



Linking project credits to the EU emissions trading scheme

COM(2003)403

23 July 2003



1. Starting point

Joint Implementation (JI) and Clean Development Mechanism (CDM) are:

- ... primarily designed to provide flexibility to Parties
 - Some Member States already prepare their use (Dutch ERUPT/CERUPT, Austria, Finland ...)
- But mainly driven by the private sector
- Project-based instruments governed by International Law

EU Emissions Trading Scheme (EU ETS) is:

- ... designed as an entity-based domestic cap and trade emissions allowance programme
- ... governed by Community Law specifying specific conditions for trading between entities and using a special unit of trade – allowances – within the EU
- ... compatible with international emissions trading under the KP and contribute towards achievement of KP target



2. The EU Emissions Trading Scheme

entity-based domestic cap and trade allowance scheme

Timing

- three-year mandatory “warm-up” phase from 2005 to 2007
- five-year mandatory Kyoto phase from 2008 to 2012

Coverage

- Five major downstream sectors with thresholds
- start with carbon dioxide

Allocation

- Member States may auction up to 5% for 2005 to 2007 and up to 10% for 2008 to 2012
- Each Member State draws up an ex-ante national allocation plan
 - transparency and comments by the public
 - scrutiny by the Commission
- Member States observe common allocation criteria



3. The EU Emissions Trading Scheme

Monitoring and reporting

- companies will monitor and report emissions following the monitoring and reporting guidelines adopted pursuant to the Directive
- emission reports will be subject to independent verification

Registries

- Member States and the Community must establish and maintain electronic registries to track allowances
- at Community level a transaction log will be developed and maintained

Sanctions

- for every tonne of emissions that is not covered by an allowance a company will have to pay a penalty of 40 Euro in 2005 to 2007 and 100 Euro thereafter
- companies will also have to surrender a compensating amount of allowances in the subsequent year



4. What does “linking” mean?

- Linking JI/CDM to the EU ETS means creating a direct link to provide more flexibility and certainty to legal entities
- In concrete terms, linking means that JI/CDM credits can be used by operators to fulfil their obligations under the EU ETS
- Linking implies the recognition of JI/CDM credits as equivalent to allowances from an environmental and economic point of view



5. Creating a bridge to Kyoto

Linking JI/CDM to EU ETS implies a bridge between two different frameworks:

Community Cap and Trade / Kyoto Project Mechanisms

- ▷ Different nature: cap and trade of direct emissions (ex-ante allocation) / baseline and credit (ex-post verification)
- ▷ Different regulatory context and institutions involved
- ▷ Different timing
- ▷ Different unit of trade: allowances / ERUs and CERs
- ▷ Different level of certainty: EU ETS final / ratification of Kyoto Protocol necessary for implementation of JI/CDM



6. Elements to be taken into consideration

- Need to preserve the architecture and the environmental integrity of the Community emissions trading scheme
- Necessary compatibility with the Kyoto Protocol and the Marrakech Accords for the issuance and transfer of JI and CDM credits
- JI can happen within the EU, particularly in an enlarged EU: the importance of the *Acquis Communautaire*:
 - ▷ Baseline JI project
 - ▷ EU ETS is part of the *Acquis*: interface with JI



7. Desirability of linking JI/CDM

- Increase of compliance options for entities
- Reduction in allowance price and compliance costs
- Increase liquidity of the EU emissions trading market
- Stimulate demand for JI/CDM credits
- Contribution to host countries' Sustainable Development
- Promotion of the transfer of environmentally sound technologies to third countries
- Drive environmental policy integration in EU external policies and contribute to the EU Strategy on Sustainable Development



8. Key elements of the proposal

- How to link?
 - ▷ Conversion of JI/CDM credits into allowances = maintain a single currency within the EU ETS
 - ▷ Participant in EU ETS delivers project credit to national authority and gets issued an allowance in exchange for it
- When to link?
 - ▷ As of the second trading period in the EU ETS (2008 to 2012)
 - ▷ no JI before 2008 available
 - ▷ companies can accrue CDM credits before 2008 and convert them in 2008



9. Key elements of the proposal

- What projects to link with?
 - ▷ All types of credits allowed for conversion except
 - ▷ Pursuant the Marrakesh Accords no JI or CDM credits from nuclear facilities
 - ▷ no credits from carbon sink enhancement projects
 - ▷ no issuance of credits for intra-EU projects that would result in double counting of emission reductions

- How much to link?
 - ▷ As soon as credits amounting to 6 % of initially allocated allowances have been converted the Commission must undertake a review and decide whether a quantitative limit of for example 8 % should be introduced



10. Double counting

- 1 tonne of emission reduction could be rewarded twice in the carbon market
 - ▷ Creating a surplus allowance
 - ▷ Generating a JI credit (ERU)
- Activities falling under the scope of the EU ETS as listed in Annex I or “opted-in”
 - ▷ Example: fuel switching in a district heating plant
- Other project activities which directly or indirectly affect emissions from installations covered by the EU ETS
 - ▷ Example 1: hydro power plant
 - ▷ Example 2: demand side management project (energy efficient light bulbs or double glazing)
- choice of transitional period for on-going JI projects or immediate switch to ET



11. Consequences of linking

More flexibility and certainty for entities and operators:

- If projects fit with objective criteria, entities will have full certainty upon conversion they can use credits for EU ETS compliance
- Newly issued allowances can be used as any other “original” allowance
- No further restriction on use and banking or other obligations arising from Kyoto/Marrakech

More control for Member States:

- To check – at the moment of conversion – against objective criteria what project credits “come in” and if they are compatible with national climate strategy + national JI/CDM programmes
- To implement Kyoto Protocol requirements on banking of JI/CDM credits, commitment period reserve and complementarity