is even clearer when this decision is based on the argument that this type of projects do not comply with EU law.

Thus, the CER restriction measures could inform decisions about what projects are non-eligible under Article 11a(2) and could not therefore generate credits to be used to claim allowances from 2013. In the current case, as the HFC-23 projects are in breach of EU law introduced by provisions of international agreements such as the UNFCCC ultimate objective and the Kyoto Protocol requirements for CDM projects as well as the spirit of the Montreal Protocol, the EU is justified to decide on the non-eligibility of this type of projects from 6 months after the adoption of the Comitology decision.

ClientEarth considers that under article 11a(9) the Commission could set a date prior to January 2013, which would be (the earliest) 6 months after the adoption of the Comitology decision, when specific CDM restriction measures regarding certain type of projects could be taken into account for implementing article 11a(2). The Comitology decision adopting measures for restricting the use of credits from HFC-23 offsetting projects could therefore inform decisions declaring that HFC-23 destruction projects could not be considered eligible at EU level from the date of 6 months after the adoption of the Comitology measure which could be adopted anytime during the period 2008-2012. Those projects would not be available for funding from EU Member States or operators and would not generate CERs that would be exchangeable for EU allowances from 2013.

This decision would ensure consistency with the measure to be applied from January 2013. Indeed, if CERs from HFC-23 projects were allowed to be swapped with allowances from 2013, the measure banning these type of projects from January 2013 would not have any effect. It is necessary that operators in the market understand that specific type of projects banned from 2013 should not be generating CERs during phase 2 as they would not be able to be swapped with allowances from 2013.

This decision would apply to credits from projects eligible during the period 2008-2012 but that would be exchanged for allowances from 2013 in respect to emission reductions up to 2012.

Article 11a(3) – projects should not be registered under phase 2 – CERs from restricted type of projects cannot be swap with EUAs from 2013

Similarly, under Article 11a(9) the CDM restriction measure has to set the date from which the use of credits under Article 11a(3) shall be in accordance with the restriction requirements. Article 11a(3) relate to the exchange of CERs and ERUs from projects registered before 2013 issued in respect of emission reductions from 2013 onwards for allowances valid from 2013 onwards. This measure empowers the EU to determine that CDM projects such as HFC-23 destruction projects operating before 2013 that are in breach of EU law should not be registered and therefore their CERs could not be exchanged for allowances valid from 2013 in relation to emission reductions from 2013. Article 11a(3) states:

> "… competent authorities shall allow operators to exchange CERs and ERUs from projects that were registered before 2013 issued in respect of emission reductions from 2013 onwards for allowances valid from 2013 onwards."

Under Article 11a(9), the Comitology decision defining restriction measures for the use of HFC-23 offsetting projects should also include the date when Article 11a(3) shall be in

accordance with the restriction measure. Therefore, if a Comitology decision were adopted to ban HFC-23 destruction projects from 2013, the decision could determine that 6 months from its adoption article 11a(3) should be in accordance with the restriction measure and therefore HFC-23 projects could not be registered before 2013 and their CERs could not be exchanged for EU allowances.

The Commission could require from the date of 6 months after the adoption of the Comitology decision measures banning HFC-23 destruction projects, that Article 11a(3) should be applied in accordance with the restriction measure and that registration of such type of projects would not be allowed, impeding that operators exchange CERs from those projects for allowances valid from 2013 as foreseen under Article 11a(3).

This decision would ensure that the first sentence of Article 11a(9) is effectively applied. Indeed, projects during phase 2 generating CERs registered before 2013 could not be swapped for allowances from 2013 due to the restriction applicable from that date.
The decision to restrict the use of credits generated from HFC-23 offsetting projects would certainly be applied from 2013. However, 6 months after the decision is adopted, the Commission could apply the restriction measures to the rules governing the swapped of CERs by EU allowances valid from 2013.

The Comitology decision would apply to credits from projects registered during the period 2008-2012 but that would be exchanged for allowances from 2013 in respect of emission reductions from 2013.

Conclusion: The Commission is empowered to adopt through Comitology a decision establishing a total restriction on the use of credits from HFC-23 destruction projects. This decision could also state that the use of credits generated from HFC-23 destruction projects to be exchanged for EU allowances under paragraphs 1 to 4 of article 11a should be in accordance with the total restriction measure from the date of 6 months from the adoption of the decision. Therefore, 6 months after the decision is taken, HFC-23 destruction projects could be considered ineligible and the registration of this type of projects would be rejected.

