A view on CDM qualitative restrictions

This paper outlines 6 principles on which the criteria for restrictions should be based, and according to which the restrictions should be designed and applied, if the Commission's assessment arrives at the conclusion that qualitative restrictions will be necessary.
Following these principles will allow the Commission to provide the market with basis for legitimate expectations and a minimum degree of certainty over the eligibility of international credits as compliance means in phase III of the EU ETS.

1. **Stringent environmental integrity should be sole eligibility criterion**
Environmental integrity, being one of the main pillars of the EU ETS, should be safeguarded for any type of credit eligible within the trading scheme. Justified doubts over the environmental integrity of a project type should therefore be the only legitimate reason for excluding certain types of CER/ERU. Since the outset of the trading scheme this has been the basis for excluding certain credits, namely from forestry, nuclear and large hydro projects which are not in accordance with the requirements by the World Commission on Dams (WCD), from the EU ETS.

2. **Maintain utmost confidence in the EU ETS as unbiased market mechanism**
Qualitative restrictions based on other factors than environmental integrity, e.g. multipliers relative to the abatement cost, are failing the spirit of the cap and trade system as they dictate where to invest. Such restrictions will be taken as arbitrary. Exposing the private sector to the risk of disputable regulatory factors will harm the attractiveness of all credit types, increase the compliance cost of the EU-ETS installations, deter the carbon finance community from CDM and JI as cost containment mechanisms and turn away the project finance from emission reduction projects.

3. **Liquidity is vital for the EU ETS to fulfil its objective of cost containment**
In order for international credits to serve as cost containment tools sufficient supply within the EU ETS needs to be insured in order not to adversely affect liquidity and distort price signal. In its proposal the Commission should therefore take into account how any type of restrictions will affect the quantity of international credits available for compliance and carefully assess their impact on liquidity.

4. **Multipliers jeopardise both market dynamics and participants' support to the EU ETS**
The introduction of multipliers would inevitably lead to a fragmentation of the market, adding complexity to transactions and to managing CO2 risk. Fragmentation typically opens doors to fraud and abuse of clients' interests while

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complexity puts off smaller compliance entities from making use of the flexible mechanisms. Multipliers are therefore a threat to market dynamics and will adversely affect liquidity.

Crystal-clear and undisputable approaches within the EU-ETS, such as that all compliance instruments have the same value of one tonne, have led to highest levels of support and recognition by compliance players, the financial community and public. It is of outmost importance to maintain this support to the scheme, both in the EU and internationally, as key policy tool to control emissions.

5. **No retroactive application of qualitative restrictions: i.e. Eligibility dictated by rules at the time of the project registration should dictate acceptance of the credit in the EU ETS**

No retroactive application of qualitative restrictions: I.e. Eligibility dictated by Emission reductions for a project's first crediting period should be subject to the eligibility rules that were in place at the time of the project's registration (and at the time of renewal for subsequent crediting periods). CERs from projects must/shall be bankable into and usable until the end of phase III under the same conditions that applied at the time the project was registered. Imposing new restrictions on existing projects will distort compliance strategies as entities look to sell credits while they are still eligible.

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6. **Transparency and conclusiveness of the process are key**

a. In order for the process to arrive at legitimate restrictions, while allowing for a maximum degree of certainty in order to not distort the market it will need to be transparent and conclusive. The Commission's assessment should include any type of international credit, not as announced exclusively look at certain project types, and determine the eligibility until 2020. Limiting the proposal announced for November to industrial gases will effectively mean that the process will have various stages, during which every type of credit risks to be excluded at some point in the future. The Commission should put an end to this regulatory uncertainty by defining eligibility once and for all in order to re-install confidence in the CDM and JI.

b. The outcome of the process should be clear criteria, requiring no further clarifications, and that leave no room for interpretation.

c. Given the very lengthy process of developing CDM projects, the commitology process addressing potential restrictions on ALL credit types – not only industrial gases – should ideally lead to a proposal by the Commission by Q1 of 2011 in order to allow the market a minimum of time to adapt to these changes.

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