

CDM Watch submission to the European Commission on design aspects of quality restrictions on the use of credits from industrial gas projects

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CDM Watch welcomes this opportunity to set out its position regarding quality restrictions on the use of credits from industrial gas projects in the EU ETS.

CDM Watch has grave concerns about the risks the Clean Development Mechanism poses to the environmental integrity of the EU Emissions Trading Scheme if European polluters continue to be allowed to use “hot air” emissions credits (CERs) - that is credits that do not represent real emission reductions - from industrial gas projects to achieve their emissions targets under the Scheme.

In the case of the CDM, it is important to bear in mind that it is an offsetting mechanism. This means that the emission reductions credited under the CDM entitle the buyers of the CERs to increase their domestic emissions correspondingly. The CDM in itself does not directly reduce global greenhouse gas (GHG) emissions but helps to achieve a given emission reduction target at a lower cost.

Failure to exclude fake offsets from the EU ETS will result in a rise in global greenhouse gas emissions and cast serious doubt over the European Union’s claim to be spearheading international efforts to combat climate change.

As explained in the accompanying documentation, we are particularly concerned about the risks to environmental integrity posed by CDM projects which abate the waste gases HFC-23 and nitrous oxide (N₂O) from adipic acid.

HFC-23 – strict ban needed

The UN methodology used to calculate emissions from HFC-23 projects under the CDM is deeply flawed. Indeed, the perverse incentives inherent in the current system have encouraged plant operators to increase HCFC-22 production with the sole purpose of maximizing the number of CERs they receive from HFC-23 abatement, thereby creating “hot air” credits which lead to an increase in global GHG emissions.

HFC-23 destruction projects are projected to deliver more than 476 million CERs by 2012. Almost half of these credits, e.g. 218 million credits, have already been issued, representing about half of all the 440 million CERs issued to date. According to recent analysis annexed to this submission, there is overwhelming evidence that a large majority of these credits do not represent real emission reductions. Therefore, there are serious grounds for concern that a **large percentage of the remaining 258 million credits** expected to be issued from this project type under the same crediting methodology up to 2012 **do not represent real emission reductions either**.

According to data derived from the CITL by the campaign group Sandbag, a total of 97 million HFC-23 CERs were surrendered into the ETS for compliance in 2008 and 2009. This leaves a possible 121 million CERs that were generated under the flawed UN crediting methodology as well as a projected 258 million credits that will possibly continue to be issued under this crediting methodology if the CDM Executive Board does not take appropriate action and which could be surrendered in the EU ETS during the remainder of Phase II.

For this reason, CDM Watch is resolutely opposed to the use of credits from HFC-23 abatement projects for compliance under the EU ETS. We call on the Commission to implement a **strict ban on the use of credits from HFC-23 abatement projects in the EU ETS as soon as possible**, i.e. at the very latest as of 1 January 2013. To be effective, this **ban shall apply to all emission reductions that were generated after a certain cut-off date** that is no later than 1 January 2013 and must **strictly prohibit holders of HFC-23 CERs to “bank” these credits for use in Phase III of the EU ETS**. CDM Watch sees this restriction as an essential means of addressing the enormous number of HFC-23 credits that have not yet been surrendered. In addition to undermining the environmental integrity of the EU ETS during Phase II, unsurrendered credits also pose a serious risk to the success of Phase III of the EU ETS if banking was allowed. This ban would also provide the scarcity and carbon price needed to shift investment to good quality projects.

Most importantly, the **restrictions must apply - regardless of the project’s approved crediting period - as soon as possible** and as of 1 January 2013 at the very latest. Restrictions that only applied after the current crediting period expires would effectively only fully materialize in November 2018 for the following reason: 15 out of the 19 HFC-23 destruction projects are registered for a renewable 7-year period. This 7-year period has already expired for the oldest of the projects (the “Ulsan” project) and will run until 20 April 2016 for the most recent of the 7-year projects. 4 HFC-23 projects have applied for a non-renewable 10-year crediting period. Here, the crediting period of the oldest project would only expire in July 2014 while the most recent of the 10-year projects would generate credits until November 2018.

The Montreal Protocol would provide a more appropriate forum for HFC-23 abatement than the CDM. We believe that the current “two-track” approach jeopardises efforts to phase out HCFC-22 production under the Protocol, to which the EU is a signatory.

N₂O from adipic acid – imminent need for quality standards

Currently CDM adipic acid projects can receive credits for 100% of their N₂O abatement, even though large parts of the industry have been abating 90% of their emissions on a voluntary basis since the 1990s.

CDM adipic acid plants are able to net carbon revenues for N₂O abatement of about €1,000 per tonne of adipic acid. This puts CDM plant operators in a position where they can produce adipic acid at very low or even negative costs, which in turn places non-CDM plant operators at a significant competitive disadvantage. This has distorted the market by causing a shift in production from non-CDM plants in countries where 90% of N₂O emissions are voluntarily abated as a matter of course to plants operating under the CDM.

