

Questions and answers on use of international credits in the third trading phase of the EU ETS

With phase 3 of the EU ETS approaching, the Commission has received several questions from stakeholders on the eligibility of international credits for compliance in the EU ETS post 2012.

The rules of for the recognition of international credits have undergone a substantial change in the revision of the ETS Directive as part of the Climate and Energy Package. Most importantly the wider objectives pursued by the European Union in the recognition of international credits have been extended. While initially the use of international credits was allowed for cost-effective compliance, this has been complemented with the objective of actively using the leverage the EU possesses as the by far most important source of demand for international credits.

The Commission provides the below answers in order to give industry, project developers and investors equal access and more clarity on the interpretation of the relevant provisions in the EU ETS Directive and the Effort Sharing Decision, while also indicating that the strategic use of international credit recognition rules implies that the rules may evolve over time and in line with progress on wider climate objectives pursued by the EU.

Stakeholders are invited to submit any further questions to the following functional mailbox: credits-inquiries@ec.europa.eu. The Commission will reply to such further questions in the form of updates to this memo.

I. Terminology

1. Least Developed Countries (LDCs) list: As there had been no international agreement at the end of 2010, nor had there been any EU agreements with third countries, article 11a(4-5) provides a default situation of prohibition on using new-project CERs beyond 2013, unless they are from LDCs or can be swapped for CERs from LDCs. What happens if a country loses its LDC status: if the project is at validation stage, if the project is registered, if CERs have already been issued?

Answer:

The guidance on the DG CLIMA webpage explains that "A project in an LDC that is included in the UN list when the project is registered by the CDM Executive Board may continue to generate credits up to 2020, whatever happens to the list, see: http://ec.europa.eu/clima/documentation/ets/docs/linking/def_ldc.pdf

2. Crediting period renewal: Does the registration date pertaining to 'projects that were registered before 2013' referred to in Article 11a(2-4) correspond to the start date of the first crediting period of the project, or to the start date of any subsequent crediting period?

Answer:

The start date refers to the start date of the first crediting period. Hence credits from projects that were registered prior to 2013 and that have their crediting period renewed after 2012 will continue to be usable (in the absence of use restrictions).

3. Date of registration: What will be the applicable cut-off date for the registration of CDM projects for being able to produce EU-ETS-eligible CERs post 2012?

Subject to no other quality restrictions, credits from projects registered before 2013 will be eligible for use in the EU ETS. The date of registration shall be the registration date determined by the EB, including the effective date of registration in accordance with Decision 3/CMP.6 i.e. "the date on which a complete request for registration has been submitted by the designated operational entity where the project activity has been registered automatically".

II. Implementation of provisions

4. Swapping process: As from 2013, recognised international credits must be exchanged into (phase 3) allowances before surrendering them for compliance.

- a. What are the modalities for this swapping process? Who will do it, when will it start?

Answer:

The exchange of credits will start from 1 January 2013 onwards or as soon as a forthcoming revision of the Registry Regulation has been adopted, whatever is latest. The modalities will be developed in this revision. Only "operators" as defined in the ETS Directive can exchange CERs/ERUs for allowances.

- b. Will this be an instant process or would there be a delay in receiving an allowance in return for a CER on the same user account?

Answer:

Details in this regard will be determined in a forthcoming amendment of the registry regulation.

- c. Can a request for a swap be refused on grounds other than the credit not being a compliance credit and if yes under which circumstances?

Answer:

Details in this regard will be determined in a forthcoming amendment of the Registry Regulation. Given that the exchange route is only for operators, an exchange will be declined if an operator has exhausted the limit of its entitlements for exchanging credits, as reflected in articles 11.a(2-4) and (8) of the ETS Directive.

- d. Can swapping be done at any time during the year, or do operators have to wait until the surrender deadline?

Answer:

Details in this regard will be determined in a forthcoming amendment of the Registry Regulation. The Commission envisages for the exchange to take place throughout the calendar year and not limited to the annual compliance date. The competent authority will make the exchange on request from operators.

