

IETA Questions on Use of International Offsets in the Third Trading Phase of the EU ETS

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With phase 3 of the EU ETS approaching, a number of questions have been identified by our members on the eligibility of international offset credits for compliance within the EU ETS post 2012.

Changes in the offset eligibility rules are not only of concern to end-users though. Many industry buyers may act in the international offset market for other than compliance purpose and there are numerous small and large-scale financial actors who are directly affected by the (absence of clear) rules. Project developers and investors are also concerned about the impact of changes in the offset eligibility rules.

IETA asks the Commission to provide answers to the questions listed below with a view to equip industry, project developers and investors with the necessary clarity on the interpretation of the relevant provisions in the EU ETS Directive and the Effort Sharing Decision.

For the avoidance of doubt, this paper is not an IETA position paper but a fact-finding document and therefore the language used should not in any way be interpreted as an acceptance by IETA or support for any of the issues mentioned below.

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.
 - a. 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, etc?
2. Crediting period renewal: Could the Commission confirm that the registration date pertaining to 'projects that were registered before 2013' referred to in Article 11a(2-4) corresponds to the start date of the first crediting period of the project, not to the start date of any subsequent crediting period?

II. Implementation of provisions

IETA – Making markets work for the environment

24, Rue Merle d'Aubigné
Geneva, 1207, Switzerland
Tel: +41 (22) 737 0500

Rue de la Loi 235
Brussels, 1040, Belgium
Tel: +32 (0)22 30 11 60
Reg. 0889.072.702

1730 Rhode Island Ave., NW,
Suite 802, Washington, DC
20036 USA
Tel: +1 (202) 629-5980

100 King Street West, Suite
5700, Toronto, Ontario
M5X 1C7, Canada
Tel. +1 (416) 913 0135



3. International agreement: How is Article 11a(7) – host country must have ratified an international agreement (once there is one) for credits to be accepted - going to be implemented in terms of time limits, retroactive restrictions, etc?
4. Swapping process: As from 2013, offset credits must be exchanged into EUAs before surrendering them for compliance.
 - a. What are the modalities for this swapping process? Who will do it, when will it start?
 - b. Will this be an instant process or would there be a delay in receiving an EUA in return for a CER on the same user account?
 - 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?
 - d. Can swapping be done at any time during the year, or do operators have to wait until the surrender deadline?
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?
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. It seems that, in general, Member States have adopted this rule in their national legislations but only few have considered what it means in practice and the consequences if the limits are exceeded.
 - a. Can a compliance company, or a non-compliance actor carry over offset credits “as credits” to the post-2012 period? In other words, will it be possible to bank CERs/ERUs?
 - b. Are all EU ETS account holders able to carry over credits within limits and how can it be ensured that all account holders are treated equally if countries have not considered the possible consequences if the limit is exceeded?

III. Future policy developments

7. Bilateral agreements: The only route forward for the majority of CDM projects after 2013 is through the conclusion of a bilateral agreement according to article 11a(5-6).
 - a. Given the continuing absence of an international agreement, what action has the Commission taken to negotiate bilateral agreements with major host countries?
 - b. How can IETA and other stakeholders contribute to the set-up and implementation of bilateral agreements?
 - c. Will bilateral agreements be broad in nature (e.g. for all sectors in the host country) or targeted to specific sectors and/or projects?



8. Domestic offsets: Article 24a provides for adoption of implementing measures for a domestic offset scheme (outside ETS sectors). How will the Commission take this forward?
9. 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'?
 - b. Will the EU develop objective criteria for qualitative restrictions?
 - c. Are there further proposals under consideration to apply qualitative restrictions to any specific project type?
 - d. Would such a process be coordinated with the development of bilateral agreements and/or sectoral crediting to avoid any shortage of credits in the absence of a reliable alternative?
 - e. What is the Commission's understanding and projection of the impacts on the carbon market and project investments following the qualitative restriction?
 - f. Moreover, how will quality restrictions be tracked and controlled?
 - g. Is a positive list of unrestricted credits possible? Planned?
10. Type of qualitative restrictions: What type of restrictions could be invoked according to article 11a(9)? For illustration here are some options for providing us with an answer:
 - a. Type of mitigation activity (for instance defined through the supporting methodology for CDM projects).
 - b. Host country.
 - c. Period over which the emission reductions in regard of which the credit has been issued took place, e.g. excluding credits from projects where emissions reductions took place post-2012, but exempting credits which were issued post-2012 but from projects where emission reductions took place pre-2013.
 - d. Track followed for JI projects.
 - e. Credit issuance date, e.g. covering credits issued in phase 3 but exempting those issued in phase 2.
 - f. Project registration date, eg, excluding credits, whenever issued, to projects registered prior to the entry into force of any qualitative restrictions.
 - g. Crediting period renewal date, eg, excluding credits, whenever issued, to projects for their current crediting periods.
11. Programme of Activities (PoAs): According to Article 11a(2) credits from projects registered pre-2013 are eligible for ETS Compliance. This implies that CDM Project Activities (CPAs) included after 2012 to PoAs registered pre-2013 are also eligible.
 - a. Can the Commission confirm this?
 - b. Would restrictions (if adopted according to article 11a(9)) 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)?
12. JI 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 KP – hence the absence of AAUs – would frustrate continuation of JI projects after 2012. On the other hand, continued issuance and transfer of ERUs could be ensured in several other ways, for instance:

- Bilateral agreement with Host Parties, in case these are not part of EU ETS
- Recognition of projects under art. 24a, in case projects are located in EU countries and fall outside the scope of ETS

Has the Commission considered how to implement Article 11a(3) with regard to ERUs, in the absence of a second KP commitment period:

- 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?
- b. In the event that projects fall outside the EU ETS – what is the EU position on allowing projects to use commitment period 1 AAUs to back ERUs generated January 2013 – March 2015 also with a view to support new projects registration post-2012?

13. Sectoral crediting& trading: The Commission 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 wealthier developing countries.

- a. Has the Commission assessed the actual possibility of sectoral mechanisms to meet demand for offsets in the EU ETS in the near future?
- 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)?
- c. Has the Commission had any thoughts as to what kind of process and governance structure will be needed to underpin any move to sectoral crediting ?
- d. Has the Commission any plans to consult with stakeholders on the practical implementation of sectoral crediting?
- e. How could the private sector get involved with sectoral crediting?
- f. What are the timelines with regards to a detailed road map for the design, construction, implementation and operation of a sectoral crediting system?
- g. Could the emerging international REDD mechanism qualify as a sectoral mechanism?

14. 30% target: The CDM pipeline would imply that 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, assuming that registration/issuance continues to function and not accounting for non-EU ETS demand. However, any proposed qualitative restrictions would further restrict a large proportion of these CERs.

- a. Could potential rules on credit eligibility (except where bilateral agreements) be relaxed in a -30% scenario (assuming the CDM/JI import limit is increased to 50% of effort against 2005 levels)?
- b. In case of a 30% target with increased access to credits, what would be the share of use of these credits between ETS and non ETS sectors?