In addition to creating an unfair competitive advantage for CDM plants, this phenomenon also leads to an overall increase in emissions, owing to the fact that the CERs issued from such shifts entitle third parties to increase their GHG emissions.

The four projects that are registered under the CDM to destroy N₂O from adipic acid production are projected to deliver more than 161 million CERs by 2012. More than half of these credits (85 million) have already been issued. Under the current crediting methodology, another 76 million credits are expected to be issued until 2012. A recent study, annexed to this submission, sets out serious concerns that about 20% of these credits are a result of carbon leakage and do not represent real emission reductions.

An immediate revision of the crediting methodology that took into account the voluntary benchmark of 90% applied by many non-CDM adipic acid plants could potentially be a step in the right direction in terms of putting an end to the carbon leakage created by the CDM. A decision on this would have

to be taken by the UN's CDM Executive Board. However, although concerns about carbon leakage in relation to adipic acid projects have been raised for many years, the CDM Executive Board has so far failed to take appropriate action. Even if the CDM Executive Board did review the current crediting methodology, an **ambitious benchmark would only apply at the renewal of the current crediting period**. All of the four registered projects started their 7-year renewable crediting period between 1 September 2006 and 14 March 2008. Allowing credits generated under the current crediting period to continue entering the EU ETS would enable the most recent of the four projects to generate credits until 14 March 2015.

For these reasons, CDM Watch is resolutely opposed to the use of credits from N₂O from adipic acid abatement projects in the EU ETS. We call on the Commission to implement a **strict ban on the use of credits from N₂O from adipic acid abatement projects in the EU ETS as soon as possible** and at the latest by 1 January 2013. To be effective, this **ban shall apply to all emission reductions that were generated after a certain cut-off date** that is no later than 1 January 2013 and must **strictly prohibit holders of adipic acid N₂O credits to "bank" these credits for use in Phase III of the EU ETS**. This restriction is ultimately necessary to provide the scarcity and carbon price needed to shift investment to good quality projects.

Full exclusion versus discounting

CDM Watch does not support calls for a discount factor to be applied to credits from HFC-23 projects but recommends an outright ban. As regards credits from projects that destroy N₂O from adipic acid production, we believe that the EU must entirely prohibit the use of these credits from the EU ETS unless the CDM Executive Board adopts an ambitious benchmark that fully takes account of the high levels of abatement that can be achieved at non-CDM adipic acid plants. A discount factor at EU level is not recommended. If applied before the CDM Executive Board has revised the crediting methodology to include an ambitious benchmark, a discounting factor at EU level could even have the indirect effect of enabling the CDM EB to postpone indefinitely the application of such a factor.

Investor security safeguarded

As pointed out above, the restrictions must apply - regardless of the project's approved crediting period - as soon as possible and as of 1 January 2013 at the very latest. Although this would interfere with current crediting periods approved by the CDM Executive Board, the arguments currently being circulated by industry that so-called "investor security" would be at risk are not well-founded.

Within this context it is important to note that the reviewed EU ETS Directive which was adopted in December 2008 includes a provision (Art 11a (9)) which enables the introduction of measures to restrict the use of credits from specific project types in the EU ETS. Therefore, any companies which signed CER purchasing agreements after the adoption of the Directive did so in full knowledge that credits resulting from CER purchasing agreements could potentially be excluded from the EU ETS. Therefore any argument that is based on "investor security" only counts if final steps for the i.e. purchase of CERs were taken before the adoption of the Directive in December 2008. Furthermore, concerns about HFC-23 and N₂O from adipic acid projects are nothing new: investing in these abatement projects has always been controversial and was therefore a calculated risk, for which investors have already reaped large financial rewards.

Discussions with carbon exchanges, banks and project investors have all confirmed that the market would indeed be able to adapt to the loss of credits from industrial gas projects during the remainder of Phase II and in Phase III. In fact the halting of credit issuance since July 2010 by the UNFCCC's Executive Board has already prepared the market for such a move. **Further quality restrictions beyond 2012**

We would like to stress that the exclusion of certain industrial gas credits from the EU ETS should only be seen as a first step in addressing the multiple problems associated with the use of carbon offsets for compliance with EU emissions targets. Quality restrictions on industrial gases should not preclude future action to restrict the use of credits from certain other project activities from the EU ETS. This must be made clear in any upcoming proposal in order to provide investors with the opportunity to prepare themselves accordingly.

Equivalent quality restrictions to be applied for non-ETS sectors

Finally, it is important to prevent the provisions from being circumvented by national registries that allow the eligibility of CERs for compliance with targets for sectors not included in the EU ETS. To this end, Member States must be encouraged to apply equivalent unilateral quality restrictions that ban the use of credits from HFC-23 projects and N₂O destruction from adipic acid plants. These unilateral quality restrictions shall also include the prohibition of banking for sectors covered by the Effort Sharing Decision.

Sincerely,



Eva Filzmoser
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