



Brussels, 20 March 2001
StaffA2/Peter/ECCP/Background Document 5-final

CHAIRMAN'S BACKGROUND DOCUMENT 5

Subject: The project mechanisms of the Kyoto Protocol and the Community role

5. Use of the project mechanisms of Joint Implementation and the Clean Development Mechanism is to be encouraged both by companies established within the EU, Member States and the European Community. This Background Document assumes that the project mechanisms as agreed in the context of the Kyoto Protocol will be environmentally sound, as well as contribute towards increasing cost-effectiveness.

Part 1: Motivation for involvement

- 5.1 If companies are to engage in JI and CDM projects there should be a reason for them wanting credits. The 2 main reasons are:
 - to use in fulfilment of obligations or commitments that they have;
 - to have the opportunity to sell to others (companies or Parties to the Protocol) that want to buy credits to cover their own obligations.
- 5.2 Buying for Parties and companies' own use is conditional upon them having some obligations or commitments. The tighter these commitments, the more incentive there will be to invest in projects, or buy credits from others who invest. Identifying and implementing suitable projects may require substantial amounts of time and resources.
- 5.3 Opportunities for selling will depend upon credits from project mechanisms being recognised for the fulfilment of obligations. In the context of the Protocol, JI and CDM credits will ultimately only have value if the Protocol enters into force. Until this happens, or is clearly likely to happen, there is a risk for the investing company. Governments may choose to assume this responsibility by undertaking to buy credits from their entities irrespective of whether the Protocol enters into force or not. This is the case with the "ERUPT" programme that has been introduced by the government of the Netherlands. However, it is probable that project numbers will be constrained until the Protocol's entry into force.

As only Parties have obligations under the Protocol, it is Parties rather than companies who will be the end consumers of credits. However, in addition to

buying credits on the open market, Parties might require commitments to be undertaken by their entities and agree to accept JI and CDM credits as a means of fulfilment of these obligations. Companies may then invest in projects to fulfil the commitments devolved upon them.

Part 2: The role of the Community

- 5.4 If Member State Governments undertake to buy credits from companies, open procurement rules must be respected. The Dutch programme is open to companies established anywhere in the Community.
- 5.5 As a Party to the Protocol, the European Community may fund both JI and CDM projects. The suitability of doing this should be decided with the Member States. Although it is still uncertain how credits could be used, it may be decided that they are used towards fulfilment of the European Community's own target. One option could be for the Community to establish a reserve.
- 5.6 There would be no added value in the Community adding further rules to the operation of JI and CDM – over and above those rules that are required to respect the Protocol and its implementing provisions – *if those are deemed to be sufficient to guarantee environmental integrity*. However, if the international rules are not judged to be adequate, then additional rules at Community level on the eligibility of certain types of project, for example, could send a strong political signal and would be consistent with the EU's advocacy of limited project eligibility within the context of the UNFCCC negotiations. EU governments may be willing to restrict access to the project mechanisms (including the right to buy credits from particular types of projects). However, such restrictions may not be effective from an environmental point of view if companies could engage in emissions trading under the Protocol and other Parties did not impose the same restrictions.
- 5.7 One possible added value that the European Community could provide could be in the establishment of, or contribution towards, centres of expertise, capacity building (both for the “investor” and “host” countries”) and in baseline methodologies, for example. Several Member States envisage the establishment of such centres of expertise and the creation of enabling structures. Clearly, value might also be added by ensuring synergies with the enlargement process, in respect of which considerable investments are being channelled to applicant countries. Ways of taking this idea further within the context of the ECCP could be discussed.
- 5.8 Access to the mechanisms for entities must be with the agreement of the Party. Company access may not, therefore, be harmonised across the Community. Restrictions on access would, however, appear to be a case of “reverse discrimination”. In this case, the Treaty would not provide any means of redress.
- 5.9 State aid scrutiny will apply to projects undertaken by private entities with partial government funding (including risk under-writing). Governments that buy credits from their own entities must do so at no more than market prices for incompatible state aid not to be given. Both these cases could also potentially infringe international free trade rules as well (e.g. WTO).

Part 3: Project mechanisms within the context of a Community emissions trading regime

- 5.10 This is theoretically possible. Indeed the UK plans to incorporate this feature into its own national emissions trading scheme. In the UK, projects are not at the core of the scheme, but they can bring emissions reductions to new areas, provided they are carefully defined to ensure genuine emissions reductions are delivered.
- 5.11 If an EC trading system recognised such credits, common rules and methodologies on eligibility, baseline establishment, monitoring and certification – for example – would be necessary. Given that these rules will be established within the context of the Kyoto Protocol, and that Joint Implementation projects can be undertaken between Member States, it is questionable what benefit there would be in having a Community scheme for project-based credits (unless different rules were to be applied).
- 5.12 The forestry sector would probably appreciate being able to generate such credits, and users of the credits (e.g. sources covered by an emissions trading scheme) would probably appreciate such credits being accepted also. However, the complexities of incorporating credit-based mechanisms within a Community context would be considerable. Trying to do so would risk delaying the commencement of emissions trading within the Community.
- 5.13 Conclusion: Joint Implementation and the Clean Development Mechanism do not warrant further rules at Community level – over and above those rules that are required to respect the Protocol and its implementing provisions – *if those are deemed to be sufficient to guarantee environmental integrity*. There will be a continuing need for scrutiny at Community level of the functioning of the project mechanisms to ensure the absence of incompatible state aid and adherence to public procurement rules.

The viability of comparable project mechanisms operating within a Community context seems unnecessary as long as the Kyoto Protocol is likely to enter into force. However, in the case that the Protocol did not enter into force, consideration might be given to the establishment of project mechanisms both within the EU and with developing countries that could generate credits that could be used towards the fulfilment of domestic obligations, including those arising under any possible Community emissions trading system.