5. Quantitative limits: Article 11a(8) provides for options whereby operators would be able to use additional volumes of credits beyond the quantity they were allowed to use between 2008 and 2012.
 - a. What are the steps and timeline of the comitology process to 'specify the exact percentages' of additional allowed credit volumes?

Answer:

The ETS Directive does not specify the time by which these volumes should be determined. The Commission foresees that the necessary rules should be in place before credits are used in respect of phase 3.

6. UNFCCC carry-over rules: The Marrakesh rules (Decision 13/CMP.1) state that Parties are allowed to carry over CERs and ERUs 2.5% of their initial Kyoto AAUs to the potential subsequent commitment period. This amount will be confirmed after the true up period in 2015.
 - a. Can a compliance company, or a non-compliance actor carry over international credits "as credits" to the post-2012 period? In other words, will it be possible to bank CERs/ERUs?

Answer:

For phase 3, credits can only be used for compliance in the EU ETS if exchanged for phase 3 allowances. This exchange of international credits with a first commitment period identifier into allowances will only be allowed until March 2015, which is before the end of the Kyoto Protocol's true-up period. On the difficulties of banking under the Kyoto protocol of selective CDM CP1 into the future, see chapter 6.2.4. '*Transition and predictability*' of the 2008 impact assessment accompanying the revision of the EU ETS http://ec.europa.eu/clima/documentation/ets/docs/sec_2008_52_en.pdf

- b. Are all EU ETS account holders able to carry over credits within limits?

Answer:

Under the EU ETS, all compliance buyers (i.e. not all account holders) can exchange

unused credits within the limits provided in article 11a and this exchange is guaranteed until the end of March 2015.

III. Future policy developments

7. Bilateral agreements:

- a. Given the continuing absence of an international agreement, what action has the Commission taken to negotiate bilateral agreements with major host countries?

Answer:

The Commission envisages the primary focus of potential bilateral agreements to be on creating demand for credits from new market mechanisms and to pilot the establishment of such new market mechanisms. The Commission contributes and actively participates in the World Bank's Programme for Market Readiness to promote such initiatives.

- b. How can interested stakeholders contribute to the set-up and implementation of bilateral agreements?

Answer:

Stakeholders are encouraged to reach out to developing countries to support and explain the EU's position on the future of the carbon market, share lessons learned from emissions trading, Joint Implementation, Activities Implemented Jointly, and the CDM and explore areas for testing new market mechanisms

- c. Will bilateral agreements be broad in nature (e.g. for all sectors in the host country) or targeted to specific sectors?

Answer:

EU legislation is very open with regard to the scope of bilateral agreements that might be reached.

8. Process for qualitative restrictions: From 1 January 2013, measures may be applied to restrict 'the use of specific credits from project types' according to article 11a(9).

- a. What is the definition of 'type'? What is the definition of 'specific credits'?

Answer:

Under 'type' the Commission understands credits that were generated using one or several methodologies approved by the UNFCCC CDM Executive Board and JI Supervisory Committee. 'Specific credits' could refer to all credits under a project type or credits from a project type generated in a set of countries.

b. Have any such qualitative restrictions been adopted so far?

Answer:

From the start of the EU ETS in 2005 full use restrictions have already been applied in the EU ETS to CERs from projects at nuclear facilities and from projects in agriculture and forestry (so-called LULUCF). As of 1 January 2013 CERs and ERUs from projects involving the destruction of trifluoromethane (HFC-23) and nitrous oxide (N₂O) emissions from adipic acid production will be prohibited in the EU ETS. An exception is made until 30 April 2013 for destruction from existing projects that is credited before 1 January 2013, for compliance with 2012 commitments, see:

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/615>

c. Are there further proposals under consideration to apply qualitative restrictions to any specific project type?