Other actions under the ETS Directive

On the basis of a Commission decision declaring HFC-23 destruction projects unlawful and therefore invalid and ineligible as CDM projects and CERs in the EU system, the European Commission could challenge Member States that would authorise offsetting of emissions through these projects. The European Commission would in that case act under article 258 TFEU. It can also act against Member States for their responsibility to authorize private and public participation in projects breaching basic requirements under the UNFCCC and the Kyoto Protocol as stated under Article 11b(5) of the ETS Directive 2003/87/EC.

Under article 16 of the ETS Directive, Member States are required to lay down rules on effective, dissuasive and proportionate penalties that would be applicable to infringements of national provisions. Similarly Member States are required to take all measures necessary to ensure that rules are implemented by operators that might be involved in offsetting projects breaching EU law.

7. Additional measures that the EU could take: the Cotonou Agreement

The "Partnership Agreement between the members of the African, Caribbean and Pacific Group of States of the one part and the European Community and its Member States of the other part" was signed on 23 June 2000 in Cotonou, Bénin – hence the name " ACP-EC Partnership Agreement" or "Cotonou Agreement". It was concluded for a twenty-year period from March 2000 to February 2020, and entered into force in April 2003. It was for the first time revised in June 2005, with the revision entering into force on 1 July 2008. The Cotonou Agreement is the most comprehensive partnership agreement between developing countries and the EU. Since 2000, it has been the framework for the EU's relations with 79 countries from Africa, the Caribbean and the Pacific (ACP). The new revision of the Agreement has just been finished. Negotiations were concluded on 19/03/2010. The official signature ceremony took place in Ouagadougou, Burkina Faso, on 23/06/2010. The revised Cotonou agreement will be applicable from 01/11/2010.

The cooperation with the ACP States is funded from the European Development Fund (EDF) as the main instrument to provide EU assistance to development cooperation under the Cotonou Agreement. It is complemented by development cooperation funded from the EC budget through the Development Cooperation Instrument, the Instrument for Stability, the European Instrument for Democracy and Human Rights and the European Humanitarian Aid Instrument.

Cotonou agreement's role includes fostering cooperation, peace and security and promoting growth. For the first time, the EU and the ACP recognize the global challenge of climate change as a major subject for their partnership. The Parties commit to raising the profile of climate change in their development cooperation, and to support ACP efforts in mitigating and adapting to the effects of climate change.The partnership main objective is reducing and eventually eradicating poverty in consistency with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy (Art. 1 of Cotonou Agreement).

Article 1 of the Revision of the Partnership Agreement declares that:
"…the principles of sustainable management of natural resources and the environment, including climate change, shall be applied and integrated at every level of the partnership."

Article 20(2) requires that systematic account of environmental sustainability and climate change (amongst other thematic areas) is taken in mainstreaming in all areas of cooperation. These areas will also be eligible for community support.

Article 32b is is dedicated entirely to climate change requiring that "cooperation shall:
…
- strengthen and support policies and programmes to mitigate and adapt to the consequences of and threat posed by climate change …
- Enhancing the capacity of ACP States in the development of, and the participation in the global carbon market"

The Cooperation shall focus on integrating climate change into the development strategies and poverty reduction efforts, amongst other activities.

On this basis, we conclude that the Cotonou agreement is the appropriate legal framework to implement any decision by the EU such as a total restriction in the use of CERs from HFC-23 destruction projects. The EU could insert certain conditions on the basis of climate change objectives in the relationships with ACP countries. This would allow the EU to reinforce its leadership role on climate change and broaden the implementation of climate change commitments outside the EU. Through the implementation of the Cotonou Agreement the EU could ensure that specific projects that are considered not-eligible or invalid by the EU due to its breach with EU law and their climate change impact are also excluded from all bilateral agreements with ACP countries signed on the basis of the current Partnership Agreement. The EU could also introduce the exclusion of HFC-23 projects restricted by an EU decision into the conditions for any funding. The EU could require specific commitments from ACP countries regarding the development of projects that are considered in breach of the EU and International Law.

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