Answer:

The revised ETS Directive provides for use restrictions to be introduced as part of the implementing provisions for credits which are otherwise usable during phase 3 of the EU ETS, running from 2013 to 2020. While the legislation allows putting in place further use restrictions adding to those adopted in early 2011, the European Commission is currently not considering any additional use restrictions.

d. How will qualitative restrictions be tracked and controlled?

Answer:

Qualitative restrictions will be tracked and controlled through the introduction of automatic checks in the Union registry, based on the information regarding the project ID and the commitment period identifier of relevant international credits.

e. Is a positive list of unrestricted credits possible?

Answer:

EU legislation does not foresee such a list.

f. Type of qualitative restrictions: What type of restrictions could be invoked according to article 11a(9)?

Answer:

The Directive does not limit the types of restrictions that can be introduced. These will depend on project-type, economic, environmental, strategic and administrative circumstances.

9. Programme of Activities (PoAs): According to Article 11a(2) credits from projects registered pre-2013 are eligible for compliance in the EU ETS .
- a. Does this imply that CDM Project Activities (CPAs) included after 2012 to PoAs registered pre-2013 are also eligible?

Answer:

Article 11.a(3) of the EU ETS Directive states that "...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". This wording would indicate that the moment of registration of a project is to be taken as a cut-off date for determining whether future CERs would be eligible for use in the EU ETS. A PoA is only registered once and CPAs are added to a PoA without a separate registration. It is therefore the Commission's interpretation that CERs from CPAs added after 2012 to a PoA registered prior to 2013 can be used for compliance in the EU ETS.

The Commission is, however, also aware that this interpretation of article 11.a(3) may increase the supply of CERs from non-LDCs. This contradicts the spirit of the Directive to allow only CERs from projects registered after 2012, if they come from LDCs. The Commission will therefore continue to monitor the evolution of PoAs, including their impact on the development of new sectoral mechanisms. The Commission notes that the Directive allows the Commission to propose appropriate regulatory measures under article 11.a(9) of the EU ETS, if the situation would require this.

- b. Would restrictions (if adopted according to article 11a(9)) be applicable to PoAs?

Answer:

Any use restrictions for specific credits from project-types agreed under article 11.a(9) would also be applicable to PoAs.

- c. Will CERs from CPAs in LDCs be EU ETS eligible, if the PoA (no matter date of registration) also includes non-LDCs (so called cross country PoAs)?

Answer:

This will depend on the possibility to clearly distinguish the country of origin of each CER, and whether such a filter can easily be introduced in the CITL. If this is the case, the Commission sees no objections to this.

10. Jl projects registered before 2012: Article 11a(3) allows exchange of credits from projects registered before 2013 issued in respect of emission reductions from 2013 onwards. This applies both to CERs and ERUs. However, in the case of ERUs, issuance and transfer by the Host Party is subject to prior conversion of AAUs. This means that the absence of a second commitment period under the Kyoto Protocol would imply no continuation of JI projects

after 2012. Has it been considered how to implement Article 11a(3) with regard to ERUs, in the absence of a second commitment period under the Kyoto Protocol:

- a. Continuation of JI project baselines beyond 2012 via a bilateral agreement – would this be a bilateral agreement signed between the EU as a block and various host countries to allow continuation of projects within that country?

Answer:

As explained in relation to question 6, bilateral agreements are envisaged to focus on the promotion of sectoral market mechanisms.

- b. In the event that projects fall outside the EU ETS: Can such projects use commitment period 1 (CP1) AAUs to back ERUs generated January 2013 – March 2015?

Answer:

The Commission considers that this is not in line with the Kyoto Protocol, according to which AAUs have been created in respect of emissions from 2008 to 2012 (CP1). In line with the principle of the Kyoto Protocol, the continuation of JI after 2012 is subject to new quantified emission targets being in place (CP2). This is also referred to in the recitals of the EU legislation (recital 28 of Directive 2009/29/EC). Using CP1 AAUs for backing ERUs generated between January 2013 and March 2015 is opposed to this, as it would allow the conversion of CP1 AAUs (not usable in the EU ETS) into a CP1 ERUs on behalf of post 2013 reductions (usable in the EU ETS). This would mix up the accounting system under which these units are created. Also, the UNFCCC Secretariat's advice on CDM accounting goes in the opposite direction, thereby creating an inconsistency that should not be supported. The CDM Executive Board have advised that "CERs may be used by Annex I Parties in complying with their emission targets for the first commitment period, as long as they have been issued for emission reductions or removals taking place up to the end of 2012". If nothing else, the continuation of crediting CDM projects is less of an issue as these projects do not impact on the inventories of Annex I Parties.

11. Sectoral crediting / trading: The EU intends to develop new mechanisms to scale up the use of carbon markets for climate finance and to provide better incentives for own mitigation action in developing countries.

- a. Has the Commission assessed the actual possibility of sectoral mechanisms to meet demand for international credits in the EU ETS in the near future?

Answer:

Under existing commitments there is currently no shortage of supply to accommodate the maximum possible EU demand for international credits. In fact, one of the main challenges for the introduction of sectoral mechanisms is to ensure sufficient demand for such credits. The speed by which new mechanisms can be implemented will also

depend on other factors, including progress made in the international negotiation on their establishment, the geographical and sectoral scope of the first application, and the level of interest from developing countries.

- b. How does the Commission intend to address possible disruptions in the market (due to the combined effect of possible CDM restrictions and new crediting mechanisms)?

Answer:

The Commission does not share the view that the market would be disrupted by a (temporary) shortage of supply of international credits. The flexible nature of the EU ETS design would simply result in the allowance price incentivising more reductions in installations covered by the EU ETS and a reduced reliance on international credits for compliance purposes.

- c. Does the Commission have plans to consult with stakeholders on the practical implementation of sectoral crediting?

Answer:

No specific stakeholder consultation is planned on this issue, as the Commission regularly interacts with interested stakeholders and always welcomes ideas and input from stakeholders on practical implementation of sectoral crediting.

- d. How could the private sector get involved with sectoral crediting?

Answer:

Implementation of sectoral crediting will require a considerably more important role of the host country governments. They offer host governments to implement sectoral policies that achieve structural transformations of targeted sectors. The role of the private sector, in particular current project developers and consultants, is likely to change significantly. Instead of directly receiving credits from an international body as it is the case with CDM, project developers will need to interact with national governments. This provides for a more proactive role of national governments to introduce appropriate regulatory frameworks for blending of public and private sources of finance. The incentives for the private sector to invest in GHG emissions reductions will depend on the chosen policy mix, and will be country-specific. The proactive interaction between developing country host governments and the private sector on how to best put an incentive structure in place to attract private capital should be encouraged.

- e. Could the emerging international REDD+ mechanism qualify as a sectoral mechanism?

Answer:

No, for reasons of liability, non-permanence and capacity to monitor emissions with sufficient level of accuracy credits from a possible REDD+ mechanism will not be considered for compliance use in the EU ETS before the end of phase 3.

12. Stepping up the EU reduction target: The CDM pipeline would imply that CERs from projects registered pre-2013 could be sufficient to cover the demand from the current CER/ERU import limits in phases two and three.

- a. Could potential rules on credit eligibility (except where bilateral agreements) be relaxed in a move beyond the current 20% reduction target?

Answer:

The impact assessment accompanying the introduction of use restrictions on industrial gas credits in the EU ETS has identified significant economic and environmental shortcomings of such credits. These would not disappear with more stringent EU targets. Therefore there are no reasons to reconsider the ban on such credits. But more generally, under a stricter cap strategic decisions will have to be made whether to allow for more credits, and if so which types of credits this would be (new market mechanisms, CDM, etc.).

- b. In case of a 30% reduction target with increased access to credits, what would be the share of use of these credits between ETS and non ETS sectors?

Answer:

This would have to be determined through an appropriate impact assessment, if and when such an increased target is politically decided.